General Assembly Retirement System of the State of Illinois

Auditor's Report and Financial Audit

For the Year Ended June 30, 2014
Performed as Special Assistant Auditors for
the Auditor General, State of Illinois

BKD LLP
CPAs & Advisors

General Assembly Retirement System of the State of Illinois

Financial Audit

For the Year Ended June 30, 2014

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General Assembly Retirement System of the State of Illinois

Financial Audit

For the Year Ended June 30, 2014

System Officials

Executive Secretary	Timothy B. Blair
Division Manager	Jayne Waldeck
Accounting Division Supervisor	David M. Richter, CPA
Internal Auditor	Staci A. Crane (effective 07/01/13 – 11/15/13)
Internal Auditor	Casey Evans (effective 10/1/14 – Present)

Office Locations

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160 North LaSalle Street, Suite N725
Chicago, Illinois 60601

General Assembly Retirement System of the State of Illinois
Financial Statement Report Summary
For the Year Ended June 30, 2014

Summary

The audit of the accompanying financial statements of the General Assembly Retirement System of the State of Illinois ("System") was performed by **BKD, LLP**.

Based on their audit and the report of other auditors, the auditors expressed an unmodified opinion on the General Assembly Retirement System of the State of Illinois' financial statements.

Summary of Findings

The auditors identified matters involving the System's internal control over financial reporting that they considered to be significant deficiencies. The significant deficiencies are described in the accompanying Schedule of Findings on pages 34-36 of this report as items 2014-001, *Noncompliance with the Fiscal Control and Internal Auditing Act*, and item 2014-002, *Controls over Census Data*.

Exit Conference

The findings and recommendations appearing in this report were discussed with System personnel at an exit conference on December 3, 2014. Attending were:

<u>Representing General Assembly Retirement Systems</u>

Executive Secretary	Mr. Timothy B. Blair
Accounting Division Supervisor	Mr. David M. Richter, CPA
Internal Audit	Mr. Casey Evans

<u>Representing BKD LLP</u>

Director	Ms. Heather M. Powell, CPA

<u>Representing the Office of the Auditor General</u>

Audit Manager	Mr. Jon Fox, CPA

The responses to the recommendations were provided by Mr. Alan Fowler, Accounting Division Manager, in an e-mail dated December 11, 2014.

BKD LLP
CPAs & Advisors

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Independent Auditor's Report

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

Report on the Financial Statements

As Special Assistant Auditors for the Auditor General, we have audited the accompanying financial statements of the General Assembly Retirement System of the State of Illinois (System) as of and for the year ended June 30, 2014, and the related notes to the financial statements, which collectively comprise the System's basic financial statements as listed in the table of contents.

Management's Responsibility for the Financial Statements

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

Auditor's Responsibility

Our responsibility is to express an opinion on these financial statements based on our audit. We did not audit the 2014 financial statements of the Illinois State Board of Investment, an internal investment pool of the State of Illinois, which statements represent 87 percent, 91 percent, and 35 percent, respectively, of total assets, net position restricted for pension benefits, and total additions of the System. Those financial statements were audited by other auditors whose report thereon has been furnished to us, and our opinion, insofar as it relates to the amounts included for the Illinois State Board of Investment is based solely on the report of the other auditors. We conducted our audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free from material misstatement.

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

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

Opinion

In our opinion, based on our audit and the report of other auditors, the financial statements referred to above present fairly, in all material respects, the fiduciary net position of the System as of June 30, 2014, and the respective changes in fiduciary net position for the year then ended in accordance with accounting principles generally accepted in the United States of America.

Emphasis of Matters

As discussed in Note 7, the System is significantly underfunded which raises doubts about the financial solvency of the System if there is a significant market downturn. Our opinion is not modified with respect to this matter.

As discussed in Note 3c to the financial statements, in 2014 the System adopted new accounting guidance GASB Statement No. 67, *Financial Reporting for Pension Plans an amendment of GASB Statement No. 25*. The new accounting guidance changed the approach for measuring the pension liability and presenting certain required pension information. Our opinion is not modified with respect to this matter.

Other Matters

Required Supplementary Information

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

Other Information

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

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

Other Reporting Required by *Government Auditing Standards*

In accordance with *Government Auditing Standards*, we have also issued our report dated December 22, 2014 on our consideration of the System's internal control over financial reporting and on our tests of its compliance with certain provisions of laws, regulations, contracts and grant agreements and other matters. The purpose of that report is to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing, and not to provide an opinion on the internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* in considering the System's internal control over financial reporting and compliance.

BKD, LLP

Decatur, Illinois
December 22, 2014

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

This section presents management's discussion and analysis of the financial position and performance of the General Assembly Retirement System (System) for the year ended June 30, 2014. It is presented as a narrative overview and analysis.

The System is a defined benefit, single-employer public employee retirement system. It provides services to 158 active participants and 421 benefit recipients. Throughout this discussion and analysis units of measure (i.e. billions, millions, thousands) are approximate, being rounded up or down to the nearest tenth of the respective unit value.

OVERVIEW OF THE FINANCIAL STATEMENTS

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

1. *Basic Financial Statements.* For the fiscal year ended June 30, 2014, basic financial statements are presented for the System. This information presents the fiduciary net position restricted for pensions for the System as of June 30, 2014. This financial information also summarizes the changes in the fiduciary net position restricted for pensions for the year then ended.

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

3. *Required Supplementary Information.* The required supplementary information consists of three schedules and related notes concerning actuarial information, funded status, actuarially determined contributions, and investment returns.

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

FINANCIAL HIGHLIGHTS

- The System's net position increased by approximately $2.4 million during fiscal year 2014. This increase was primarily due to a $528.9 thousand increase in cash and a $1.7 million increase in investments.
- The System was actuarially funded at 14.3% as of June 30, 2014.
- The overall rate of return for the Illinois State Board of Investment (ISBI) Commingled Fund was 17.9% for fiscal year 2014.

ADDITIONS TO FIDUCIARY NET POSITION

Additions to Fiduciary Net Position include employer and participant contributions and net income from investment activities. Participant contributions were approximately $1.5 million for the year ended June 30, 2014. Participant contribution rates are set by statute as a percentage of gross salary. Employer contributions decreased to approximately $14.0 million in 2014 from $14.2 million in 2013. This decrease was the result of the actuarially determined employer contributions required by the State's funding plan.

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

Condensed Statements of Fiduciary Net Position
(in thousands)

	As of June 30		
	2014	2013	Increase/(Decrease)
Cash	$ 4,767.6	$ 4,238.7	$ 528.9
Receivables	589.9	1,197.5	(607.6)
Investments, at fair value *	53,818.4	52,111.8	1,706.6
Equipment, net	3.2	2.9	0.3
Total assets	$ 59,179.1	57,550.9	1,628.2
Liabilities *	2,389.6	3,203.9	(814.3)
Total fiduciary net position	$ 56,789.5	$ 54,347.0	$ 2,442.5

* *Including securities lending collateral*

DEDUCTIONS FROM FIDUCIARY NET POSITION

Deductions from Fiduciary Net Position are primarily benefit payments. During 2014, the System paid out approximately $21.0 million in benefits and refunds, an increase of 4.4% from 2013. These higher payments were mainly due to a 3% automatic annuity increase paid to annuitants each year. The administrative costs of the System represented 1.6% of total deductions in 2014.

FUNDED RATIO

The funded ratio of the plan measures the ratio of the fiduciary net position against actuarially determined liabilities and is one indicator of the fiscal strength of a pension fund's ability to meet obligations to its members. An annual actuarial valuation is performed. The most recent available valuation showed the funded status of the System was 14.3% on June 30, 2014 and June 30, 2013. The amount by which actuarially determined liabilities exceeded the fiduciary net position was $340.7 million on June 30, 2014.

INVESTMENTS

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

The net investment income of the total ISBI Commingled Fund was approximately $2.3 billion during fiscal year 2014, resulting in a return of 17.9%. The actual rate of return earned by the System will vary from the return earned on the total ISBI Commingled Fund as the result of overall market conditions at the time of additional investments in or withdrawals from the ISBI Commingled Fund. For the three, five, and ten year period ended June 30, 2014, the ISBI Commingled Fund earned a compounded rate of return of 10.4%, 12.3%, and 6.7%, respectively.

The ISBI is exposed to general market risk. This general market risk is reflected in asset valuations fluctuating with market volatility. Any impact from market volatility on the ISBI's investment portfolio depends in large measure on how deep the market downturn is, how long it lasts, and how it fits within fiscal year reporting periods. The resulting market risk and associated realized and unrealized gains and losses could significantly impact the ISBI's financial condition.

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

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

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

	For the Year Ended June 30		
	2014	2013	Increase/(Decrease)
Additions			
Participant contributions	$ 1,502.6	$ 1,451.2	$ 51.4
Employer contributions	13,956.7	14,150.0	(193.3)
Net investment income	8,363.4	6,492.6	1,870.8
Total additions	23,822.7	22,093.8	1,728.9
Deductions			
Benefits	20,800.5	20,110.1	690.4
Refunds	245.1	41.1	204.0
Administrative expenses	334.6	339.5	(4.9)
Total deductions	21,380.2	20,490.7	889.5
Net increase in fiduciary net position	$ 2,442.5	$ 1,603.1	$ 839.4

LEGISLATIVE

Public Act 98-0599 ("The Act") was signed by the Governor on December 5, 2013. The Act amends the Illinois Pension Code, and is effective June 1, 2014. The Act applies to all active, inactive and retired Tier 1 members. Tier 2 members are not affected.

The Act's goal is to stabilize retirement system finances and eliminate the retirement system's unfunded liability by 2045. The Act reduces the annual pension adjustments for current and future retirees and requires the skipping of a certain number of the annual pension adjustments for future annuitants retiring on or after July 1, 2014.

The number of annual adjustments to be skipped is based on the future retiree's age at the time the Act becomes effective. In addition, the Act caps the pensionable salary amount and increases the retirement age on a graduated scale and creates a new defined contribution plan. The Act also reduces the employee contribution toward retirement benefits by one percentage point. It provides a funding guarantee requiring the State to make the applicable employer contributions. The System continues to analyze the implementation of this law and its overall effects.

On January 2, 2014, a lawsuit was filed in Circuit Court which challenges the constitutionality of the new pension law. A court injunction was also issued in May, 2014 to delay the implementation of the new pension law.

On November 21, 2014, the Circuit Court ruled that Public Act 98-0599 was unconstitutional and void in its entirety. The State has filed an appeal of the ruling directly to the Supreme Court.

GENERAL ASSEMBLY RETIREMENT SYSTEM, STATE OF ILLINOIS

Statement of Fiduciary Net Position
June 30, 2014

	2014
Assets	
Cash	$ 4,767,584
Receivables:	
Employer contributions	577,370
Participants' contributions	7,557
Refundable annuities	3,295
Interest on cash balances	1,656
Total receivables	589,878
Investments - held in the Illinois State Board of Investment Commingled Fund at fair value	51,549,374
Securities lending collateral with State Treasurer	2,269,000
Equipment, net of accumulated depreciation	3,187
Total Assets	59,179,023
Liabilities	
Benefits payable	16,294
Refunds payable	5,210
Administrative expenses payable	27,520
Due to Judges' Retirement System of Illinois	71,539
Securities lending collateral	2,269,000
Total Liabilities	2,389,563
Net position – restricted for pensions	$56,789,460

See accompanying notes to financial statements

GENERAL ASSEMBLY RETIREMENT SYSTEM, STATE OF ILLINOIS

Statement of Changes in Fiduciary Net Position for the Year Ended June 30, 2014

	2014
Additions:	
Contributions:	
Participants	$ 1,502,605
Employer	13,956,669
Total contributions	15,459,274
Investment income:	
Net appreciation in fair value of investments	6,988,375
Interest and dividends	1,517,141
Less investment expense, other than from securities lending	(153,577)
Net income from investing, other than from securities lending	8,351,939
Net securities lending income	11,489
Net investment income	8,363,428
Total Additions	23,822,702
Deductions:	
Benefits:	
Retirement annuities	17,218,504
Survivors' annuities	3,581,998
Total benefits	20,800,502
Refunds of contributions	245,133
Administrative expenses	334,628
Total Deductions	21,380,263
Net Increase	2,442,439
Net position - restricted for pensions:	
Beginning of year	54,347,021
End of year	$ 56,789,460

See accompanying notes to financial statements.

GENERAL ASSEMBLY RETIREMENT SYSTEM, STATE OF ILLINOIS

Notes to Financial Statements June 30, 2014

1. Reporting Entity

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

The General Assembly Retirement System (System) is administered by a Board of Trustees consisting of seven persons, which include the President of the Senate, ex-officio, or his designee, two members of the Senate appointed by the President of the Senate, three members of the House of Representatives appointed by the Speaker of the House of Representatives, and one person elected from the member annuitants.

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

Pursuant to federal tax law and regulations governing the administration of public employee pension plans, the System has established a separate fund for the sole purpose of paying benefits in accordance with Section 415 of the Internal Revenue Code. The receipts and disbursements from the fund for fiscal year 2014 were $45,109 and $44,595, respectively. Due to the immaterial nature of the separate fund, these receipts and disbursements have been included in the System's financial statements.

2. Plan Description

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

a. Eligibility and Membership

The General Assembly Retirement System covers members of the General Assembly of the State and persons elected to the offices of Governor, Lieutenant Governor, Secretary of State, Treasurer, Comptroller and Attorney General for the period of service in such offices and the Clerks and Assistant Clerks of the respective Houses of the General Assembly. Participation by eligible persons is optional.

b. Contributions

In accordance with Chapter 40, Section 5/2-126 of the Illinois Compiled Statutes, participants contribute specified percentages of their salaries for retirement annuities, survivors' annuities, and automatic annual increases as shown on the next page. Tier 1 participants contribute based on total annual compensation. Beginning January 1, 2011, Tier 2 participants contribute based on an annual compensation rate not to exceed $106,800 with limitations for future years increased by the lesser of 3% or the annual percentage increase in the Consumer Price Index. The calendar year 2014 rate is $113,551. Contributions are excluded from gross income for Federal and State income tax purposes.

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

At June 30, 2014, the System membership consisted of:

	2014
Retirees and beneficiaries	
currently receiving benefits:	
Retirement annuities	303
Survivors' annuities	117
Reversionary annuities	1
	421
Inactive participants entitled to benefits	
but not yet receiving them	74
Total	495
Current participants:	
Vested	114
Nonvested	44
Total	158

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

The total contribution rate is 11.5% as shown below:

8.5%	Retirement annuity
2.0%	Survivors' annuity
1.0%	Automatic annual increases
11.5%	

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

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

c. Benefits

Retirement Annuity: Tier 1

Participants have vested rights to full retirement benefits beginning at age 55 with at least 8 years of credited service or at age 62 with at least 4 years of credited service.

The retirement annuity is determined according to the following formula based upon the applicable final salary:

3.0% for each of the first 4 years of service
3.5% for each of the next 2 years of service
4.0% for each of the next 2 years of service
4.5% for each of the next 4 years of service
5.0% for each year of service in excess of 12 years.

The maximum retirement annuity is 85% of the applicable final salary. Annual automatic increases of 3% of the current amount of retirement annuity are provided.

Retirement Annuity: Tier 2

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

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

Other Benefits:

The General Assembly Retirement System also provides survivors' annuity benefits, reversionary annuity benefits, and under certain specified conditions, lump-sum death benefits.

Participants who terminate service may receive, upon application, a refund of their total contributions. Participants who are not married are entitled to refunds of their contributions for survivors.

3. Summary of Significant Accounting Policies and Plan Asset Matters

a. Basis of Accounting

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

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

b. Cash

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

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

c. Implementation of New Accounting Standards

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

GASB Statement No. 67, "Financial Reporting for Pension Plans, an amendment of GASB Statement No. 25", was established to provide improved financial reporting by state and local governmental pension plans. The scope of the Statement addresses accounting and financial reporting for the activities of pension plans that are administered through trusts that have the specific characteristics. For defined benefit pension plans, the Statement establishes standards of financial reporting for separately issued financial reports and specifies the required approach to measuring the pension liability for benefits provided through the pension plan. The System has implemented this Statement for the year ended June 30, 2014. Adoption of GASB Statement No. 67 had no effect on the System's fiduciary net position but changed the approach for measuring the pension liability and required certain changes to note disclosures and required supplementary information.

d. General Litigation

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

e. Methods Used to Value Investments

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

Investments owned are reported at fair value as follows: (1) U.S. Government and Agency, Foreign and Corporate Obligations, Convertible Bonds – prices quoted by a major dealer in such securities; (2) Common Stock and Equity Funds, Foreign Preferred Stock, Foreign Equity Securities, Forward Foreign Currency Contracts and Options: (a) Listed – closing prices as reported on the composite summary of national securities exchanges; (b) Over-the-counter – bid prices; (3) Money Market Instruments – average cost which approximates fair values; (4) Real Estate Investments – fair values as determined by the ISBI and its investment managers; and (5) Alternative Investments (Private Equity, Hedge Funds, Bank Loans and Real Assets) - fair values as determined by the ISBI and its investment managers; and (6) Commingled Funds - fair values as determined by the ISBI and its investment managers.

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

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

f. Actuarial Experience Review

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

g. Administrative Expenses

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

Administrative expenses common to the General Assembly Retirement System and the Judges' Retirement System are allocated 25% to the General Assembly Retirement System and 75% to the Judges' Retirement System.

Invoices/vouchers covering common expenses incurred are paid by the Judges' Retirement System, and the appropriate amount is allocated to and reimbursed by the General Assembly Retirement System. Administrative expenses allocated to and reimbursed by the General Assembly Retirement System as of June 30, 2014, was $248,940.

h. Risk Management

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

i. Use of Estimates

In preparing financial statements in conformity with U.S. generally accepted accounting principles, the System makes estimates and assumptions that affect the reported amounts of assets and liabilities and disclosures of contingent assets and liabilities at the date of the financial statements, as well as the reported amounts of revenue and expenses during the reporting period. Actual results could differ from those estimates and assumptions.

4. Investments

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

	June 30, 2014
U.S. govt. and agency obligations	$ 784,475,648
Foreign obligations	832,282,402
Corporate obligations	799,514,242
Common stock & equity funds	4,553,283,316
Commingled funds	733,010,980
Foreign equity securities	2,346,503,129
Foreign preferred stock	72,907
Hedge funds	1,485,145,060
Real estate funds	1,483,445,971
Private equity	667,730,266
Money market instruments	217,737,000
Real assets	524,284,793
Bank loans	689,256,558
Foreign currency forward contracts	(637,600)
Total investments	$ 15,116,104,672

Rate of Return

For the fiscal year ended June 30, 2014, the annual money-weighted rate of return on pension plan investments, net of pension plan investment expense, was 17.86 percent. The money-weighted rate of return expresses investment performance, net of investment expense, adjusted for the changing amounts actually invested.

Deposits

Custodial credit risk for deposits is the risk that, in the event of a financial institution failure, the System's and ISBI's deposits may not be returned. All non-investment related bank balances at year-end are insured or collateralized with securities held by the Illinois State Treasurer or agents in the name of the State Treasurer. As of June 30, 2014, the ISBI had non-investment related bank balances of $474,083. During fiscal year 2007, a Credit Risk Policy was implemented by the ISBI staff and formally adopted by the ISBI Board in July of 2007. The policy outlines the control procedures used to monitor custodial credit risk. These assets are under the custody of State Street Bank and Trust Company. State Street Bank and Trust Company has an AA- Long-term Deposit/Debt rating by Standard & Poor's and an Aa3 rating by Moody. Certain investments of the ISBI with maturities of 90 days or less would be considered cash equivalents; these consist of short-term investment funds and U.S. Treasury bills with maturities of 90 days or less, which are not subject to the custodial credit risk. For financial statement presentation and investment purposes, the ISBI reports these types of cash equivalents as Money Market Instruments within their investments. As of June 30, 2014, the ISBI had investment related bank balances of $8,923,164. These balances include USD and foreign cash balances. As of January 1, 2013, cash held in the investment related bank account is neither insured nor collateralized for amounts in excess of $250,000. At any given point and time, the foreign cash balances may be exposed to custodial credit risk.

Investment Commitments

The ISBI's real estate and private equity investment portfolios consist of passive interests in limited partnerships. The ISBI had outstanding commitments to these limited partnerships of approximately $426 million as of June 30, 2014. Also, at the end of fiscal year 2014, the ISBI had outstanding commitments of $61 million to separate real estate accounts. Also at the end of fiscal year 2014, the ISBI had outstanding amounts of $32 million committed to real assets. The ISBI would fund outstanding commitments by utilizing available cash and then selling liquid securities in the portfolio as necessary.

Investment Liquidity

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

Alternative Investments

The ISBI's investments in hedge funds are structured to achieve a diversified hedged equity fund-of-funds portfolio. Capital is allocated to a select group of hedge fund managers that invest predominately in equity securities, both long and short. The investments shall be managed with the intent of preserving capital in a declining market and in a rising market they will generate a smaller return than the overall equity market.

The ISBI's investments in Private Equity and Real Estate funds represent investment vehicles used for making investments in various equity and debt securities according to the investment strategies as determined by the fund managers at the commencement of the fund.

Investment strategies of Private Equity funds include, but are not limited to, leveraged buyouts, venture capital, growth capital and mezzanine capital.

Investment strategies of Real Estate investments include, but are not limited to, the purchase, development, ownership, management, rental and/or sale of real estate for profit.

Certain real estate investments are leveraged whereby partnerships have been established to purchase properties through a combination of contributions from the ISBI and through acquisition of debt. At June 30, 2014, real estate equities of approximately $1,483 million are reported at estimated fair value. Of this amount, $1,288 million is equity and $195 million is long term debt.

Required repayment of real estate debt, which is non-recourse debt is as follows as of June 30, 2014:

Debt Maturities Year Ending June 30	2014
2014	$ –
2015	–
2016	28,240,488
2017	57,416,040
2018	–
2019–2023	88,046,051
2024–2026	21,321,503
	$ 195,024,082

The ISBI's investments in Real Assets represent pooled investment vehicles used to seek capital appreciation and current income by acquiring, holding, financing, refinancing and disposing of infrastructure investments and farmland assets. Real Assets include various public works (e.g. bridges, tunnels, toll roads, airports, public transportation and other public works) that are made typically as a part of a privatization initiative on the part of a government entity.

A Commingled fund is a kind of mutual fund or common trust fund which consists of multiple kinds of assets from several accounts combined together. 'Commingling' these separate assets mitigates risk for the trader through investment diversification and reduces the cost of managing each account separately. Commingled funds are also called "pooled funds" and "master trusts".

Concentration of Credit Risk and Credit Risk for Investments

The ISBI's portfolio of investments is managed by professional investment management firms. These investment management firms are required to maintain diversified portfolios. Each investment manager must comply with risk management guidelines individually assigned to them as part of their investment management agreement. The ISBI did not have any single issuer investment that exceeded 5% of the total net assets of the fund as of June 30, 2014. The table to the right presents the quality ratings of debt securities held by the ISBI as of June 30, 2014.

	Moody's Quality Rating	2014
U.S. Government and Agency obligations	AAA	$ 425,527,082
	AA	7,344,587
	A	12,943,001
	Not Rated	338,660,978
Total U.S. govt. and agency obligations		$ 784,475,648
Foreign Obligations	AAA	$ 141,563,493
	AA	186,950,502
	A	81,171,275
	BAA	204,409,825
	BA	36,645,027
	B	41,169,215
	Not rated	140,373,065
Total Foreign Obligations		$ 832,282,402
Corporate Obligations		
Bank and Finance	AA	$ 2,957,585
	A	50,029,728
	BAA	82,453,817
	BA	34,830,061
	B	35,544,808
	Not Rated	2,340,263
Total Bank and Finance		$ 208,156,262
Industrial	AA	$ 10,224,115
	A	21,987,306
	BAA	44,506,699
	BA	159,584,773
	B	209,039,592
	CAA	6,992,615
	Not Rated	13,073,374
Total Industrial		$ 465,408,474
Other	AAA	$ 1,521,596
	A	7,995,874
	BAA	19,568,129
	BA	48,791,454
	B	48,352,453
	Not rated	(280,000)
Total Other		$ 125,949,506
Total Corporate Obligations		$ 799,514,242
Money Market	Not Rated	$ 217,737,000
Total Money Market		$ 217,737,000

Custodial Credit Risk for Investments

The custodial credit risk for investments is the risk that, in the event of the failure of the counterparty to a transaction, the ISBI will not be able to recover the value of investments or collateral securities that are in the possession of a counterparty. As of June 30, 2014, there were no investments that were uninsured and unregistered, securities held by the counterparty or by its trust department or agent but not in the ISBI's name.

Interest Rate Risk

The ISBI manages its exposure to fair value losses arising from interest rate risk by diversifying the debt securities portfolio and maintaining the debt securities portfolio to an effective weighted duration between 80% and 120% of the benchmark index.

Duration is the measure of a debt investment's exposure to fair value changes arising from changing interest rates. It uses the present value of cash flows, weighted for those cash flows as a percentage of the investment's fair value. The effective duration measures the sensitivity of market price to parallel shifts in the yield curve. As of June 30, 2014, the ISBI benchmarked its debt security portfolio to Barclay's Capital Intermediate U.S. Government/Credit Bond Index. At June 30, 2014, the effective duration of the Barclay's Capital Intermediate U.S. Government/Credit Bond Index was 5.6 years. At the same point in time, the effective duration of the ISBI debt security portfolio at June 30, 2014 was 5.3 years. The table below shows the detail of the duration by investment type as of June 30, 2014.

	2014	
Investment Type	Fair Value	Effective Weighted Duration Years
U.S. Govt. and Agency Obligations		
U.S. Government	$380,521,606	6.7
Federal Agency	403,954,042	3.5
Foreign Obligations	832,282,402	5.8
Corporate Obligations		
Bank & Finance	208,156,262	5.8
Industrial	465,408,474	4.7
Other	125,949,506	4.6
Total	$2,416,272,292	

Foreign Currency Risk

The ISBI's international portfolio is constructed on the principles of diversification, quality growth, and value. Risk of loss arises from changes in currency exchange rates. International managers may also engage in transactions to hedge currency at their discretion.

Certain investments held in infrastructure funds trade in a reported currency of Euro-based dollars valued at $61,343,167 as of June 30, 2014. The table below presents the foreign currency risk by type of investment as of June 30, 2014.

	2014	
Currency	Foreign Equity Securities & Foreign Preferred Stock	Foreign Obligations
Australian Dollar	$ 90,774,346	$ 23,031,004
Brazilian Real	20,078,894	29,522,411
Canadian Dollar	141,782,577	36,442,872
Chilean Peso	–	3,713,553
Colombian Peso	–	15,223,691
Czech Koruna	804,780	3,560,005
Danish Krone	44,415,985	5,392,244
Egyptian Pound	627,634	–
English Pound Sterling	410,712,209	46,015,531
Euro Currency	614,324,960	144,113,041
Hong Kong Dollar	129,948,463	2,550,498
Hungarian Forint	642,189	329,052
Indonesian Rupian	2,609,187	12,085,949
Israeli Shekel	2,886,339	4,040,894
Japanese Yen	302,710,537	66,876,957
Malaysian Ringgit	453,753	20,518,690
Mexican Peso	11,149,254	41,011,377
New Russian Ruble	–	41,669,459
New Zealand Dollar	3,297,560	2,365,325
Nigerian Naira	–	10,909,408
Norwegian Krone	30,066,361	5,799,023
Peruvian Nouveau Sol	–	1,817,219
Philippine Peso	–	755,069
Polish Zloty	–	25,311,976
Singapore Dollar	34,481,140	5,121,850
South African Rand	14,851,595	23,599,596
South Korean Won	72,778,832	21,003,245
Swedish Krona	41,872,359	2,241,325
Swiss Franc	219,282,841	12,141,173
Thailand Baht	–	8,619,111
Turkish Lira	–	18,968,168
Uruguayan Peso	–	4,198,906
Foreign investments denominated in U.S. Dollars	156,024,241	193,333,780
Total	$ 2,346,576,036	$832,282,402

Securities Lending

The ISBI participates in a securities lending program with Credit Suisse AG, New York Branch who acts as securities lending agent. Securities are loaned to brokers and, in return, the ISBI receives cash and non-cash collateral. All of the securities are eligible for the securities lending program. Collateral consists solely of cash and government securities having a fair value equal to or exceeding 102% of the value of the loaned securities (105% for non-U.S. securities). In the event of borrower default, Credit Suisse AG, New York Branch provides the ISBI with counterparty default indemnification. Investments in the cash collateral account represent securities that were distributed to the ISBI in connection with the in-kind redemption of the ISBI's ownership in the State Street Bank and Trust Company Quality Funds for Short-Term Investment (Quality D). Credit Suisse is not responsible for any losses with regards to these legacy investments. This arrangement subjects the ISBI to credit risk as the credit quality of these investments may decline over time. The credit risk on the legacy investments is the risk of a possible loss arising from the inability of a counterparty to meet its obligations. These losses could include the loss of principal, interest and/or decreased expected cash flows in any of the investments held in the ISBI's cash collateral account. In the event a counterparty defaults on its obligations, the ISBI would need to credit the cash collateral account with the amount of the default to make the account whole so that once loaned securities are returned, the cash pledged by borrowers can be returned to them. As of June 30, 2014, the collateral received exceeded the fair value of the securities loaned. As of June 30, 2014, there were outstanding loaned investment securities having fair values of $168,534,354 against which collateral was received with a fair value of $182,644,281. Collateral received at June 30, 2014 consisted of $61,409,324 in cash and $121,234,957 in government securities for which the ISBI does not have the ability to pledge or sell.

The cash collateral received is invested in a short-term instrument having a fair value of $60,114,354 as of June 30, 2014. This investment pool had an average duration of 23.86 days as of June 30, 2014. Any decrease in the fair value of invested cash collateral is recorded by the ISBI as unrealized losses and reported as a component of the investment income/loss on the ISBI's Statement of Changes in Net Position.

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

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

During fiscal year 2014, Deutsche Bank AG lent U.S. Treasury and U.S. Agency securities and received as collateral U.S. dollar denominated cash. Borrowers were required to deliver collateral for each loan equal to at least 100% of the aggregated fair value of the loaned securities. Loans are marked to market daily. If the fair value of collateral falls below 100%, the borrower must provide additional collateral to raise the fair value to 100%.

The State Treasurer did not impose any restrictions during fiscal year 2014 on the amount of the loans available or the eligible securities. In the event of borrower default, Deutsche Bank AG provides the State Treasurer with counterparty default indemnification. In addition, Deutsche Bank AG is obligated to indemnify the State Treasurer if the Deutsche Bank AG loses any securities, collateral or investments of the State Treasurer in Deutsche Bank AG's custody. Moreover, there were no losses during fiscal year 2014 resulting from a default of the borrowers or Deutsche Bank AG.

During fiscal year 2014, the State Treasurer and the borrowers maintained the right to terminate all securities lending transactions on demand. The cash collateral received on each loan was invested in repurchase agreements with approved counterparties collateralized with securities approved by Deutsche Bank AG and marked to market daily at no less than 102%. Because the loans are terminable at will, their duration did not generally match the duration of the investments made with the cash collateral. The State Treasurer had no credit risk as a result of its securities lending program as the collateral held exceeded the fair value of the securities lent. The securities lending cash collateral received that was invested in repurchase agreements and the fair value of securities on loan for the State Treasurer as of June 30, 2014 was $5,758,768,925 and 5,727,657,697, respectively. The System's portion of securities lending collateral that was invested in repurchase agreements as of June 30, 2014 was $2,269,000.

Derivative Securities

In fiscal year 2010, the ISBI implemented GASB Statement No. 53 *Accounting and Financial Reporting for Derivative Instruments* with respect to investments held in derivative securities. A derivative security is an investment whose payoff depends upon the value of other assets such as commodity prices, bond and stock prices, or a market index. The ISBI invests in derivative instruments including forward foreign currency contracts, futures, rights and warrants. The ISBI's derivatives are considered investment derivatives.

Foreign currency forward contracts (FX forwards) are used to protect against the currency risk in the ISBI's foreign equity portfolio. A foreign currency forward contract is an agreement to buy or sell a specific amount of a foreign currency at a specified delivery or maturity date for an agreed-upon price. Fluctuations in the market value of foreign currency forward contracts are marked to market on a daily basis. These investments are reported at fair value in the investment section of the ISBI's Statement of Net Position. The gain or loss arising from the difference between the original contracts and the closing of such contracts is recognized in the net increase/decrease in the fair value of investments in the ISBI's Statement of Changes in Net Position. In May 2011, the ISBI removed language from the investment management agreements allowing managers to hedge foreign currencies and/or to hedge equity positions.

The ISBI's investment managers use financial futures to replicate an underlying security they wish to hold (sell) in the portfolio. In certain instances, it may be beneficial to own a futures contract rather than the underlying security (arbitrage). Additionally, financial futures are used in the ISBI's fixed income portfolio to adjust portfolio strategy and overall portfolio duration. A financial futures contract is an agreement to buy or sell a specific amount at a specified delivery or maturity date for an agreed-upon price. As the fair values of the futures contract vary from the original contract price, a gain or loss is recognized and paid to or received from the clearinghouse. The gain or loss is recognized in the net increase/decrease in the fair value of investments in the ISBI's Statement of Changes in Net Position. Financial futures represent an off-balance sheet obligation, as there are no balance sheet assets or liabilities associated with those contracts. The cash or securities to meet these obligations are held in the ISBI's investment portfolio.

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

Rights and warrants allow the ISBI's investment managers to replicate an underlying security they wish to hold (sell) in the portfolio. Rights and warrants provide the holder with the right, but not the obligation, to buy or sell a company's stock at a predetermined price. Rights usually expire after a few weeks and warrants can expire from one to several years. Under certain circumstances, a type of warrant called Participatory Notes (P-Notes) are used in the portfolio by the ISBI's investment managers that are not registered to trade in domestic Indian Capital Markets. P-Notes are issued by Indian-based brokerage firms against an underlying Indian security permitting holders to get a share in the income from the security. These investments are reported at fair value in the investment section of the ISBI's Statement of Net Position within the common stock and foreign equity classifications. The gain or loss associated with rights and warrants is recognized in the net increase/decrease in the fair value of investments in the ISBI's Statement of Changes in Net Position.

The fair values of the forward contracts are estimated based on the present value of their estimated future cash flows. Futures contracts are exchange traded instruments where the fair value is determined by the equilibrium between the forces of supply and demand. The fair value of a right or warrant closely tracks the intrinsic value of the underlying stock and can be determined either by formulaic methodology (most commonly Black-Scholes) or intrinsic value methodology.

The table below presents the investment derivative instruments aggregated by type that were held by the ISBI as of June 30, 2014.

	Changes in Fair Value	Fair Value at Year End	Notional Amount Number of Shares
	2014	2014	2014
FX Forwards	$ (4,557,072)	$ (637,600)	n/a
Futures	n/a	n/a	(19,492,453)
Options	(9,152,466)	(2,635,570)	3,450,575
Rights	687,576	21,258	32,233
Warrants	43,476	145,805	77,375
	$(12,978,487)	$(3,106,107)	(15,932,270)

The table below shows the futures positions held by the ISBI as of June 30, 2014.

	2014	
	Number of Contracts	Contract Principal*
Equity Futures Purchased	984	$94,707,150
Fixed Income Futures Purchased	500	58,038,549
Fixed Income Futures Sold	519	90,728,863

** Contract principal amounts shown represent the market value of the underlying assets the contracts control. These are shown to present the volume of the transactions but do not reflect the extent to which positions may offset one another. These amounts do not represent the much smaller amounts potentially subject to risk. Contract principal values also do not represent actual recorded values reported in the ISBI's Statement of Net Position.*

Derivative transactions involve, to varying degrees, credit risk and market risk. Credit risk is the possibility that a loss may occur because a party to a transaction fails to perform according to terms. Derivatives which are exchange traded are not subject to credit risk. No derivatives held are subject to custodial credit risk. Market risk is the possibility that a change in interest (interest rate risk) or currency rates (foreign currency risk) will cause the value of a financial instrument to decrease or become more costly to settle. The market risk associated with derivatives, the prices of which are constantly fluctuating, is regulated by imposing strict limits as to the types, amounts and degree of risk that investment managers may undertake. These limits are approved by the Board of Trustees and management of the ISBI and the risk positions of the investment managers are reviewed on a periodic basis to monitor compliance with the limits. As of June 30, 2014, the ISBI held futures contracts whose underlying instruments were exposed to interest risk but there were no GASB 53 reportable elements. The ISBI has not adopted a formal policy specific to master netting arrangements.

The ISBI's derivative investments in foreign currency forward contracts are held with counterparties. The credit ratings and net exposure as of June 30, 2014 for the counterparties are as follows:

	2014		
Moody's Rating	Fair Value	Net Exposure	Percentage of Net Exposure
Aa3	$ 31,958	$ 31,958	5.47%
Aa2	135,731	135,731	23.22%
A2	291,685	291,685	49.89%
A1	2,450	2,450	0.42%
Baa1	16,943	16,943	2.90%
Baa2	105,781	105,781	18.10%
	$ 584,548	$ 584,548	100.00%

The following table presents the fair value of derivative investments exposed to foreign currency risk as of June 30, 2014:

	2014			
Currency	FX Forwards	Rights	Warrants	Options
Australian Dollar	$ (10,223)	–	$ –	$ –
Brazilian Real	(468,235)	–	–	–
Canadian Dollar	18,701	–	–	–
Chilean Peso	(2,651)	–	–	–
Columbian Peso	(65,342)	–	–	–
Czech Koruna	(3,596)	–	–	–
Danish Krone	(2,479)	–	–	–
Egyptian Pound	–	–	–	–
English Pound Sterling	(15,658)	–	–	–
Euro Currency	(109,012)	8,011	140,436	–
Hong Kong Dollar	(455)	–	4,326	–
Hungarian Forint	3,661	–	–	–
Indian Ruppe	(40,098)	–	–	–
Indonesian Rupiah	6,912	–	–	–
Israeli Shekel	(1,833)	–	–	–
Japanese Yen	125,773	–	–	–
Malaysian Ringgit	(7,300)	11,665	–	–
Mexican Peso	4,770	–	–	–
New Zealand Dollar	1,912	–	–	–
Norwegian Krone	(2,286)	–	–	–
Peruvian Nouveau Sol	3,634	–	–	–
Polish Zloty	13,381	–	–	–
Russian Ruble	72,949	–	–	–
Singapore Dollar	(3,924)	–	–	–
South African Rand	(44,578)	–	–	–
South Korean Won	(20,558)	–	–	–
Swedish Krona	7,769	–	–	–
Swiss Franc	(65,602)	–	–	–
Taiwan Dollar	6,992	–	–	–
Thailand Baht	(944)	–	–	–
Turkish Lira	(8,039)	–	–	–
Yuan Renminbi	(31,241)	–	–	–
Investments denominated in U.S. dollars	–	1,043	1,582	(2,635,570)
	$ (637,600)	$ 20,719	$ 146,344	$(2,635,570)

Other Information

The System owns approximately 1% of the net position of the ISBI Commingled Fund as of June 30, 2014. A schedule of investment expenses is included in the ISBI's annual report.

For additional information on ISBI's investments, please refer to their Annual Report as of June 30, 2014. A copy of the report can be obtained from the ISBI at 180 North LaSalle Street, Suite 2015, Chicago, Illinois 60601.

5. Administrative Expenses

A summary of the administrative expenses for the General Assembly Retirement System for fiscal year 2014 is listed below.

Administrative expenses for fiscal year 2014

	2014
Personal services	$133,567
Employee retirement contributions paid by employer	2,252
Employer retirement contributions	53,907
Social security contributions	9,781
Group insurance	32,264
Contractual services	95,473
Travel	502
Printing	1,675
Commodities	194
Telecommunications	873
Information technology	1,275
Automotive	379
Depreciation	728
Change in accrued compensated absences	1,748
Loss on disposal of equipment	10
Total	$334,628

6. Funding - Statutory Contributions Required & Contributions Made

On an annual basis, a valuation of the liabilities and reserves of the System is performed by the System's actuarial consultants in order to determine the amount of contributions statutorily required from the State of Illinois. For fiscal year 2014, the actuary used the projected unit credit actuarial method for determining the proper employer contribution amount.

For fiscal year 2014, the required employer contribution was computed in accordance with the State's funding plan. This funding legislation provides for a systematic 50-year funding plan with an ultimate goal to fund the cost of maintaining and administering the System at an actuarial funded ratio of 90%.

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

The total amount of statutorily required employer contributions for fiscal year 2014 was $13,856,000. The total amount of employer contributions received from the state during fiscal year 2014 was $13,856,000.

7. Net Pension Liability of the State

The components of the State's net pension liability for this plan at June 30, 2014 are as follows:

Total pension liability	$ 397,502,761
Plan fiduciary net position	56,789,460
State's net pension liability	$ 340,713,301

Plan fiduciary net position as a percentage of the total pension liability	14.29%

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

Actuarial assumptions

The total pension liability was determined by an actuarial valuation as of June 30, 2014, using the following actuarial assumptions, applied to all periods included in the measurement:

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

Inflation: 3.0 percent

Investment rate of return:
7.0 percent per year, compounded annually

Salary increases:
3.50 percent per year (consisting of an inflation component of 3.0 percent per year, a productivity component of .40 percent per year, and a merit/promotion component of .10 percent per year), compounded annually.

Group size growth rate: 0.0 percent

Post-retirement increase:
Tier 1: 3.0 percent per year, compounded annually.
Tier 2: 3.0 percent per year or the annual change in the Consumer Price Index, whichever is less, compounded annually.

Long-term expected return on plan assets

The long-term expected real rate of return on pension plan investments was determined based on information provided by the Illinois State Board of Investment (ISBI) in conjunction with its investment consultant, Marquette Associates, Inc. The ISBI and Marquette Associates, Inc. provided the simulated average 10-year annualized geometric return for each major asset class. These returns are combined to produce the long-term expected rate of return by weighting the expected future rates of return by the target asset allocation percentage. For each major asset class that is included in the pension plan's target asset allocation as of June 30, 2014, the 10-year simulated real rates of return are summarized in the following table:

	Asset Allocation	
Asset Class	Target Allocation	10 Year Simulated Real Rate of Return
U.S. Equity	30%	5.69%
Fixed Income	20%	1.62%
Hedge Funds	10%	4.00%
International Equity	20%	6.23%
Real Estate	10%	5.50%
Infrastructure	5%	6.00%
Private Equity	5%	10.10%
Total	100%	5.03%

Discount Rate

A single discount rate of 5.11% was used to measure the total pension liability. This single discount rate was based on the expected rate of return on pension plan investments of 7.0% and a municipal bond rate of 4.29%, based on an index of 20 year general obligation bonds with an average AA credit rating as published by the Federal Reserve. The projection of cash flows used to determine this single discount rate assumed that plan member contributions will be made at the current contribution rate and that employer contributions will be made at rates equal to the difference between actuarially determined contribution rates and the member rate. Based on these assumptions, the pension plan's fiduciary net position and future contributions were sufficient to finance the benefit payments through the year 2030. As a result, the long-term expected rate of return on pension plan investments was applied to projected benefit payments through the year 2030, and the municipal bond rate was applied to all benefit payments after that date.

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

The following presents the plan's net pension liability, calculated using a single discount rate of 5.11%, as well as what the plan's net pension liability would be if it were calculated using a single discount rate that is 1-percentage point lower or 1-percentage point higher.

	1% decrease (4.11%)	Current Discount Rate (5.11%)	1% increase (6.11%)
State's net pension liability	$390,590,041	$340,713,301	$299,185,957

8. Pension Plan & Other Post-Employment Benefits

Plan Description. All of the System's full-time employees who are not eligible for participation in another state-sponsored retirement plan participate in the State Employees' Retirement System (SERS), which is a pension trust fund in the State of Illinois reporting entity.

The SERS is a single-employer defined benefit public employee retirement system (PERS) in which state employees participate, except those covered by the State Universities, Teachers', General Assembly, and Judges' Retirement Systems.

The financial position and results of operations of the SERS for fiscal year 2014 is included in the State of Illinois' Comprehensive Annual Financial Report (CAFR) for the year ended June 30, 2014. The SERS also issues a separate CAFR that may be obtained by writing to the SERS, 2101 South Veterans Parkway, Springfield, Illinois, 62794-9255 or by calling 217-785-7202.

The State of Illinois' CAFR may be obtained by writing to the State Comptroller's Office, Financial Reporting Department, 325 West Adams St., Springfield, Illinois, 62704-1858 or by calling 217-782-2053.

A summary of SERS' benefit provisions, changes in benefit provisions, employee eligibility requirements including eligibility for vesting, and the authority under which benefit provisions are established, are included as an integral part of the SERS' CAFR. Also included is a discussion of employer and employee obligations to contribute, and the authority under which those obligations are established.

Funding Policy. The System pays employer retirement contributions based upon an actuarially determined percentage of its payrolls. For fiscal years 2014, 2013, and 2012, the employer contribution rates were 40.312%, 37.987%, and 34.190%, respectively. The System's contributions to SERS for fiscal years 2014, 2013, and 2012 were $53,907, $48,235, and $41,758, respectively, and were equal to the required contributions for each fiscal year.

Other Post-Employment Benefits. The State provides health, dental, vision, and life insurance benefits for retirees and their dependents in a program administered by the Department of Central Management Services. Substantially all State employees become eligible for post-employment benefits if they eventually become annuitants of one of the State sponsored pension plans. Health, dental, and vision benefits include basic benefits for annuitants and dependents under the State's self-insurance plan and insurance contracts currently in force. Annuitants may be required to contribute towards health, dental, and vision benefits with the amount based on factors such as date of retirement, years of credited service with the State, whether the annuitant is covered by Medicare, and whether the annuitant has chosen a managed health care plan. Annuitants who retired prior to January 1, 1998, and who are vested in the State Employee's Retirement System do not contribute towards health, dental, and vision benefits. For annuitants who retired on or after January 1, 1998, the annuitant's contribution amount is reduced five percent for each year of credited service with the State allowing those annuitants with twenty or more years of credited service to not have to contribute towards health, dental, and vision benefits. Annuitants also receive life insurance coverage equal to the annual salary of the last day of employment until age 60, at which time the benefit becomes $5,000.

The State pays the System's portion of employer costs for the benefits provided. The total cost of the State's portion of health, dental, vision, and life insurance benefits of all members, including post-employment health, dental, vision, and life insurance benefits, is recognized as an expenditure by the State in the Illinois Comprehensive Annual Financial Report. The State finances the costs on a pay-as-you-go basis. The total costs incurred for health, dental, vision, and life insurance benefits are not separated by department or component unit for annuitants and their dependents nor active employees and their dependents.

A summary of post-employment benefit provisions, changes in benefit provisions, employee eligibility requirements including eligibility for vesting, and the authority under which benefit provisions are established are included as an integral part of the financial statements of the Department of Central Management Services. A copy of the financial statements of the Department of Central Management Services may be obtained by writing to the Department of Central Management Services, Stratton Office Building, 401 South Spring Street, Springfield, Illinois, 62706.

9. Analysis of Changes in Reserve Balances

The funded statutory reserves of the General Assembly Retirement System are composed of the following:

a. Reserve for Participants' Contributions

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

b. Reserve for Future Operations

This reserve is the balance remaining in the General Assembly Retirement System from State of Illinois contributions and revenue from investments after consideration of charges for payouts by the General Assembly Retirement System.

Statement of Changes in Reserve Balances
Year Ended June 30, 2014

	Participants' Contributions	Future Operations	Total Reserve Balances
Balance at June 30, 2013	$ 16,059,997	$ 38,287,024	$ 54,347,021
Add (deduct):			
Excess of revenues over expenses	1,358,140	1,084,299	2,442,439
Reserve transfers:			
Accumulated contributions of participants who retired or died with eligible survivor during the year	(797,626)	797,626	–
Balance at June 30, 2014	$ 16,620,511	$ 40,168,949	$ 56,789,460

10. Compensated Absences

Employees of the General Assembly Retirement System are entitled to receive compensation for all accrued but unused vacation time and one-half of all unused sick leave earned after December 31, 1983 and prior to January 1, 1998 upon termination of employment. These accrued compensated absences as of June 30, 2014 total $24,531 and are included in administrative expenses payable.

11. Equipment

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

12. Subsequent Event

On December 5, 2013, Governor Patrick Quinn signed Public Act 98-0599 into law. This new law included a reduction of the Automatic Annual Increase, the capping of pensionable earnings of Tier 1 employees, creation of a new defined contribution plan, a delay of the retirement age of members under age 46, the reduction of employee contributions for Tier 1 employees, and certain funding guarantees. It was to take effect no earlier than June 1, 2014.

On January 2, 2014, a lawsuit was filed in Circuit Court which challenges the constitutionality of the new pension law. A court injunction was also issued in May, 2014 to delay the implementation of the new pension law.

On November 21, 2014, the Circuit Court ruled that Public Act 98-0599 was unconstitutional and void in its entirety. The State has filed an appeal of the ruling directly to the Supreme Court.

Summary of the changes in equipment for fiscal year 2014

	Beginning Balance	Additions	Deletions	Ending Balance
Equipment	$ 15,076	$ 964	$ (317)	$ 15,723
Accumulated depreciation	(12,115)	(728)	307	(12,536)
Equipment, net	$ 2,961	$ 236	$ (10)	$ 3,187

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

	2014
Total pension liability	
Service Cost	$ 5,383,133
Interest on the total pension liability	20,110,452
Benefit changes	-
Difference between expected and actual experience	12,389,130
Assumption changes	-
Benefit payments	(20,800,502)
Refunds	(245,133)
Administrative expense	(334,628)
Net change in total pension liability	16,502,452
Total pension liability - beginning	381,000,309
Total pension liability - ending (a)	$ 397,502,761
Plan fiduciary net position	
Contributions - employer	$ 13,956,669
Contributions - participant	1,502,605
Net investment income	8,363,428
Benefit payments	(20,800,502)
Refunds	(245,133)
Administrative expense	(334,628)
Net change in plan fiduciary net position	2,442,439
Plan fiduciary net position - beginning	54,347,021
Plan fiduciary net position - ending (b)	$ 56,789,460
State's net pension liability - ending (a)-(b)	$ 340,713,301
Plan fiduciary net position as a percentage of the total pension liability	14.29%
Covered-employee payroll	$ 12,777,821
State's net pension liability as a percentage of covered employee payroll	2,666.44%

SCHEDULE OF INVESTMENT RETURNS

	2014
Annual money-weighted rate of return, net of investment expense	17.9%

SCHEDULE OF STATE CONTRIBUTIONS

Fiscal Year Ended June 30	Actuarially determined contribution	Contributions received	Contribution (deficiency) excess	Covered Employee Payroll	Contributions received as a percentage of covered employee payroll
2014	$17,110,135	$13,956,669	$(3,153,466)	12,777,821	109.23%

Notes to Required Supplementary Information

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

Methods and Assumptions Used to Determine Contribution Rates as of the Valuation Date:

Actuarial Cost Method:	Projected Unit Credit
Amortization Method:	Level percentage of total payroll.
Remaining Amortization Period:	30 years, open.
Asset Valuation Method:	5 year smoothed market
Inflation:	3.00 percent
Salary Increases:	A salary increase assumption of 3.50 percent per annum, compounded annually, was used. This 3.50 percent salary increase assumption includes an inflation component of 3.00 percent per annum, a productivity component of 0.40 percent per annum, and a merit/promotion component of 0.10 per cent per annum. Post-retirement benefit increases of 3.00 percent, compounded, for Tier 1 and 3.00 percent or the annual change in the Consumer Price Index, whichever is less, compounded for Tier 2.
Investment Rate of Return:	7.00 percent as of the June 30, 2014 valuation.
Retirement Age:	Age-based table of rates that are specific to the type of eligibility condition.
Mortality:	RP-2000 Combined Healthy Mortality Table, sex distinct, projected to 2015 (static table) setback 3 years for males and 2 years for females.

SUMMARY OF REVENUES BY SOURCE
Year Ended June 30, 2014

	2014
Contributions:	
Participants:	
Participants	$ 1,483,878
Interest paid by participants	18,727
Total participant contributions	1,502,605
Employer:	
General Revenue Fund	13,856,000
Paid by participants	100,669
Total employer contributions	13,956,669
Total contributions revenue	15,459,274
Investment income:	
Net appreciation in fair value of investments	6,988,375
Interest and dividends from investments	1,499,303
Interest earned on cash balances	17,838
Less investment expense, other than from securities lending	(153,577)
Net income from investing, other than from securities lending	8,351,939
Net securities lending income	11,489
Net investment income	8,363,428
Total revenues	$ 23,822,702

SCHEDULE OF PAYMENTS TO CONSULTANTS
Year Ended June 30, 2014

	2014
Actuary	$ 40,508
Audit fees	28,528
Legal Services	63
Medical services	160
Total	$ 69,259

SUMMARY SCHEDULE OF CASH RECEIPTS AND DISBURSEMENTS
Year Ended June 30, 2014

	2014
Cash balance, beginning of year	$ 4,238,695
Receipts:	
Participant contributions	1,501,274
Employer contributions:	
General Revenue Fund	14,457,830
Paid by participants	100,669
Interest income on cash balances	17,677
Tax-deferred installment payments	8,381
Cancellation of annuities	61,414
Transfers from Illinois State Board of Investment	5,800,000
Total cash receipts	21,947,245
Disbursements:	
Benefit payments:	
Retirement annuities	17,205,444
Survivors' annuities	3,588,592
Refunds	292,603
Administrative expenses	331,717
Total cash disbursements	21,418,356
Cash balance, end of year	$ 4,767,584

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

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

As Special Assistant Auditors for the Auditor General, we have audited, in accordance with the auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards* issued by the Comptroller General of the United States, the financial statements of the General Assembly Retirement System of the State of Illinois (System), as of and for the year ended June 30, 2014, and the related notes to the financial statements, which collectively comprise the System's basic financial statements, and have issued our report thereon dated December 22, 2014. Our report includes a reference to other auditors who audited the financial statements of the Illinois State Board of Investment, an internal investment pool of the State of Illinois, as described in our report on the System's financial statements. This report does not include the results of the other auditors' testing of internal control over financial reporting or compliance and other matters that are reported on separately by those auditors.

Internal Control Over Financial Reporting

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

A *deficiency in internal control* exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent, or detect and correct, misstatement on a timely basis. A *material weakness* is a deficiency, or a combination of deficiencies, in internal control such that there is a reasonable possibility that a material misstatement of the System's financial statements will not be prevented, or detected and corrected on a timely basis. A *significant deficiency* is a deficiency, or a combination of deficiencies, in internal control that is less severe than a material weakness, yet important enough to merit attention by those charged with governance.

Our consideration of internal control was for the limited purpose described in the first paragraph of this section and was not designed to identify all deficiencies in internal control that might be material weaknesses or significant deficiencies and therefore material weaknesses or significant deficiencies may exist that were not identified. Given these limitations, during our audit we did not identify any deficiencies in internal control that we consider to be material weaknesses. However, material weaknesses may exist that have not been identified. We did identify certain deficiencies in internal control, described in the accompanying schedule of findings as items 2014-001 and 2014-002 that we consider to be significant deficiencies.

Compliance and Other Matters

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

System's Response to Findings

The System's responses to the findings identified in our audit are described in the accompanying schedule of findings. The System's responses were not subjected to the auditing procedures applied in the audit of the financial statements and, accordingly, we express no opinion on the responses.

Purpose of this Report

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

BKD, LLP

Decatur, Illinois
December 22, 2014

General Assembly Retirement System
Schedule of Findings
June 30, 2014

2014-001. Finding – Noncompliance with the Fiscal Control and Internal Auditing Act

The General Assembly Retirement System (System) was not in compliance with the Fiscal Control and Internal Auditing Act (the Act).

The Internal Auditor position became vacant during November 2013 and a new internal auditor was not hired until October 2014. The System is required by the Act (30 ILCS 10/2001) to have a full-time program of internal auditing.

The Act (30 ILCS 10/2003) requires the chief executive officer to ensure that internal audits of all major systems of internal control are conducted at least once every two years. As a result of the vacancy only three of the eight internal audits planned for fiscal year 2014 were completed; therefore, the System was not in compliance with this provision of the Act.

According to System officials the System was not able to fill the internal audit position as quickly as they had hoped because of difficulty in finding an appropriate candidate to fill the position.

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

Recommendation

We recommend System management develop a plan to ensure the internal audit function continues in the event the position is left vacant for a period of time.

System Response

The System accepts the finding. The Chief Internal Auditor position was filled by the System on 10/01/2014.

2014-002. Finding – Controls over Census Data

The General Assembly Retirement System of the State of Illinois (System) has weaknesses in controls over creditable earnings and member census data reported by the Illinois Office of the Comptroller (Comptroller).

During our current fiscal year testing we noted no errors in the census data reported to the System out of 16 active members tested. However during a review of the System's internal controls over creditable earnings and member census data, it was noted the System's current processes and controls for verifying creditable earnings and member census data rely heavily on the reporting of the information by the Comptroller and there are limited controls in place by the System to verify the creditable earnings and member census information.

System management is responsible for the design, implementation, and maintenance of internal control relevant to the preparation and fair presentation of financial statements that are free from material misstatement, whether due to error or fraud. System controls should encompass effective management processes and controls to sufficiently address the appropriate risks and verify the underlying payroll records of member's census data maintained by the Comptroller. This would include developing processes and controls to verify significant elements of census data which originates at the Comptroller.

The Fiscal Control and Internal Auditing Act (30 ILCS 10/3001) requires all State agencies, including the System, to establish and maintain a system or systems, of internal fiscal administrative controls, such that information is properly recorded and accounted for to permit the preparation of reliable financial and statistical reports.

System officials indicated the System did not have procedures in place to conduct audits of the Comptroller to verify census data.

Certain financial statement assertions relating to single employer plans (that is, the Total Pension Liability (TPL) and revenues and receivables relating to Contributions) are dependent on the completeness and accuracy of census data. Weaknesses in controls over the significant elements of census data could lead to a misstatement in the valuation of the TPL, a required disclosure to the System's financial statements. In addition, a misstatement could lead to a misstatement in contributions which directly impacts valuation of Fiduciary Net Position and the financial statements of the System directly. A misstatement within the financial statements will impact the calculation of the Net Pension Liability (NPL) as required under GASB Statement No. 67 Financial Reporting for Pension Plans - An Amendment to GASB Statement No. 25.

2014-002. Finding – Controls over Census Data (continued)

A misstatement of the NPL will also impact the reporting of the NPL and related pension activity by the State under GASB Statement No. 68 Accounting and Financial Reporting for Pensions – An Amendment of GASB Statement No. 27. The auditors consider the weaknesses to be significant deficiencies in the System's internal control over financial and fiscal operations. (Finding Code No. 2014-002)

Recommendation

We recommend the System update current processes and controls to include the verification of significant elements of census data.

System Response

The System accepts the finding. GARS is committed to ensuring the accuracy of the census data of its members. GARS is currently exploring additional opportunities for electronic data matches, verifications through surveys and polling of members, and potential employer audits, all of which will require the assistance and cooperation from State Agencies and members of the Retirement System.