

# McGladrey & Pullen

Certified Public Accountants

## State of Illinois State Employees' Retirement System of Illinois

Compliance Examination  
Year Ended June 30, 2007  
Performed as Special Assistant Auditors  
for the Auditor General, State of Illinois

# State Employees' Retirement System of Illinois

## Compliance Examination

Year Ended June 30, 2007

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# State Employees' Retirement System of Illinois

## Compliance Examination

Year Ended June 30, 2007

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**State Employees' Retirement System of Illinois**

**Compliance Examination**

**Year Ended June 30, 2007**

**System Officials**

Acting Executive Secretary

Timothy B. Blair

Accounting Division Manager

Nicholas C. Merrill, Jr., CPA

Legal Counsel

Attorney General's Office

Internal Auditor

Larry L. Stone

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



STATE  
RETIREMENT  
SYSTEMS

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

Internet: <http://www.state.il.us/srs>

E-Mail: [ser@mail.state.il.us](mailto:ser@mail.state.il.us)

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

February 8, 2008

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

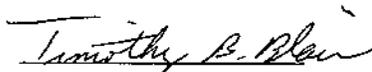
Ladies and Gentlemen:

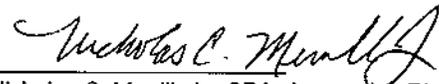
We are responsible for the identification of, and compliance with, all aspects of laws, regulations, contracts, or grant agreements that could have a material effect on the operations of the System. We are responsible for and we have established and maintained an effective system of, internal controls over compliance requirements. We have performed an evaluation of the System's compliance with the following assertions during the year ended June 30, 2007. Based on this evaluation, we assert that during the year ended June 30, 2007, the System has materially complied with the assertions below.

- 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.
- 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.
- 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.
- 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.
- 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, 2007

### 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.

### Accountants' Report

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>Compliance Report</u>	<u>Financial Report</u>	<u>Prior Compliance Report</u>
Findings	2	1	1
Repeated findings	1	None	None
Prior recommendations implementation or not repeated	None	None	1

Details of State compliance findings are presented in a separately tabbed section of this report. Details of the *Government Auditing Standards* finding relate to a significant deficiency in internal control over financial reporting. The *Government Auditing Standard* finding has been issued separately with the System's financial statement audit report.

### Schedule of Findings

<u>Item No.</u>	<u>Page</u>	<u>Description</u>
		CURRENT FINDINGS ( <i>GOVERNMENT AUDITING STANDARDS</i> )
07-1	*	Segregation of Duties
		CURRENT FINDINGS (STATE COMPLIANCE)
07-2	7	Follow-Up on Audit Documentation Exception Identified During Internal Audit Self-Assessment
07-3	8	Statements of Economic Interest Not Filed by Three Employees

\* See separately issued financial statement audit report for detail of the finding.

### Exit Conference

System management reviewed the entire report and waived a formal exit conference. The responses to the recommendations were provided by Nicholas C. Merrill, Jr., CPA, Chief Fiscal Officer, in an email dated February 7, 2008.

# 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

Board of Trustees  
State Employees' Retirement System 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, 2007. 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.

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

In our opinion, the System complied, in all material respects, with the requirements listed in the first paragraph of this report during the year ended June 30, 2007. However, the results of our procedures disclosed instances of noncompliance, which are required to be reported in accordance with criteria established by the Audit Guide, issued by the Illinois Office of the Auditor General and which are described in the accompanying schedule of findings and as Findings 07-2, and 07-3. 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 listed in the first paragraph of this report. In planning and performing our examination, we considered the System's internal control over compliance with the requirements listed in the first paragraph of this report in order to determine our examination procedures for the purpose of expressing our opinion on compliance and to test and report on internal control over compliance in accordance with the Audit Guide, issued by the Illinois Office of the Auditor General, but not for the purpose of expressing an opinion on the effectiveness of the System's internal control over compliance. Accordingly, we do not express an opinion on the effectiveness of the System's internal control over compliance.

Our consideration of internal control over compliance with the requirements listed in the first paragraph of this report was for the limited purpose described in the preceding paragraph of this section and would not necessarily identify all deficiencies in internal control that might be significant deficiencies or material weaknesses.

A *control deficiency* in an entity's internal control over compliance exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent or detect noncompliance with the requirements listed in the first paragraph of this report on a timely basis. A *significant deficiency* is a control deficiency, or combination of control deficiencies, that adversely affects the entity's ability to comply with the requirements listed in the first paragraph of this report such that there is more than a remote likelihood that noncompliance with a requirement that is more than inconsequential will not be prevented or detected by the entity's internal control. We do not consider the deficiencies in internal control over compliance described in the accompanying schedule of findings and questioned costs as Findings 07-2 and 07-3 to be significant deficiencies.

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

Additionally, the results of our procedures disclosed other matters involving internal control over compliance, which are required to be reported in accordance with criteria established by the Audit Guide issued by the Illinois Office of the Auditor General and which are described in the accompanying schedule of findings and questioned costs as Findings 07-2 and 07-3.

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.

System responses to the findings identified in our examination are described in the accompanying schedule of findings and questioned costs. We did not examine the System responses and, accordingly, we express no opinion on them.

### 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, 2007 and 2006, and the related statements of changes in plan net assets for the years then ended, and have issued our report thereon dated February 8, 2008. The accompanying supplementary information, as listed in the table of contents as Supplementary Information for State Compliance Purposes, is presented for purposes of additional analysis and is not a required part of the basic financial statements of the System. The Supplementary Information for State Compliance Purposes, except for that portion marked "unaudited" on which we express no opinion, has been subjected to the auditing procedures applied in the audit of the basic financial statements and, in our opinion, is fairly stated in all material respects in relation to the basic financial statements taken as a whole. We have also previously audited, in accordance with auditing standards generally accepted in the United States of America 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, 2006 and 2005. In our report dated February 21, 2007, we expressed an unqualified opinion on the respective statements of plan net assets and the related statements of changes in plan net assets. In our opinion, the 2006 and 2005 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, 2006 and 2005, 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, System Board of Trustees and 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 8, 2008

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

Year Ended June 30, 2007

**Schedule of Findings**

**Current Findings – State Compliance**

**Finding No. 07-2      Follow –up on Audit Documentation Exception Identified During Internal Audit Self Assessment**

A formal self assessment of the State Employees' Retirement System's (System) Internal Audit function with validation performed by an independent reviewer was conducted for the period ending June 30, 2006, and the formal report was released on November 17, 2006. The report noted the System's Internal Audit function did not formally document steps / procedures to be performed during internal audits.

We examined the workpapers / documentation of 7 internal audits performed after the formal internal self assessment report was released and noted the internal audit workpapers still did not formally document steps / procedures to be performed. Only informal documentation of audit steps / procedures was located within the workpapers. In addition, the audit objectives and scope sections were also not completed as part of the internal audit workpaper documentation. The System should have initiated remedial action to correct the exceptions noted as soon as they were identified in the formal self assessment report.

Per the Institute of Internal Auditors (IIA) Standard 2240.A1 the auditor should develop work programs that achieve the engagement objectives by establishing procedures for identifying, analyzing, and recording information during the engagement. The work programs should be recorded. Per IIA Standard 2210, the engagement objectives and scope of work should be established and documented as part of planning.

System management indicated they did not take corrective action to address the exception noted in the formal self assessment report because it was overlooked. System management noted they have made corrections, and now believe they are in compliance.

By not formally documenting and completing work programs that include the audit procedure to be performed as well as establishing and documenting the scope and objectives for each internal audit, the System's Internal Audit function is not in compliance with the Institute of Internal Auditors (IIA) Standards. Compliance with these professional standards helps ensure the quality of the work performed. (Finding Code No. 07-2)

**Recommendation:**

We recommend the System ensure the preparation of detailed work programs that include a separate scope and objective sections for all internal audits.

**System Response:**

The System concurs with the Recommendation of the auditors.

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

Year Ended June 30, 2007

**Schedule of Findings**

**Current Findings – State Compliance**

**Finding No. 07-3                      Statements of Economic Interests Not Filed by Three 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 three employees had not filed Statements of Economic Interests as of either May 1, 2006 or May 1, 2007. All 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. One of the employees was involved in the execution of a contract in the amount of \$309,350 in fiscal year 2007.

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 because the employees were not aware they were required to file.

Failure to file Statements of Economic Interests could result in the State's inability to properly detect transactions involving parties having financial, business or personal relationships with System personnel. (Finding Code No. 07-3, 06-1)

**Recommendation:**

We recommend System management review and update the list of those employees who are in positions required to file Statements of Economic Interests to ensure an accurate and complete listing is submitted to the Secretary of State.

**System Response:**

The System concurs with the Recommendation of the auditors.

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

**Year Ended June 30, 2007**

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

State Employees' Retirement System of Illinois

Compliance Examination

Schedule of Appropriations, Expenditures and Lapsed Balances  
Fourteen Months Ended August 31, 2007

<b>Appropriated Funds</b>	Appropriations (Net After Transfers)	Expenditures Through June 30, 2007	Lapse Period Expenditures July 1, 2007 Through August 31, 2007	Total Expenditures	Balances Lapsed
General Revenue Fund for Administration of the Social Security Enabling Act (Public Act 94-0798)					
Personal services	\$ 46,800	\$ 46,800	\$ -	\$ 46,800	\$ -
Employee retirement contributions paid by employer	-	-	-	-	-
Employer retirement contributions	5,425	5,394	-	5,394	31
Social Security contributions	3,600	3,459	-	3,459	141
Contractual services	17,300	14,175	3,125	17,300	-
Travel	1,200	1,143	-	1,143	57
Commodities	200	176	-	176	24
Telecommunications	575	384	151	535	40
Total	<u>75,100</u>	<u>71,531</u>	<u>3,276</u>	<u>74,807</u>	<u>293</u>
General Revenue Fund Appropriation for Employee Retirement Contributions Paid by Employer for Prior Fiscal Years (Public Act 94-0798)					
	136,500	37,212	-	37,212	99,288
Total all appropriated funds	<u>211,600</u>	<u>108,743</u>	<u>3,276</u>	<u>112,019</u>	<u>99,581</u>
<b>Nonappropriated Funds</b>					
State Employees' Retirement System Trust Fund					
Benefits and other nonadministrative expenditures					
Pensions and annuities	-	1,136,241,811	-	1,136,241,811	-
Nonrecurring refunds and distributions	-	12,407,692	-	12,407,692	-
Refunds of prior calendar year retirement contributions	-	219,127	-	219,127	-
Refunds, not classified elsewhere	-	26,012,336	-	26,012,336	-
Payments to General Obligation Retirement Fund	-	63,532,438	9,164,951	72,697,389	-
	-	<u>1,238,413,404</u>	<u>9,164,951</u>	<u>1,247,578,355</u>	<u>-</u>
Administrative expenditures					
Personal services	-	3,445,469	5,110	3,450,579	-
Employee retirement contributions paid by employer	-	54,571	204	54,775	-
Retirement contributions	-	397,394	589	397,983	-
Social Security contributions	-	255,400	391	255,791	-
Group insurance	-	848,056	2,272	850,328	-
Contractual services	-	1,307,788	65,176	1,372,964	-
Travel	-	44,722	295	45,017	-
Commodities	-	19,825	1,552	21,377	-
Printing	-	32,994	4,512	37,506	-
Equipment	-	40,211	-	40,211	-
Electronic data processing	-	2,054,657	24,181	2,078,838	-
Telecommunications	-	59,731	5,843	65,574	-
Automotive	-	12,631	4,055	16,686	-
	-	<u>8,573,449</u>	<u>114,180</u>	<u>8,687,629</u>	<u>-</u>
Total nonappropriated funds	<u>\$ -</u>	<u>1,246,986,853</u>	<u>9,279,131</u>	<u>1,256,265,984</u>	<u>\$ -</u>
Grand total, all Funds					
		<u>\$ 1,247,095,596</u>	<u>\$ 9,282,407</u>	<u>\$ 1,256,378,003</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, 2007, 2006 and 2005

	Fiscal Year		
	2007 P.A. 94-0798	2006 P.A. 94-0015	2005 P.A. 93-0842
General Revenue Fund			
Appropriations (net after transfers)	\$ 211,600	\$ 220,450	\$ 65,932,906
Expenditures			
Administration of the Social Security Enabling Act			
Personal services	46,800	43,809	42,228
Employee retirement contributions paid by employer	-	-	-
Employer retirement contributions	5,394	3,413	6,802
Social Security contributions	3,459	3,238	3,120
Contractual services	17,300	17,750	19,350
Travel	1,143	1,167	494
Commodities	176	188	182
Telecommunications	535	354	341
	74,807	69,919	72,517
Employee retirement contributions paid by employer for prior fiscal years	37,212	150,000	89,988
Certified FY04 Shortfall	-	-	65,769,356
Total expenditures	112,019	219,919	65,931,861
Lapsed balances	\$ 99,581	\$ 531	\$ 1,045
Grand total			
Appropriations (net after transfers)	\$ 211,600	\$ 220,450	\$ 65,932,906
Total expenditures	112,019	219,919	65,931,861
Lapsed balances	\$ 99,581	\$ 531	\$ 1,045

State Employees' Retirement System of Illinois

Compliance Examination

Comparative Schedules of Revenue and Expenses  
Years Ended June 30, 2007 and 2006

	2007	2006
Revenue		
Contributions		
Participants	\$ 224,722,599	\$ 214,108,896
Employing State agencies and appropriations	358,786,650	210,499,791
Total contributions	<u>583,509,249</u>	<u>424,608,687</u>
Investment Income		
Net investment income	266,766,628	264,013,416
Interest earned on cash balances	12,633,405	8,724,784
Net appreciation in fair value of investments	1,500,507,144	840,493,512
Total net investment income	<u>1,779,907,177</u>	<u>1,113,231,712</u>
Total revenue	<u>2,363,416,426</u>	<u>1,537,840,399</u>
Expenses		
Benefits		
Retirement annuities	1,030,284,942	985,503,023
Survivors' annuities	65,215,133	61,100,647
Disability benefits	43,053,148	40,271,558
Lump-sum benefits	22,737,815	23,710,733
Total benefits	<u>1,161,291,038</u>	<u>1,110,585,961</u>
Refunds of contributions (including transfers to reciprocating systems)	14,261,872	13,410,048
Administrative expenses	8,807,627	8,139,278
Total expenses	<u>1,184,360,537</u>	<u>1,132,135,287</u>
Excess of revenue over expenses	<u>\$ 1,179,055,889</u>	<u>\$ 405,705,112</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, 2007 and 2006

<b>Nonappropriated Funds</b>	2007	2006
State Employees' Retirement Trust Fund		
Personal services	\$ 3,450,579	\$ 3,235,537
Employee retirement contributions paid by employer	39,467	108,812
Employer retirement contributions	397,983	252,355
Social Security contributions	255,791	241,079
Group insurance	850,328	868,983
Contractual services	1,338,551	1,352,042
Travel	43,884	45,970
Commodities	21,472	21,844
Printing	31,553	55,944
Electronic data processing	2,048,396	1,570,156
Telecommunications	63,704	61,765
Automotive	16,686	20,535
Depreciation	278,553	269,841
Other	(29,320)	34,415
Total	<u>\$ 8,807,627</u>	<u>\$ 8,139,278</u>

**Appropriated Funds**

General Revenue Fund - Social Security Division		
Personal services	\$ 46,800	\$ 43,809
Employer retirement contributions	5,394	3,413
Social Security contributions	3,459	3,238
Contractual services	17,300	17,750
Travel	1,143	1,167
Commodities	176	188
Telecommunications	535	354
Total	<u>\$ 74,807</u>	<u>\$ 69,919</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, 2007

	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	2,220,233	63,256	(167,942)	2,115,547
Total	<u>6,478,218</u>	<u>63,256</u>	<u>(167,942)</u>	<u>6,373,532</u>
Accumulated depreciation	<u>(3,591,790)</u>	<u>(278,552)</u>	<u>167,226</u>	<u>(3,703,116)</u>
Property and equipment - net	<u>\$ 2,886,428</u>	<u>\$ (215,296)</u>	<u>\$ (716)</u>	<u>\$ 2,670,416</u>
Social Security Contribution Fund				
Furniture and equipment	<u>\$ 3,987</u>	<u>\$ -</u>	<u>\$ -</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, 2007 and 2006

	2007	2006
Total revenue for the year	\$ 2,363,416,426	\$ 1,537,840,399
Add (deduct)		
Net appreciation in fair value of investments reinvested in the Illinois State Board of Investment (ISBI) Commingled Fund	(1,500,507,144)	(840,493,512)
Net investment income reinvested in the ISBI Commingled Fund	(266,766,628)	(264,013,416)
Transferred from ISBI	612,000,000	721,000,000
Decrease in receivables	(1,146,119)	7,919,622
(Increase) decrease in amount due to State of Illinois for bond principal and interest payments	231,594	(7,649,010)
Contribution credits earned by members during periods of disability	(5,873,143)	(5,395,636)
Cancellation or reimbursement of benefits and administrative expenses	4,909,785	4,687,995
Cancellation of contribution refunds	193,162	93,024
Installment collections to establish service credits	311,049	130,757
Bond principal and interest payments collected and remitted to the State of Illinois	72,488,118	78,271,456
Other adjustments not affecting cash receipts	(9,297)	18,462
Total cash receipts	<u>1,279,247,803</u>	<u>1,232,410,141</u>
Add (deduct)		
Interest on cash balances	(12,495,855)	(8,324,160)
Cancelled warrants and adjustment deposits classified by the comptroller as reductions of expenditures	(4,563,876)	(4,253,334)
Cash in transit		
Beginning of year	182,585	281,225
End of year	(146,708)	(182,585)
Deposits in transit		
Beginning of year	87,257	5
End of year	(1,500)	(87,257)
Deposits remitted to the State Comptroller for order into the State Treasury	<u>\$ 1,262,309,706</u>	<u>\$ 1,219,844,035</u>
Fund 788	\$ 53,675	\$ 58,924
Fund 479	1,262,256,031	1,219,785,111
	<u>\$ 1,262,309,706</u>	<u>\$ 1,219,844,035</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 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
06/30/2002	\$ 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
06/30/2007	12,078,908,954	22,280,916,665	10,202,007,711	54.2	3,762,777,000	271.1

Schedules of Employer Contributions

Year Ended June 30	Annual Required Contribution per GASB Statement No. 25 <sup>(1)</sup>	Percentage Contributed	(A) Annual Required Payroll Contribution per State Statute <sup>(2)</sup>	(B) State Pension Fund Contribution	(A) + (B) Total Required State Contribution	Percentage Contributed
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
2007	823,802,760	43.6	361,113,709	-	361,113,709	100

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

(2) Employer required contribution determined in accordance with Public Act 88-0593 and Public Act 94-004 (for fiscal years 2006 and 2007 only). 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, 2007
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	30 years, open
(b) Per State Statute	38 years, closed
Asset valuation method	Fair value
Actuarial assumptions:	
Investment rate of return	8.5 percent
Projected salary increases	1.0 to 5.35 percent, based upon member's age
Assumed inflation rate	3.0 percent
Group size growth rate	0.0 percent
Postretirement increase	3.0 percent - compounded
Mortality table	1994 Group Annuity Mortality Table for males and females. Five percent of deaths amongst active employees are assumed to be in the performance of their duty.

## State Employees' Retirement System of Illinois

### Compliance Examination

#### Explanation of Significant Variations in Revenues Year Ended June 30, 2007

	2007	2006	Increase	
Contributions from participants	\$ 224,722,599	\$ 214,108,896	\$ 10,613,703	(1)
Contributions by employing state agencies	358,786,650	210,499,791	148,286,859	(2)
Net investment income	266,766,628	264,013,416	2,753,212	(3)
Interest earned on cash balances	12,633,405	8,724,784	3,908,621	(4)
Net appreciation in fair value of investments	1,500,507,144	840,493,512	660,013,632	(3)

#### Comments on Significant Variations Between Certain Revenue Accounts

- (1) Total covered employee payroll increased from FY2006 to FY2007 by approximately 5.3%, and employee contributions rose by nearly 4.96% in relation to the increase.
- (2) The employer contribution rate in FY2006 was 7.792%, and the employer contribution rate in FY2007 was 11.525%.
- (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, 2007 and 2006. The return on investments managed by ISBI was 11.0% for FY2006 as compared to 17.1% for FY2007. Net appreciation in fair value was higher than the previous fiscal year.
- (4) The System maintained a higher average daily balance (FY07 - \$246.8 million compared to FY06 - \$220.0 million), and had a higher average yield (FY07 - 5.118% compared to FY06 - 3.965%) which resulted in the higher interest income amount.

State Employees' Retirement System of Illinois

Compliance Examination

Explanation of Significant Variations in Expenses  
Year Ended June 30, 2007

	2007	2006	Increase	
Retirement annuities	\$ 1,030,284,942	\$ 985,503,023	\$ 44,781,919	(1)

Comments on Significant Variations Between Certain Expense Accounts

- (1) The increase is primarily due to a scheduled benefit increase of 3% and a larger number of annuitants receiving payments. The number of annuitants receiving retirement annuity payments increased to 42,979 during FY2007, from 42,676 in FY2006.

State Employees' Retirement System of Illinois

Compliance Examination

Analysis of Significant Statement of Plan Net Assets Accounts  
Year Ended June 30, 2007

	<u>2007</u>	<u>2006</u>
<b>Cash balances</b>		
State Treasury	\$ 250,063,178	\$ 226,911,800
Vouchers in transit	(351,390)	(343,507)
Cash in transit	<u>146,708</u>	<u>182,585</u>
	249,858,496	226,750,878
Petty cash fund	<u>200</u>	<u>200</u>
	<u>\$ 249,858,696</u>	<u>\$ 226,751,078</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>2007</u>	<u>2006</u>
<b>Receivables</b>		
Participants' contributions	\$ 12,023,467	\$ 13,154,690
Employing State agencies	13,421,494	11,284,318 (1)
Other accounts	<u>5,452,610</u>	<u>5,066,573</u>
	\$ 30,897,571	\$ 29,505,581

- (1) The amount due from Employing State agencies was higher in FY2007 due to a higher employer contribution rate than in FY2006. The FY2007 rate was 11.525%, and the FY2006 rate was 7.792%.

## State Employees' Retirement System of Illinois

### Compliance Examination

#### Analysis of Significant Statement of Plan Net Assets Accounts (continued) Year Ended June 30, 2007

#### 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, 2007 and 2006 is summarized as follows:

	<u>2007</u>	<u>2006</u>
Balance at beginning of year, at fair value	\$ 10,654,863,723	\$ 10,271,356,795
Net cash (withdrawn) from investments	(612,000,000)	(721,000,000)
	<u>10,042,863,723</u>	<u>9,550,356,795</u>
Investment income		
Interest, dividends and other	304,940,692	292,393,986
Expenses	(38,174,064)	(28,380,570)
	<u>266,766,628</u>	<u>264,013,416</u>
Net appreciation in fair value of investments		
Net realized gain on sale of investments	798,735,493	734,112,782
Net unrealized gain on investments	701,771,651	106,380,730
	<u>1,500,507,144</u>	<u>840,493,512</u>
<b>Total net investment gain</b>	<u>1,767,273,772</u>	<u>1,104,506,928</u>
Balance at end of year, at fair value	<u>\$ 11,810,137,495</u>	<u>\$ 10,654,863,723</u>

State Employees' Retirement System of Illinois

Compliance Examination

Analysis of Significant Statement of Plan Net Assets Accounts (continued)  
Year Ended June 30, 2007

Investments (continued)

An analysis of net investment gain for the years ended June 30, 2007 and 2006 is summarized as follows:

	2007	2006	Increase
Net ISBI Investment income	\$ 266,766,628	\$ 264,013,416	\$ 2,753,212
Net appreciation in fair value of investments	1,500,507,144	840,493,512	660,013,632
Total net investment gain	<u>\$ 1,767,273,772</u>	<u>\$ 1,104,506,928</u>	<u>\$ 662,766,844</u>

The increase in the net investment gain of the System is the result of higher returns in FY2007 as compared to FY2006. The investment rate of return for FY2007 was 17.1% and in FY2006, the rate of return was 11.0%.

State Employees' Retirement System of Illinois

Compliance Examination

Analysis of Investment Performance (Unaudited)  
Year Ended June 30, 2007

An analysis of investment performance for the years ended June 30, 2007 and 2006 is summarized as follows:

	<u>2007</u>	<u>2006</u>
Total return *	17.1%	11.0%

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

## State Employees' Retirement System of Illinois

### Compliance Examination

#### Analysis of Operations

Year Ended June 30, 2007

#### System's Functions and Planning Program

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

The System is governed by Article 14 of the Illinois Pension Code (Chapter 40 of the Illinois Compiled Statutes). As of June 30, 2007, the System had approximately 55,300 benefit recipients and 67,700 active members.

Management of the System is vested in a Board of Trustees (Board) 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

#### Analysis of Operations

Year Ended June 30, 2007

#### 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 2007. 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 2007 included six new projects: a) review of tax information brochure; b) collective bargaining project; c) toll-free telephone service study; d) qualified Illinois domestic relations order; e) new attendance system; and f) a trustee election review. Several of the fiscal year 2006 projects continued into fiscal year 2007.

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

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

## State Employees' Retirement System of Illinois

### Compliance Examination

#### Analysis of Operations

Year Ended June 30, 2007

#### Progress in Funding the System

The actuarial accrued liability of the System as of June 30, 2007 amounted to approximately \$22.3 billion. The actuarial value of the assets as of June 30, 2007 amounted to approximately \$12.1 billion, leaving an unfunded actuarial liability of approximately \$10.2 billion.

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

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

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

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

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

## State Employees' Retirement System of Illinois

### Compliance Examination

#### Analysis of Operations

Year Ended June 30, 2007

#### Progress in Funding the System (Continued)

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

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

## State Employees' Retirement System of Illinois

### Compliance Examination

#### System Employees

Year Ended June 30, 2007

#### 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, 2007 and 2006 is summarized by functional classification as follows:

	2007	2006
Executive and administrative	13	13
Accounting, bookkeeping and clerical	28	27
Other office employees	24	27
Electronic data processing	15	15
Total	<u>80</u>	<u>82</u>

#### Social Security Contribution Fund

The Social Security Contribution Fund had one employee for both the years ended June 30, 2007 and 2006.

#### Comparison of Administrative Expenses to Total Expenses

	2007	2006
Total expenses		
Benefits	\$ 1,161,291,038	\$ 1,110,585,961
Refunds of contributions, including transfers to reciprocating systems	14,261,872	13,410,048
Administrative expenses	8,807,627	8,139,278
	<u>\$ 1,184,360,537</u>	<u>\$ 1,132,135,287</u>
Administrative expenses as a percentage of total expenses	<u>0.7%</u>	<u>0.7%</u>

## State Employees' Retirement System of Illinois

### Compliance Examination

#### Analysis of Operations

Year Ended June 30, 2007

#### 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 17.1% during the year ended June 30, 2007, which is the same as the overall return for the Board's investment portfolio.

## State Employees' Retirement System of Illinois

### Compliance Examination

#### Schedule of Contributions / Deductions and Effect on Investments Year Ended June 30, 2007

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.

	2007	2006
<b>Contributions</b>		
Participant Contributions	\$ 224,722,599	\$ 214,108,896
State of Illinois Employer Contributions	358,786,650	210,499,791
<b>Total Contributions</b>	<u>583,509,249</u>	<u>424,608,687</u>
<b>Deductions</b>		
Retirement Benefits	1,030,284,942	985,503,023
Survivors' Benefits	65,215,133	61,100,647
Disability Benefits	43,053,148	40,271,558
Lump-Sum Death Benefits	22,737,815	23,710,733
Refunds (including transfers to reciprocating systems)	14,261,872	13,410,048
Administrative Expenses	8,807,627	8,139,278
<b>Total Deductions</b>	<u>1,184,360,537</u>	<u>1,132,135,287</u>
<b>Investments Used to Pay Benefits and Expenses</b>	<u>\$ (600,851,288)</u>	<u>\$ (707,526,600)</u>

State Employees' Retirement System of Illinois

Compliance Examination

Service Efforts and Accomplishments (Unaudited)  
Year Ended June 30, 2007

	2007	2006
Membership data		
Coordinated members	86,094	86,313
Noncoordinated members	3,227	3,134
	<u>89,321</u>	<u>89,447</u>
Active members	<u>67,699</u>	<u>68,075</u>
Benefit payments processed		
Recurring		
Retirement annuities	42,979	42,676
Survivors' annuities	10,074	10,036
Disability benefits	2,212	2,156
	<u>55,265</u>	<u>54,868</u>
Termination refunds processed	<u>1,660</u>	<u>1,903</u>
Retirement counseling		
Preretirement sessions		
Number of sessions	256	317
Number of attendees	6,275	7,664
Postretirement sessions		
Number of sessions	37	43
Number of attendees	1,169	1,468
Regional and other meetings		
Number of sessions	103	124
Number of attendees	8,540	7,365