

McGladrey & Pullen

Certified Public Accountants

State of Illinois State Employees' Retirement System of Illinois

Compliance Examination
Year Ended June 30, 2006
Performed as Special Assistant Auditors
for the Auditor General, State of Illinois

State Employees' Retirement System of Illinois

Compliance Examination

Year Ended June 30, 2006

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State Employees' Retirement System of Illinois

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Year Ended June 30, 2006

System Officials

Acting Executive Secretary	Timothy B. Blair (Beginning June 1, 2006)
Executive Secretary	Robert V. Knox (Through May 31, 2006)
Accounting Division Manager	Nicholas C. Merrill, Jr.
Legal Counsel	Attorney General's Office
Internal Auditor	Larry Stone

System offices are located at:

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

State of Illinois Building
160 North LaSalle Street
Suite N725
Chicago, Illinois 60601



February 21, 2007

McGladrey & Pullen, LLP
20 North Martingale Road
Suite 500
Schaumburg, IL 60173

Ladies and Gentlemen:

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 the year ended June 30, 2006. Based on this evaluation, we assert that during the year ended June 30, 2006, 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 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, Acting Executive Secretary

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



State Employees' Retirement System of Illinois

Compliance Report

Year Ended June 30, 2006

Summary

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

Auditors' Reports

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

Summary of Findings

<u>Number of</u>	<u>This Report</u>	<u>Prior Report</u>
Findings	1	1
Repeated findings	None	None
Prior recommendations implementation or not repeated	1	2

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

Schedule of Findings

<u>Item No.</u>	<u>Page</u>	<u>Description</u>
CURRENT FINDINGS (STATE COMPLIANCE)		
06-1	9	Statements of Economic Interests Not Filed for Required Employees
PRIOR FINDINGS NOT REPEATED (STATE COMPLIANCE)		
06-2	10	Late Deposits of Cash Receipts

Exit Conference

System management reviewed the entire report and waived a formal exit conference. Response to the recommendation was provided by Timothy B. Blair, Acting Executive Secretary, in a letter dated March 20, 2007.

McGladrey & Pullen

Certified Public Accountants

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
Springfield, Illinois

Compliance

As Special Assistant Auditors for the Auditor General, we have examined the State Employees' Retirement System 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, 2006. The management of the System is responsible for compliance with these requirements. Our responsibility is to express an opinion on the System's compliance based on our examination.

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

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

In our opinion, the System complied, in all material respects, with the aforementioned requirements during the year ended June 30, 2006. However, the results of our procedures disclosed instances of noncompliance with those requirements, which are required to be reported in accordance with criteria established by the Audit Guide, issued by the Illinois Office of the Auditor General and which are described in the accompanying schedule of State findings as finding 06-1. As required by the Audit Guide, immaterial findings relating to instances of noncompliance excluded from this report have been reported in a separate letter to your office.

Internal Control

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

Our consideration of internal control over compliance with the aforementioned requirements would not necessarily disclose all matters in internal control that might be material weaknesses. A material weakness is a condition in which the design or operation of one or more internal control components does not reduce to a relatively low level the risk that noncompliance with applicable requirements of laws and regulations that would be material in relation to one or more of the aforementioned requirements being examined may occur and not be detected within a timely period by employees in the normal course of performing their assigned functions. We noted no matters involving internal control over compliance that we consider to be material weaknesses. As required by the Audit Guide, immaterial findings relating to internal control deficiencies excluded from this report have been reported in a separate letter to your office.

Supplementary Information for State Compliance Purposes

As Special Assistant Auditors for the Auditor General, we have audited and issued under separate cover the statements of plan net assets of the System as of June 30, 2006 and 2005, and the related statements of changes in plan net assets for the years then ended, and have issued our report thereon dated February 21, 2007. 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 2006 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, 2006, taken as a whole. We have also previously audited, 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, the System's basic financial statements for the years ended June 30, 2005 and 2004. In our reports dated November 3, 2005 and November 5, 2004, we expressed unqualified opinions on the respective statements of plan net assets and the related statements of changes in plan net assets. In our opinion, the 2005 and 2004 Supplementary Information for State Compliance Purposes, except for the portion marked "unaudited," is fairly stated in all material respects in relation to the basic financial statements for the years ended June 30, 2005 and 2004, taken as a whole.

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

McGladrey & Pullen, LLP

Schaumburg, Illinois
February 21, 2007

McGladrey & Pullen

Certified Public Accountants

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

Honorable William G. Holland
Auditor General, State of Illinois
Springfield, Illinois

As Special Assistant Auditors for the Auditor General, we have audited the statement of plan net assets and statement of changes in plan net assets of the State Employees' Retirement System of Illinois (System), as of and for the year ended June 30, 2006, and have issued our report thereon dated February 21, 2007. Our report was modified to include a reference to 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. Other auditors audited the financial statements of the Illinois State Board of Investment, 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, we considered the System's internal control over financial reporting in order to determine our auditing procedures for the purpose of expressing our opinion on the financial statements and not to provide an opinion on the internal control over financial reporting. Our consideration of the internal control over financial reporting would not necessarily disclose all matters in the internal control over financial reporting that might be material weaknesses. A material weakness is a reportable condition in which the design or operation of one or more of the internal control components does not reduce to a relatively low level the risk that misstatements caused by error or fraud in amounts that would be material in relation to the financial statements being audited may occur and not be detected within a timely period by employees in the normal course of performing their assigned functions. We noted no matters involving the internal control over financial reporting and its operation that we consider to be material weaknesses. However, we noted certain immaterial instances of internal control deficiencies, which we have reported to the Auditor General and management of the System in a separate letter dated February 21, 2007.

Compliance and Other Matters

As part of obtaining reasonable assurance about whether the System's financial statements are free of material misstatement, we performed tests of its compliance with certain provisions of laws, regulations, contracts and grant agreements, noncompliance with which could have a direct and material effect on the determination of financial statement amounts. However, providing an opinion on compliance with those provisions was not an objective of our audit, and accordingly, we do not express such an opinion. The results of our tests disclosed no instances of noncompliance or other matters that are required to be reported under *Government Auditing Standards*. However, we noted one instance of noncompliance which is reported as a State compliance finding in the schedule of findings. We also noted certain other immaterial matters which we have reported to the Auditor General and management of the System in a separate letter dated February 21, 2007.

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

McGladrey & Pullen, LLP

Schaumburg, Illinois
February 21, 2007

**State Employees' Retirement System
Compliance Examination**

Year Ended June 30, 2006

Schedule of Findings

Current Findings – State Compliance

Finding No. 06-1 Statements of Economic Interests Not Filed for Required Employees

Statements of Economic Interests have not been filed for all State Employees' Retirement System (System) employees having responsibility for formulation, negotiation, issuance or execution of contracts.

During our testing, we noted two employees had not filed a Statement of Economic Interests as of either May 1, 2005 or May 1, 2006. Both of these individuals either have responsibilities that require them to, or have the potential to be involved in having direct responsibility for the formulation, negotiation, issuance or execution of contracts. As a result of our testing we noted one instance in fiscal year 2006 in which one of the employees was involved in the execution of a contract in the amount of \$160,000. The other employee has the authority to approve contracts in the absence of the Administrative Services Manager and the Executive Secretary, though it was noted in our testing the employee did not exercise this authority during fiscal year 2006.

The Illinois Governmental Ethics Act (5 ILCS 420/4A-101) requires State employees who have direct supervisory authority over, or direct responsibility for the formulation, negotiation, issuance or execution of contracts entered into by the State in the amount of \$5,000 or more to file a verified written Statement of Economic Interests.

System management indicated the required Statements of Economic Interests were not filed with the Secretary of State by all employees due to a difference in interpretation of the requirement.

By not filing the required Statements of Economic Interests the System is not in compliance with the Illinois Governmental Ethics Act (5 ILCS 420/4A-101). (Finding Code No. 06-1)

Recommendation:

We recommend the two employees file Statements of Economic Interests on an annual basis. Also, the System should determine whether any other employees may be involved in the formulation or negotiation of contracts. If there is any possibility for such involvement, those individuals should also file a Statement of Economic Interests.

System Response:

The System generally agrees with the finding and the recommendation of the auditors and will implement the recommendation.

**State Employees' Retirement System
Compliance Examination**

Year Ended June 30, 2006

Schedule of Findings

Prior Findings Not Repeated – State Compliance

Finding No. 06-2 Late Deposits of Cash Receipts

Cash receipts collected by the State Employees' Retirement System's (System) Chicago office were not being deposited on a timely basis.

During our testing of cash receipts received by the Chicago office, we noted the deposits of these cash receipts were not made into the State Treasury in accordance with the statutory requirements. The Chicago office sends the cash receipts they receive to the System's Springfield office to be deposited. There were 20 deposits of cash receipts received by the Chicago office in fiscal year 2005, and we determined 8 (40%) of the deposits were not made timely. The 8 exceptions identified were deposited within a range of time from 2 days to 4 days after being received by the Chicago office. The 8 deposits noted as exceptions totaled \$106,788 or approximately 85% of the total deposits of \$126,264 received by the Chicago office during fiscal year 2005.

The State Officers and Employees Money Disposition Act (Act) (30 ILCS 230/2) requires any single receipt exceeding \$10,000 to be deposited into the State Treasury the day of actual physical receipt. In addition, the Act requires that when an accumulation of receipts is greater than \$10,000 the receipts are required to be deposited within 24 hours and when an accumulation is between \$500 and \$10,000 they must be deposited within 48 hours of actual physical receipt. The Act goes on to note that if an accumulation of receipt does not exceed \$500 it can be held until the next succeeding 1st or 15th day of the month before being deposited into the State Treasury.

The prior year finding will not be repeated due to an extension of the statutory 24/48 hour deposit rule granted by the State Treasurer. The deposit extension grants the Chicago office an extra 5 days to deposit cash receipts into the State Treasury and has been granted for the two-year period April 5, 2006 through April 5, 2008. No exceptions were noted in the cash receipts compliance testing for fiscal year 2006. (Finding Code No. 05-1)

**State Employees' Retirement System of Illinois
Compliance Examination**

Year Ended June 30, 2006

Supplementary Information for State Compliance Purposes

Summary

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 Revenue and Expenses
- Comparative Schedules of Administrative Expenses
- Schedule of Changes in State Property
- Reconciliation of Revenue to Cash Receipts and to Deposits Remitted to the State Comptroller
- Schedules of Funding Progress and Employer Contributions
- Explanation of Significant Variations in Revenues
- Explanation of Significant Variations in Expenses
- Analysis of Significant Statement of Plan Net Assets Accounts
- Analysis of Investment Performance (Unaudited)

Analysis of Operations:

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

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

State Employees' Retirement System of Illinois

Compliance Examination

Schedule of Appropriations, Expenditures and Lapsed Balances
Fourteen Months Ended August 31, 2006

Appropriated Funds	Appropriations (Net After Transfers)	Expenditures Through June 30, 2006	Lapse Period Expenditures July 1, 2006 Through August 31, 2006	Total Expenditures	Balances Lapsed
General Revenue Fund for Administration of the Social Security Enabling Act (Public Act 94-0015)					
Personal services	\$ 43,850	\$ 43,809	\$ -	\$ 43,809	\$ 41
Employer retirement contributions	3,450	3,413	-	3,413	37
Social Security contributions	3,300	3,238	-	3,238	62
Contractual services	18,050	17,750	-	17,750	300
Travel	1,200	1,167	-	1,167	33
Commodities	200	188	-	188	12
Telecommunications	400	326	28	354	46
Total	<u>70,450</u>	<u>69,891</u>	<u>28</u>	<u>69,919</u>	<u>531</u>
General Revenue Fund Appropriation for Employee Retirement Contributions Paid by Employer for Prior Fiscal Years (Public Act 94-0015)					
	150,000	150,000	-	150,000	-
Total all appropriated funds	<u>220,450</u>	<u>219,891</u>	<u>28</u>	<u>219,919</u>	<u>531</u>
Nonappropriated Funds					
State Employees' Retirement System Trust Fund					
Benefits and other nonadministrative expenditures					
Pensions and annuities	\$ -	1,085,428,730	-	1,085,428,730	\$ -
Nonrecurring refunds and distributions	-	12,022,377	-	12,022,377	-
Refunds of prior calendar year retirement contributions	-	173,971	-	173,971	-
Refunds, not classified elsewhere	-	26,292,460	3,979	26,296,439	-
Payments to General Obligation Retirement Fund	-	61,707,368	8,955,680	70,663,048	-
	<u>-</u>	<u>1,185,624,906</u>	<u>8,959,659</u>	<u>1,194,584,565</u>	<u>-</u>
Administrative expenditures					
Personal services	-	3,235,537	-	3,235,537	-
Employee retirement contributions paid by employer	-	112,187	-	112,187	-
Retirement contributions	-	252,355	-	252,355	-
Social Security contributions	-	241,079	-	241,079	-
Group insurance	-	866,420	2,563	868,983	-
Contractual services	-	1,298,912	80,273	1,379,185	-
Travel	-	45,378	592	45,970	-
Commodities	-	20,347	1,677	22,024	-
Printing	-	43,480	15,424	58,904	-
Equipment	-	51,482	-	51,482	-
Electronic data processing	-	1,565,482	35,545	1,601,027	-
Telecommunications	-	57,867	6,449	64,316	-
Automotive	-	15,893	4,642	20,535	-
	<u>-</u>	<u>7,806,419</u>	<u>147,165</u>	<u>7,953,584</u>	<u>-</u>
Total nonappropriated funds	<u>\$ -</u>	<u>1,193,431,325</u>	<u>9,106,824</u>	<u>1,202,538,149</u>	<u>\$ -</u>
Grand total, all Funds					
		<u>\$ 1,193,651,216</u>	<u>\$ 9,106,852</u>	<u>\$ 1,202,758,068</u>	

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

State Employees' Retirement System of Illinois

Compliance Examination

Comparative Schedules of Net Appropriations, Expenditures and Lapsed Balances Years Ended June 30, 2006, 2005 and 2004

	Fiscal Year		
	2006 P.A. 94-0015	2005 P.A. 93-0842	2004 P.A. 93-0062
General Revenue Fund			
Appropriations (net after transfers)	\$ 220,450	\$ 65,932,906	\$ 121,050
Expenditures			
Administration of the Social Security Enabling Act			
Personal services	43,809	42,228	42,228
Employee retirement contributions paid by employer	-	-	1,689
Employer retirement contributions	3,413	6,802	3,783
Social Security contributions	3,238	3,120	3,120
Contractual services	17,750	19,350	19,000
Travel	1,167	494	366
Commodities	188	182	169
Telecommunications	354	341	361
	<u>69,919</u>	<u>72,517</u>	<u>70,716</u>
Employee retirement contributions paid by employer for prior fiscal years	150,000	89,988	44,994
Certified FY04 Shortfall	-	65,769,356	-
Total expenditures	<u>219,919</u>	<u>65,931,861</u>	<u>115,710</u>
Lapsed balances	<u>\$ 531</u>	<u>\$ 1,045</u>	<u>\$ 5,340</u>
Pension Contribution Fund			
Appropriations (net after transfers)	\$ -	\$ -	\$ 1,420,575,000
Expenditures, annual allocation	-	-	1,385,895,278
Lapsed balances (1)	<u>\$ -</u>	<u>\$ -</u>	<u>\$ 34,679,722</u>
State Pension Fund			
Appropriations (net after transfers)	\$ -	\$ -	\$ 15,150,000
Expenditures, annual allocation	-	-	5,970,645
Lapsed balances (1)	<u>\$ -</u>	<u>\$ -</u>	<u>\$ 9,179,355</u>
Grand total, all Funds			
Appropriations (net after transfers)	\$ 220,450	\$ 65,932,906	\$ 1,435,846,050
Total expenditures	<u>219,919</u>	<u>65,931,861</u>	<u>1,391,981,633</u>
Lapsed balances	<u>\$ 531</u>	<u>\$ 1,045</u>	<u>\$ 43,864,417</u>

(1) The fiscal year 2004 balance was lapsed in accordance with P.A. 93-0665 which prohibited the System from submitting vouchers for payment after the Public Act's effective date, March 5, 2004. The Act directed the State Comptroller and State Treasurer to transfer funds equal to the remaining certified contribution amount for fiscal year 2004 from State Pension Fund appropriations from the Pension Contribution Fund. \$96,676,347 was transferred to the System from the Pension Contribution Fund in March 2004.

State Employees' Retirement System of Illinois

Compliance Examination

Comparative Schedules of Revenue and Expenses
Years Ended June 30, 2006 and 2005

	2006	2005
Revenue		
Contributions		
Participants	\$ 214,108,896	\$ 209,334,207
Employing State agencies and appropriations	210,499,791	427,434,612
Total contributions	<u>424,608,687</u>	<u>636,768,819</u>
Investment Income		
Net investment income	264,013,416	227,422,797
Interest earned on cash balances	8,724,784	4,300,338
Net appreciation in fair value of investments	840,493,512	721,856,118
Total net investment income	<u>1,113,231,712</u>	<u>953,579,253</u>
Total revenue	<u>1,537,840,399</u>	<u>1,590,348,072</u>
Expenses		
Benefits		
Retirement annuities	985,503,023	935,677,837
Survivors' annuities	61,100,647	57,542,913
Disability benefits	40,271,558	36,828,758
Lump-sum benefits	23,710,733	33,920,915
Total benefits	<u>1,110,585,961</u>	<u>1,063,970,423</u>
Refunds of contributions (including transfers to reciprocating systems)	13,410,048	14,105,301
Administrative expenses	8,139,278	8,311,269
Total expenses	<u>1,132,135,287</u>	<u>1,086,386,993</u>
Excess of revenue over expenses	<u>\$ 405,705,112</u>	<u>\$ 503,961,079</u>

State Employees' Retirement System of Illinois

Compliance Examination

State Employees' Retirement System Trust Fund and
General Revenue Fund - Social Security Division

Comparative Schedules of Administrative Expenses
Years Ended June 30, 2006 and 2005

Nonappropriated Funds	2006	2005
State Employees' Retirement Trust Fund		
Personal services	\$ 3,235,537	\$ 3,119,207
Employee retirement contributions paid by employer	108,812	119,180
Employer retirement contributions	252,355	500,477
Social Security contributions	241,079	232,929
Group insurance	868,983	803,980
Contractual services	1,352,042	1,352,284
Travel	45,970	49,509
Commodities	21,844	25,081
Printing	55,944	65,592
Electronic data processing	1,570,156	1,724,842
Telecommunications	61,765	63,012
Automotive	20,535	20,615
Depreciation	269,841	242,571
Other	34,415	(8,010)
Total	<u>\$ 8,139,278</u>	<u>\$ 8,311,269</u>

Appropriated Funds

General Revenue Fund - Social Security Division		
Personal services	\$ 43,809	\$ 42,228
Employer retirement contributions	3,413	6,802
Social Security contributions	3,238	3,120
Contractual services	17,750	19,350
Travel	1,167	494
Commodities	188	182
Telecommunications	354	341
Total	<u>\$ 69,919</u>	<u>\$ 72,517</u>

State Employees' Retirement System of Illinois

Compliance Examination

State Employees' Retirement System Trust Fund and
General Revenue Fund - Social Security Division

Schedule of Changes in State Property
Year Ended June 30, 2006

	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	2,209,825	84,843	(74,435)	2,220,233
Total	<u>6,467,810</u>	<u>84,843</u>	<u>(74,435)</u>	<u>6,478,218</u>
Accumulated depreciation	<u>(3,396,361)</u>	<u>(269,841)</u>	<u>74,412</u>	<u>(3,591,790)</u>
Property and equipment - net	<u>\$ 3,071,449</u>	<u>\$ (184,998)</u>	<u>\$ (23)</u>	<u>\$ 2,886,428</u>
Social Security Contribution Fund				
Furniture and equipment	<u>\$ 4,851</u>	<u>\$ -</u>	<u>\$ (864)</u>	<u>\$ 3,987</u>

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

State Employees' Retirement System of Illinois

Compliance Examination

Reconciliation of Revenue to Cash Receipts and
to Deposits Remitted to the State Comptroller
Years Ended June 30, 2006 and 2005

	2006	2005
Total revenue for the year	\$ 1,537,840,399	\$ 1,590,348,072
Add (deduct)		
Net appreciation in fair value of investments reinvested in the Illinois State Board of Investment (ISBI) Commingled Fund	(840,493,512)	(721,856,118)
Net investment income reinvested in the ISBI Commingled Fund	(264,013,416)	(227,422,797)
Transferred from ISBI	721,000,000	518,000,000
Decrease in receivables	7,919,622	48,051,954
(Increase) decrease in amount due to State of Illinois for bond principal and interest payments	(7,649,010)	16,691,722
Contribution credits earned by members during periods of disability	(5,395,636)	(4,890,314)
Cancellation or reimbursement of benefits and administrative expenses	4,687,995	5,331,207
Cancellation of contribution refunds	93,024	297,135
Installment collections to establish service credits	130,757	160,242
Bond principal and interest payments collected and remitted to the State of Illinois	78,271,456	117,516,923
Other adjustments not affecting cash receipts	18,462	20,282
Total cash receipts	<u>1,232,410,141</u>	<u>1,342,248,308</u>
Add (deduct)		
Interest on cash balances	(8,324,160)	(3,851,374)
Cancelled warrants and adjustment deposits classified by the comptroller as reductions of expenditures	(4,253,334)	(5,223,445)
State Pension Fund allocation receipted in error and subsequently refunded to State Pension Fund (Fund #0054)	-	14,294,361
Employer contributions refunded to state agencies due to change in rate	-	8,536,282
Cash in transit		
Beginning of year	281,225	279,524
End of year	(182,585)	(281,225)
Deposits in transit		
Beginning of year	5	-
End of year	(87,257)	(5)
Deposits remitted to the State Comptroller for order into the State Treasury	<u>\$ 1,219,844,035</u>	<u>\$ 1,356,002,426</u>
Fund 788	\$ 58,924	\$ 56,950
Fund 479	1,219,785,111	1,355,945,476
	<u>\$ 1,219,844,035</u>	<u>\$ 1,356,002,426</u>

State Employees' Retirement System of Illinois

Compliance Examination

Schedules of Funding Progress and Employer Contributions

Schedules 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
06/30/2001	\$ 8,276,661,352	\$ 12,572,240,145	\$ 4,295,578,793	65.8%	\$ 3,564,441,000	120.5%
06/30/2002	7,673,892,691	14,291,044,457	6,617,151,766	53.7	3,713,020,000	178.2
06/30/2003	7,502,111,416	17,593,980,039	10,091,868,623	42.6	3,639,334,000	277.3
06/30/2004	9,990,186,874	18,442,664,834	8,452,477,960	54.2	3,439,251,000	245.8
06/30/2005	10,494,147,953	19,304,646,648	8,810,498,695	54.4	3,475,528,000	253.5
06/30/2006	10,899,853,065	20,874,541,910	9,974,688,845	52.2	3,572,541,000	279.2

Schedules of Employer Contributions

Year Ended June 30	Annual Required Contribution per GASB Statement No. 25 ⁽¹⁾	Percentage Contributed	(A) Annual Required Payroll Contribution per State Statute ⁽²⁾	(B) State Pension Fund Contribution	(A) + (B) Total Required State Contribution	Percentage Contributed
2001	\$ 294,351,538	124.3%	\$ 354,448,013	\$ 10,490,000	\$ 364,938,013	100%
2002	306,509,801	126.0	372,787,208	10,290,000	383,077,208	100
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	100

(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 Pension 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.

Notes to Required Supplementary Information

Valuation date	June 30, 2006
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 until a 90 percent funding level is achieved
Remaining amortization period:	
(a) For GASB Statement No. 25 reporting purposes	40 years, open
(b) Per State Statute	39 years, closed
Asset valuation method	Fair value
Actuarial assumptions:	
Investment rate of return	8.5 percent
Projected salary increases	1.0 to 6.1 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 Illinois

Compliance Examination

Year Ended June 30, 2006

Explanation of Significant Variations in Revenues

Comments on Significant Variations Between Certain Revenue Accounts

	2006	2005	Increase (Decrease)	
Contributions from participants	\$ 214,108,896	\$ 209,334,207	\$ 4,774,689	(1)
Contributions by employing state agencies	210,499,791	427,434,612	(216,934,821)	(2)
Net investment income	264,013,416	227,422,797	36,590,619	(3)
Net appreciation in fair value of investments	840,493,512	721,856,118	118,637,394	(3)

- (1) Total employee payroll increased from FY2005 to FY2006 by approximately 2.8%, and employee contributions rose by nearly 2.3% in relation to the increase.
- (2) The employer contribution rate in FY2005 was 16.107%, and the employer contribution rate in FY2006 was 7.792%.
- (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, 2006 and 2005.

Net appreciation in fair value was higher than the previous fiscal year. The upward trend of the financial markets continued, however, at a lower rate of increase than in some recent years.

State Employees' Retirement System of Illinois

Compliance Examination

Year Ended June 30, 2006

Explanation of Significant Variations in Expenses

Comments on Significant Variations Between Certain Expense Accounts

	2006	2005	Increase (Decrease)	
Retirement annuities	\$ 985,503,023	\$ 935,677,837	\$ 49,825,186	(1)
Lump-sum benefits	23,710,733	33,920,915	(10,210,182)	(2)

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

(2) The lump-sum benefits decreased as a result of reduced payments under the State's Alternative Retirement Cancellation Payment (ARCP) program.

State Employees' Retirement System of Illinois

Compliance Examination

Year Ended June 30, 2006

Analysis of Significant Statement of Plan Net Assets Accounts

	<u>2006</u>	<u>2005</u>
Cash balances		
State Treasury	\$ 226,911,800	\$ 204,250,488
Vouchers in transit	(343,507)	(6,442)
Deposit and cash in transit	182,585	281,225
	<u>226,750,878</u>	<u>204,525,271</u>
Petty cash fund	200	200
	<u>\$ 226,751,078</u>	<u>\$ 204,525,471</u>

Over the course of the past several years, legislative changes have necessitated that a larger cash balance be available for the payment of: a) increased regularly recurring monthly benefits; and b) one-time payments to certain qualified individuals. The System has purposely increased the amount of cash available in the fund in order to handle these additional cash requirements.

	<u>2006</u>	<u>2005</u>
Receivables		
Participants' contributions	\$ 13,154,690	\$ 13,921,578
Employing State agencies	11,284,318	18,827,922 (1)
Other accounts	5,066,573	4,188,506
	<u>\$ 29,505,581</u>	<u>\$ 36,938,006</u>

(1) The amount due from Employing State agencies was higher in FY2005 due to a higher employer contribution rate than in FY2006. The FY2005 rate was 16.107%, and the FY2006 rate was 7.792%.

No receivables were deemed uncollectible at June 30, 2006 and no allowance for uncollectible accounts was necessary as of that date.

State Employees' Retirement System of Illinois

Compliance Examination

Year Ended June 30, 2006

Analysis of Significant Statement of Plan Net Assets Accounts (continued)

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 Illinois State Board of Investments (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.

Comparison of the changes in the System's investments held in the ISBI Commingled Fund for the years ended June 30, 2006 and 2005 is summarized as follows:

	2006	2005
Balance at beginning of year, at fair value	\$ 10,271,356,795	\$ 9,840,077,880
Net cash (withdrawn) from investments	(721,000,000)	(518,000,000)
	<u>9,550,356,795</u>	<u>9,322,077,880</u>
Investment income		
Interest, dividends and other	292,393,986	250,491,153
Expenses	(28,380,570)	(23,068,356)
	<u>264,013,416</u>	<u>227,422,797</u>
Net appreciation in fair value of investments		
Net realized gain on sale of investments	734,112,782	476,037,549
Net unrealized gain on investments	106,380,730	245,818,569
	<u>840,493,512</u>	<u>721,856,118</u>
Total net investment gain	<u>1,104,506,928</u>	<u>949,278,915</u>
Balance at end of year, at fair value	<u>\$ 10,654,863,723</u>	<u>\$ 10,271,356,795</u>

State Employees' Retirement System of Illinois

Compliance Examination

Year Ended June 30, 2006

Analysis of Significant Statement of Plan Net Assets Accounts (continued)

Investments (continued)

An analysis of net investment gain for the years ended June 30, 2006 and 2005 is summarized as follows:

	2006	2005	Increase
Net ISBI Investment income	\$ 264,013,416	\$ 227,422,797	\$ 36,590,619
Net appreciation in fair value of investments	840,493,512	721,856,118	118,637,394
Total net investment gain	<u>\$ 1,104,506,928</u>	<u>\$ 949,278,915</u>	<u>\$ 155,228,013</u>

The increase in the net investment gain of the System is the result of higher returns in FY2006 as compared to FY2005. The investment rate of return for FY2006 was 11.0% and in FY2005, the rate of return was 10.1%.

State Employees' Retirement System of Illinois

Compliance Examination

Year Ended June 30, 2006

Analysis of Investment Performance (Unaudited)

An analysis of investment performance for the years ended June 30, 2006 and 2005 is summarized as follows:

	<u>2006</u>	<u>2005</u>
Total return *	11.0%	10.1%

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

State Employees' Retirement System of Illinois

Compliance Examination

Year Ended June 30, 2006

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, 2006, the System had approximately 54,900 benefit recipients and over 68,000 active members.

Management of the System is vested in a Board of Trustees consisting of seven persons, as follows: (1) the Director of 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 Illinois

Compliance Examination

Year Ended June 30, 2006

System's Functions and Planning Program (continued)

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 2006. 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 2005 included six new projects: a) replacement of mainframe computer needs; b) staff training; c) updating member information; d) reciprocal systems benefit processing; e) a power point presentation; and f) an e-mail information study. Several of the fiscal year 2004 projects continued into fiscal year 2005.

New projects for fiscal year 2006 include: a) conducting an election for two board members; b) update of position descriptions; c) a feasibility study of electronic payment processing; d) a review of publications; and e) an internet usage study.

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. Overall, it appears that the System's management and planning procedures are sufficient with regard to the System's needs and statutory requirements.

State Employees' Retirement System of Illinois

Compliance Examination

Year Ended June 30, 2006

Progress in Funding the System

The actuarial accrued liability of the System as of June 30, 2006 amounted to approximately \$20.9 billion. The actuarial value of the assets as of June 30, 2006 amounted to approximately \$10.9 billion, leaving an unfunded actuarial liability of approximately \$10.0 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.

The annual required payroll contribution and rate as computed by the System's actuary for fiscal year 2004 was \$500,672,000 or 13.439 percent of covered payroll. The annual required payroll contribution and rate as computed by the System's actuary for fiscal year 2005 is \$432,344,000 or 12.248 percent of covered payroll (excluding the Debt Service component). The annual required payroll contribution and rate as computed by the System's actuary for fiscal year 2006 is \$690,000,000 or 19.701 percent of covered payroll (excluding the Debt Service component).

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 Illinois

Compliance Examination

Year Ended June 30, 2006

Progress in Funding the System (Continued)

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. 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 Illinois

Compliance Examination

Year Ended June 30, 2006

System Employees

State 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, 2006 and 2005 is summarized by functional classification as follows:

	2006	2005
Executive and administrative	13	12
Accounting, bookkeeping and clerical	27	27
Other office employees	27	27
Electronic data processing	15	15
Total	<u>82</u>	<u>81</u>

Social Security Contribution Fund

The Social Security Contribution Fund had one employee for both the years ended June 30, 2006 and 2005.

Comparison of Administrative Expenses to Total Expenses

	2006	2005
Total expenses		
Benefits	\$ 1,110,585,961	\$ 1,063,970,423
Refunds of contributions, including transfers to reciprocating systems	13,410,048	14,105,301
Administrative expenses	8,139,278	8,311,269
	<u>\$ 1,132,135,287</u>	<u>\$ 1,086,386,993</u>
Administrative expenses as a percentage of total expenses	<u>0.7%</u>	<u>0.8%</u>

State Employees' Retirement System of Illinois

Compliance Examination

Year Ended June 30, 2006

Proceeds from General Obligation Bonds, Pension Funding Series June 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.

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 the return of the pension bond proceeds earned an annual rate of return of 11.0% during the year ended June 30, 2006, which is the same as the overall return for the Board's investment portfolio.

State Employees' Retirement System of Illinois

Compliance Examination

Year Ended June 30, 2006

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.

	2006	2005
Contributions		
Participant Contributions	\$ 214,108,896	\$ 209,334,207
State of Illinois Employer Contributions	210,499,791	427,434,612
Total Contributions	<u>424,608,687</u>	<u>636,768,819</u>
Deductions		
Retirement Benefits	985,503,023	935,677,837
Survivors' Benefits	61,100,647	57,542,913
Disability Benefits	40,271,558	36,828,758
Lump-Sum Death Benefits	23,710,733	33,920,915
Refunds (including transfers to reciprocating systems)	13,410,048	14,105,301
Administrative Expenses	8,139,278	8,311,269
Total Deductions	<u>1,132,135,287</u>	<u>1,086,386,993</u>
Investments Used to Pay Benefits and Expenses	<u>\$ (707,526,600)</u>	<u>\$ (449,618,174)</u>

State Employees' Retirement System of Illinois

Compliance Examination

Year Ended June 30, 2006

Service Efforts and Accomplishments (Unaudited)

	2006	2005
Membership data		
Coordinated members	86,313	88,306
Noncoordinated members	3,134	3,117
	<u>89,447</u>	<u>91,423</u>
Active members	<u>68,075</u>	<u>69,163</u>
Benefit payments processed		
Recurring		
Retirement annuities	42,676	42,649
Survivors' annuities	10,036	10,041
Disability benefits	2,156	2,138
	<u>54,868</u>	<u>54,828</u>
Termination refunds processed	<u>1,903</u>	<u>1,910</u>
Retirement counseling		
Preretirement sessions		
Number of sessions	317	284
Number of attendees	7,664	6,529
Postretirement sessions		
Number of sessions	43	40
Number of attendees	1,468	1,499
Regional and other meetings		
Number of sessions	124	258
Number of attendees	7,365	12,851