

State of Illinois
State Employees' Retirement System
Compliance Examination
For the Year Ended June 30, 2010
Performed as Special Assistant Auditors for
the Auditor General, State of Illinois



**State Employees' Retirement System
of the State of Illinois
Compliance Examination
For the Year Ended June 30, 2010**

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**State Employees' Retirement System
of the State of Illinois
Compliance Examination
For the Year Ended June 30, 2010**

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The financial statements of the State Employees' Retirement System of Illinois for the year ended June 30, 2010, are published in a separate document and are supported herein by reference.

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

State Employees' Retirement System of the State of Illinois

June 30, 2010

System Officials

Executive Secretary
Accounting Division Manager
Legal Counsel
Internal Auditor

Timothy B. Blair
Nicholas C. Merrill, Jr., CPA
Attorney General's Office
Larry L. Stone

Office Locations

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P.O. Box 19255
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160 North LaSalle Street, Suite N725
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**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

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

April 2, 2011

BKD, LLP
Certified Public Accountants
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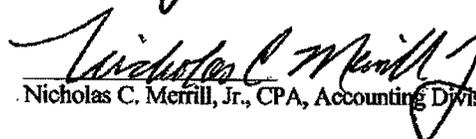
We are responsible for the identification of, and compliance with, all aspects of laws, regulations, contracts, or grant agreements that could have a material effect on the operations of the System. We are responsible for and we have established and maintained an effective system of internal controls over compliance requirements. We have performed an evaluation of the System's compliance with the following assertions during period ended June 30, 2010. Based on this evaluation, we assert that during the year ended June 30, 2010 the System has materially complied with the assertions below.

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

Yours very truly,

State Employees' Retirement System of Illinois


Timothy B. Blair, Executive Secretary


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



Compliance Report

**State Employees' Retirement System
of the State of Illinois
Compliance Report Summary
June 30, 2010**

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

Accountants' Reports

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

Summary of Findings

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

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

Summary of Findings and Recommendations

Item No.	Page	Description	Finding Type
Current Findings (State Compliance)			
No matters are reportable			
Prior Findings Not Repeated			
A	7	Lack of Disaster Contingency Planning or Testing to Ensure Recovery of Computer Systems	

Exit Conference

System management reviewed the entire report and waived a formal exit conference.

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

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

Compliance

As Special Assistant Auditors for the Auditor General, we have examined the State Employees' Retirement System of the State of Illinois' (System) compliance with the requirements listed below, as more fully described in the *Audit Guide for Financial Audits and Compliance Attestation Engagements of Illinois State Agencies* (Audit Guide) as adopted by the Auditor General, during the year ended June 30, 2010. The management of the State Employees' Retirement System of the State of Illinois is responsible for compliance with these requirements. Our responsibility is to express an opinion on the System's compliance based on our examination.

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

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

In our opinion, the System complied, in all material respects, with the requirements listed in the first paragraph of this report during the year ended June 30, 2010.

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 as a basis for designing our examination procedures for the purpose of expressing our opinion on compliance and to test and report on internal control over compliance in accordance with the Audit Guide, issued by the Illinois Office of the Auditor General, but not for the purpose of expressing an opinion on the effectiveness of the System's internal controls over compliance. Accordingly, we do not express an opinion on the effectiveness of the System's internal control over compliance.

A *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 and correct noncompliance with the requirements listed in the first paragraph of this report on a timely basis. A *material weakness* is a deficiency, or combination of deficiencies, in internal control over compliance such that there is a reasonable possibility that material noncompliance with a requirement listed in the first paragraph of this report will not be prevented, or detected and corrected on a timely basis.

Our consideration of internal control over compliance was for the limited purpose described in the first paragraph of this section and was not designed to identify all deficiencies in internal control over compliance that might be deficiencies, significant deficiencies or material weaknesses. We did not identify any deficiencies in internal control over compliance that we consider to be material weaknesses, as defined above.

As required by the Audit Guide, immaterial findings 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 the basic financial statements of the System as of and for the years ended June 30, 2010 and 2009, and have issued our report thereon dated February 17, 2011. 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.

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

BKD, LLP

April 2, 2011

State Employees' Retirement System of the State of Illinois

Schedule of Findings

June 30, 2010

Prior Findings Not Repeated

A. Finding – Lack of Disaster Contingency Planning or Testing to Ensure Recovery of Computer Systems

During the prior examination, we noted the System had not updated its disaster recover plan since May 2006. Additionally, testing of the System's recovery plan had not been conducted in the audit period. (Finding Code No. 09-1)

During the current examination, the System has updated its disaster recovery plan, but the auditors uncovered smaller, immaterial conditions of noncompliance. These conditions are described in our Letter of Immaterial Findings.

**Supplementary Information
for State Compliance Purposes**

**State Employees' Retirement System
of the State of Illinois**
Supplementary Information for State Compliance Purposes
Summary
June 30, 2010

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

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

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

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

Fiscal Schedules and Analysis

State Employees' Retirement System of the State of Illinois

Schedule of Appropriations, Expenditures and Lapsed Balances For the Fourteen Months Ended August 31, 2010

	Appropriations (Net After Transfers)	Expenditures Through June 30, 2010	Lapse Period Expenditures July 1, 2010 through August 31, 2010	Total Expenditures	Balances Lapsed
Appropriated Funds					
General Revenue Fund for Administration of the Social Security Enabling Act (Public Act 96-0042)					
Personal services	\$ 73,500	\$ 41,465	\$ —	\$ 41,465	\$ 32,035
Social Security contributions	5,700	3,122	—	3,122	2,578
Operational expense	<u>51,600</u>	<u>23,361</u>	<u>6,775</u>	<u>30,136</u>	<u>21,464</u>
Total all appropriated funds	<u>\$ 130,800</u>	<u>\$ 67,948</u>	<u>\$ 6,775</u>	<u>\$ 74,723</u>	<u>\$ 56,077</u>
Nonappropriated Funds					
State Employee Retirement System Trust Fund					
Benefits and other nonadministrative expenditures					
Pensions and annuities	\$ —	\$1,373,994,182	\$ —	\$1,373,994,182	\$ —
Nonrecurring refunds and distributions	—	15,192,684	—	15,192,684	—
Refunds of prior calendar year retirement contributions	—	162,037	—	162,037	—
Refunds, not classified elsewhere	—	15,355,322	—	15,355,322	—
Payments to General Obligation Retirement Fund	<u>—</u>	<u>22,466,907</u>	<u>3,354,563</u>	<u>25,821,470</u>	<u>—</u>
	<u>—</u>	<u>1,427,171,132</u>	<u>3,354,563</u>	<u>1,430,525,695</u>	<u>—</u>

State Employees' Retirement System of the State of Illinois

Schedule of Appropriations, Expenditures and Lapsed Balances For the Fourteen Months Ended August 31, 2010

	Appropriations (Net After Transfers)	Expenditures Through June 30, 2010	Lapse Period Expenditures July 1, 2010 through August 31, 2010	Total Expenditures	Balances Lapsed
Nonappropriated Funds					
State Employee Retirement System					
Trust Fund (continued)					
Administrative expenditures					
Personal services	\$ —	\$ 4,248,014	\$ —	\$ 4,248,014	\$ —
Employee retirement contributions paid by employer	—	42,062	—	42,062	—
Retirement contributions	—	1,206,740	—	1,206,740	—
Social Security contributions	—	314,861	—	314,861	—
Group insurance	—	944,187	2,976	947,163	—
Contractual services	—	1,680,929	128,232	1,809,161	—
Travel	—	31,916	7,581	39,497	—
Purchase of investments	—	720,745,289	—	720,745,289	—
Commodities	—	23,594	2,736	26,330	—
Printing	—	48,470	495	48,965	—
Equipment	—	25,014	20,999	46,013	—
Electronic data processing	—	2,803,272	239,958	3,043,230	—
Telecommunications	—	66,334	12,435	78,769	—
Automotive	—	12,722	1,079	13,801	—
Land, land improvements and building	—	48,663	27,665	76,328	—
	—	<u>732,242,067</u>	<u>444,156</u>	<u>732,686,223</u>	—
Total nonappropriated funds	\$ —	<u>2,159,413,199</u>	<u>3,798,719</u>	<u>2,163,211,918</u>	\$ —
Grand total, all Funds		<u>\$2,159,481,147</u>	<u>\$ 3,805,494</u>	<u>\$2,163,286,641</u>	

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

State Employees' Retirement System of the State of Illinois

Comparative Schedules of Net Appropriations, Expenditures and Lapsed Balances For the Years Ended June 30, 2010, 2009 and 2008

	Fiscal Year		
	2010 P.A. 96-0042	2009 P.A. 95-0734	2008 P.A. 95-0348
General Revenue Fund			
Appropriations (net after transfers)	\$ 130,800	\$ 146,300	\$ 207,300
Expenditures			
Administration of the Social Security Enabling Act			
Personal services	41,465	37,805	52,794
Employer retirement contributions	3,329	7,961	8,746
Social Security contributions	3,122	2,804	3,912
Contractual services	25,000	24,995	17,500
Travel	1,161	441	1,200
Commodities	242	175	188
Electronic data processing	—	—	452
Telecommunications	404	421	400
	<u>74,723</u>	<u>74,602</u>	<u>85,192</u>
Employee retirement contributions paid by employer for prior fiscal years	<u>—</u>	<u>22,972</u>	<u>45,661</u>
Total expenditures	<u>74,723</u>	<u>97,574</u>	<u>130,853</u>
Lapsed balances	<u>\$ 56,077</u>	<u>\$ 48,726</u>	<u>\$ 76,447</u>

**State Employees' Retirement System
of the State of Illinois**
Comparative Schedules of Revenues and Expenses
For the Years Ended June 30, 2010 and 2009

	2010	2009
Revenue		
Contributions		
Participants	\$ 246,172,971	\$ 242,227,432
Employing state agencies and appropriations	<u>1,095,545,856</u>	<u>774,910,344</u>
Total contributions	<u>1,341,718,827</u>	<u>1,017,137,776</u>
Investments		
Net investment income	200,200,994	224,823,314
Interest earned on cash balances	795,373	7,319,968
Net appreciation (depreciation) in fair value of investments	<u>598,899,494</u>	<u>(2,441,040,917)</u>
Total net investment gain (loss)	<u>799,895,861</u>	<u>(2,208,897,635)</u>
Total revenue	<u>2,141,614,688</u>	<u>(1,191,759,859)</u>
Expenses		
Benefits		
Retirement annuities	1,237,118,008	1,164,454,557
Survivors' annuities	89,516,980	73,697,450
Disability benefits	48,312,629	46,513,406
Lump-sum benefits	<u>15,693,575</u>	<u>15,548,262</u>
Total benefits	<u>1,390,641,192</u>	<u>1,300,213,675</u>
Refunds of contributions (including transfers to reciprocating systems)	15,274,174	14,859,487
Administrative expenses	<u>11,720,755</u>	<u>10,681,376</u>
Total expenses	<u>1,417,636,121</u>	<u>1,325,754,538</u>
Revenue over (under) expenses	<u>\$ 723,978,567</u>	<u>\$(2,517,514,397)</u>

State Employees' Retirement System of the State of Illinois

Comments on Significant Variations Between Certain Revenue Accounts For the Years Ended June 30, 2010 and 2009

	2010	2009	Increase (Decrease)
Contributions from participants	\$ 246,172,971	\$ 242,227,432	\$ 3,945,539 (1)
Contributions by employing state agencies	1,095,545,856	774,910,344	320,635,512 (2)
Net investment income	200,200,994	224,823,314	(24,622,320) (3)
Interest earned on cash balances	795,373	7,319,968	(6,524,595) (4)
Net appreciation (depreciation) in fair value of investments	598,899,494	(2,441,040,917)	3,039,940,411 (3)

(1) Total employee payroll increased from fiscal year 2009 to fiscal year 2010 by approximately 2.3% and employee contributions were up 1.7%.

(2) The employer contribution rate in fiscal year 2009 was 21.049%, and the employer contribution rate in fiscal year 2010 was 28.377%.

(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, 2010 and 2009.

(4) The average daily cash balance was significantly lower during fiscal year 2010 due to a strategy to leave more funds available for investment with The Illinois State Board of Investment. Additionally, the average interest rate of return was lower in fiscal year 2010 compared to fiscal year 2009.

Net appreciation (depreciation) in fair value was significantly greater than the previous fiscal year. These amounts may change significantly from year to year.

**State Employees' Retirement System
of the State of Illinois**
Comparative Schedules of Administrative Expenses
For the Years Ended June 30, 2010 and 2009

	<u>2010</u>	<u>2009</u>
Nonappropriated Funds		
State Employees' Retirement Trust Fund		
Personal services	\$ 4,248,014	\$ 4,044,917
Employee retirement contributions paid by employer	42,062	51,206
Employer retirement contributions	1,206,740	852,808
Social Security contributions	314,861	301,708
Group insurance	947,163	950,343
Contractual services	1,777,453	1,746,425
Travel	39,497	30,581
Commodities	27,108	29,298
Printing	42,225	52,521
Electronic data processing	2,665,507	2,210,406
Telecommunications	67,333	67,063
Automotive	13,801	19,305
Depreciation	272,329	244,771
Other	<u>56,662</u>	<u>80,024</u>
Total	<u>\$ 11,720,755</u>	<u>\$ 10,681,376</u>
Appropriated Funds		
General Revenue Fund – Social Security Division		
Personal services	\$ 41,465	\$ 37,805
Employer retirement contributions	3,329	7,961
Social Security contributions	3,122	2,804
Contractual services	25,000	24,995
Travel	1,161	441
Commodities	242	175
Electronic data processing	—	421
Telecommunications	<u>404</u>	<u>—</u>
Total	<u>\$ 74,723</u>	<u>\$ 74,602</u>

**State Employees' Retirement System
of the State of Illinois**
Analysis of Significant Variations in Expenses
For the Years Ended June 30, 2010 and 2009

	<u>2010</u>	<u>2009</u>	<u>Increase</u>
Retirement annuities	\$ 1,237,118,008	\$ 1,164,454,557	\$ 72,663,451 (1)

(1) The increase is primarily due to a scheduled benefit increase of 3%, and a larger number of annuitants receiving payments.

State Employees' Retirement System of the State of Illinois

Schedule of Changes in State Property For the Year Ended June 30, 2010

	Beginning Balance	Additions	Deletions	Ending Balance
State Employees' Retirement System Trust Fund				
Land	\$ 655,241	\$ —	\$ —	\$ 655,241
Land improvements	250,316	48,663	—	298,979
Building	3,352,428	27,665	—	3,380,093
Furniture and equipment	<u>1,945,131</u>	<u>429,910</u>	<u>(63,291)</u>	<u>2,311,750</u>
Total	6,203,116	506,238	(63,291)	6,646,063
Accumulated depreciation	<u>(3,628,357)</u>	<u>(272,329)</u>	<u>63,112</u>	<u>(3,837,574)</u>
Property and equipment – net	<u>\$ 2,574,759</u>	<u>\$ 233,909</u>	<u>\$ (179)</u>	<u>\$ 2,808,489</u>
Social Security Contribution Fund				
Furniture and Equipment	<u>\$ 4,179</u>	<u>\$ —</u>	<u>\$ —</u>	<u>\$ 4,179</u>

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

State Employees' Retirement System of the State of Illinois

Schedule of Reconciliation of Revenue to Cash Receipts and to Deposits Remitted to the State Comptroller For the Years Ended June 30, 2010 and 2009

	2010	2009
Total revenue (loss) for the year	\$ 2,141,614,688	\$(1,191,759,859)
Add (deduct)		
Net (appreciation) depreciation in fair value of investments reinvested in the Illinois State Board of Investment (ISBI) Commingled Fund	(598,899,494)	2,441,040,917
Net investment income reinvested in the ISBI Commingled Fund Transferred from ISBI	(200,200,994) 600,000,000	(224,823,314) 237,000,000
(Increase) decrease in receivables (employing state agencies, contributions and other)	18,101,997	(8,666,747)
Increase (decrease) in amount due to State of Illinois for bond principal and interest payments	(6,645,446)	(347,529)
Contribution credits earned by members during periods of disability	(7,544,522)	(6,927,654)
Cancellation or reimbursement of benefits and administrative expenses	6,874,476	6,283,274
Cancellation of Contribution refunds	77,921	56,314
Installment collections to establish service credits	208,985	120,403
Bond principal and interest payments collected and remitted to the State of Illinois	32,334,954	78,366,991
Proceeds from the sale of pension notes transferred to ISBI	(720,745,288)	—
Other adjustments not affecting cash receipts	1,218,096	(96,123)
Total cash receipts	1,266,395,373	1,330,246,673
Add (deduct)		
Interest on cash balances	(911,074)	(7,782,920)
Cancelled warrants and adjustment deposits classified by the comptroller as reductions of expenditures	(6,559,393)	(6,025,888)
Cash in transit		
Beginning of year	313,912	382,165
End of year	(792,433)	(313,912)
Deposits in transit		
Beginning of year	82,522	1,320
End of year	(2,077)	(82,522)
Deposits remitted to the State Comptroller for order into the State Treasury	\$ 1,258,526,830	\$ 1,316,424,916
Fund 788	\$ 60,250	\$ 62,810
Fund 479	1,258,466,580	1,316,362,106
	\$ 1,258,526,830	\$ 1,316,424,916

State Employees' Retirement System of the State of Illinois

Schedules of Funding Progress and Employer Contributions For the Years Ended June 30, 2010 and 2009

Schedule 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)
6/30/05	\$ 10,494,147,953	\$ 19,304,646,648	\$ 8,810,498,695	54.4%	\$3,475,528,000	253.5%
6/30/06	10,899,853,065	20,874,541,910	9,974,688,845	52.2	3,572,541,000	279.2
6/30/07	12,078,908,954	22,280,916,665	10,202,007,711	54.2	3,762,777,000	271.1
6/30/08	10,995,366,485	23,841,280,102	12,845,913,617	46.1	3,967,704,000	323.8
6/30/09	10,999,953,527	25,298,346,092	14,298,392,565	43.5	4,027,263,000	355.0
6/30/10	10,961,540,164	29,309,464,296	18,347,924,132	37.4	4,119,360,842	445.4

* For fiscal years prior to 2009, the actuarial value of assets was equal to the fair value of assets. Beginning in fiscal year 2009, the actuarial value of assets was equal to the fair value of assets adjusted for any actuarial gains or losses from investment return incurred in the fiscal year recognized in equal amounts over the five year period following that fiscal year.

Schedule of Employer Contributions

Year Ended June 30	Annual Required Contribution per GASB Statement No. 25 ⁽¹⁾	Percentage Contributed	Annual Required Payroll Contribution per State Statute ⁽²⁾	State Pension Fund Contribution	Total required State Contribution	Percentage Contributed
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	99
2008	986,410,891	59.6	576,626,422	—	576,626,422	102
2009	1,003,432,849	77.2	769,851,595	—	769,851,595	101
2010	1,177,313,343	93.1	1,093,072,413	—	1,093,072,413	100

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

⁽²⁾ Employer required contribution determined in accordance with P.A. 88-0593 and P.A. 94-0004 (for Fiscal Years 2006 and 2007 only). These amounts reflect only payroll required contributions.

**State Employees' Retirement System
of the State of Illinois**
**Schedules of Funding Progress and Employer Contributions
For the Years Ended June 30, 2010 and 2009**

Notes to Required Supplementary Information

Valuation date	June 30, 2010
Actuarial cost method	Projected Unit Credit
Amortization method:	
(a) For GASB Statement No. 25 reporting purposes	Level percent of payroll
(b) Per State Statute	15-year phase-in to a level percent of payroll unit a 90% funding level is achieved
Remaining amortization period:	
(a) For GASB Statement No. 25 reporting purposes	30 years, open
(b) Per State Statute	35 years, closed
Asset valuation method	Fair value, adjusted for any actuarial gains or losses from investment return incurred in the fiscal year recognized in equal amounts over the five year period following that fiscal year.
Actuarial assumptions:	
Investment rate of return	7.75 percent
Projected salary increases	1.0 to 5.35 percent, based upon member's age
Assumed inflation rate	3.0 percent
Group size growth rate	0.0 percent
Postretirement increase	3.0 percent – compounded
Mortality table	1994 Group Annuity Mortality Table for males and females. Five percent of deaths amongst active employees are assumed to be in the performance of their duty.

State Employees' Retirement System of the State of Illinois

Analysis of Significant Statement of Plan Net Asset Accounts For the Years Ended June 30, 2010 and 2009

Cash Balances

	2010	2009
State Treasury	\$ 49,680,641	\$ 232,376,854
Vouchers in transit	(560,609)	(11,897)
Deposit and cash in transit	792,433	313,912
	49,912,465	232,678,869
Petty cash fund	200	200
	\$ 49,912,665	\$ 232,679,069

Receivables

	2009	2009
Participants' contributions	\$ 15,308,885	\$ 16,280,628
Employing State agencies	17,119,073	35,390,539 (1)
Other accounts	6,905,516	5,764,303
	\$ 39,333,474	\$ 57,435,470

(1) The amount due from Employing State agencies was lower in fiscal year 2010 although there was a higher employer contribution rate than in fiscal year 2009. This is due to the payment of all GRF contributions being made in January 2010 through the sale of bonds (GRF wages make up roughly 6% of payrolls).

Investments

General Information:

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

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

**State Employees' Retirement System
of the State of Illinois**
Analysis of Significant Statement of Plan Net Assets Accounts
For the Years Ended June 30, 2010 and 2009

Investments (continued)

Comparison of the changes in the System's investments held in the ISBI Commingled Fund for the years ended June 30, 2010 and 2009 is summarized as follows:

	<u>2010</u>	<u>2009</u>
Balance at beginning of year, at fair value	\$ 8,200,755,918	\$ 10,653,973,521
Net cash added (withdrawn) to/from investments	<u>120,745,288</u>	<u>(237,000,000)</u>
	<u>8,321,501,206</u>	<u>10,416,973,521</u>
Investment income		
Interest, dividends and other	235,726,009	263,734,307
Expenses	<u>(35,525,015)</u>	<u>(38,910,993)</u>
	<u>200,200,994</u>	<u>224,823,314</u>
Net appreciation (depreciation) in fair value of investments		
Net realized gain (loss) on sales of investments	168,618,406	(1,229,510,422)
Net unrealized gain (loss) on investments	<u>430,281,088</u>	<u>(1,211,530,495)</u>
	<u>598,899,494</u>	<u>(2,441,040,917)</u>
Total net investment income	<u>799,100,488</u>	<u>(2,216,217,603)</u>
Balance at end of year, at fair value	<u>\$ 9,120,601,694</u>	<u>\$ 8,200,755,918</u>

**State Employees' Retirement System
of the State of Illinois**
Analysis of Investment Performance (Unaudited)
For the Years Ended June 30, 2010

An analysis of investment performance for the years ended June 30, 2010 and 2009 is summarized as follows:

	<u>2010</u>	<u>2009</u>
Total return*	9.1%	(20.1)%

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

Analysis of Operations

State Employees' Retirement System of the State of Illinois

Analysis of Operations

For the Years Ended June 30, 2010 and 2009

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, 2010, the System had approximately 58,400 benefit recipients and 64,100 active members.

The State Employees' Retirement System of Illinois is administered by a Board of Trustees of thirteen persons, which includes: a. the Comptroller, who shall be the Chairperson; b. six persons appointed by the Governor with the advice and consent of the Senate who may not be members of the system or hold an elective State office and who shall serve a term of 5 years, except that the terms of the initial appointees under the amendatory act of the 96th General Assembly shall be as follows: 3 for a term of 3 years and 3 for a term of 5 years; c. four active participants of the System having at least 8 years of creditable service, to be elected from the contributing members of the System by the contribution members; and d. two annuitants of the System who have been annuitants for at least one full year, to be elected from and by the annuitants of the System. The administration of the detailed affairs of the System is vested in the Executive Secretary, under the direction of the Board. General policy relating to the administration of the System is stated in the minutes of the Board meetings.

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

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

**State Employees' Retirement System
of the State of Illinois**
Analysis of Operations
For the Years Ended June 30, 2010 and 2009

Program planning activities of the System are under the direct supervision of the Executive Secretary and involve coordination between the governing Board and other executive staff of the System. The current planning program identifies various operational projects for fiscal year 2010. 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 2010 included a significant investment in equipment and human resources in order to allow the Information Technology Division to upgrade a number of legacy computer systems to a more current architecture; and also the implementation of a number of new legislative initiatives involving optional service credit.

New projects for fiscal year 2011 include the continuation of the modernization efforts including implementation of a new e-mail system, the re-engineering of the attendance system using new technology, the analysis of the benefits of an imaging system and the analysis of the business functions of the active member system for re-engineering.

State Employees' Retirement System of the State of Illinois

Analysis of Operations For the Years Ended June 30, 2010 and 2009

Progress in Funding the System

In August 1994, Senate Bill 533 was signed into law as Public Act 88-0593. This funding legislation, which became effective July 1, 1995, provides for a systematic 50-year funding plan with an ultimate goal to fund the cost of maintaining and administering the System at an actuarial funded ratio of 90 percent. In addition, the funding plan provides for a 15-year phase-in period to allow the State to adapt to the increased financial commitment. Once the 15-year phase-in is complete, the State's contribution will then remain at a level percentage of payroll for the next 35 years until the 90 percent funded level is achieved.

The funding legislation also provides for the establishment of a continuing appropriation of the required employer contributions to the System. This, in effect, removed the appropriation of those 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 Bond, 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. This act specified the appropriation amounts for fiscal years 2006 and 2007. The required State contributions for fiscal years 2008 through 2010 will then be increased incrementally as a percentage of the participant payroll so that by fiscal year 2011 the State is contributing at the required level contribution rate to achieve the financing objective of a 90% funded status by the end of fiscal year 2045.

**State Employees' Retirement System
of the State of Illinois
Analysis of Operations
For the Years Ended June 30, 2010 and 2009**

Public Act 96-0043 became law on July 15, 2009. As required under PA 96-0043, the method for determining the actuarial value of assets used to determine the employer contribution rate was changed beginning with the June 30, 2009 valuation. The method was changed from the market/fair value to a smoothed value. The smoothed value recognizes actuarial investment gains or losses for each fiscal year, beginning with FY09, in equal amounts over the ensuing five-year period.

Public Act 96-0889 added a lower tier of benefits for members who first contribute to SERS on or after January 1, 2011. When Public Act 96-1511 was enacted in January 2011, it required the System to assume that the provisions of Public Act 96-0889 were in effect on June 30, 2009 and to recalculate and recertify the fiscal year 2011 state funding requirement. Under this recertification, the fiscal year 2011 state contribution requirement was reduced by \$95 million, from \$1,193.3 million to \$1,098.3 million.

The actuarial accrued liability of the System at June 30, 2010, amounted to approximately \$29.3 billion. The actuarial value of assets (at smoothed value) at June 30, 2010 amounted to approximately \$11.0 billion. The difference between the actuarial accrued liability and the actuarial value of assets of \$18.3 billion reflects the unfunded actuarial accrued liability of the System at June 30, 2010. The System had a funded ratio (at smoothed value) of 37.4% at June 30, 2010.

On June 30, 2010, the market/fair value of assets was \$9.2 billion. The difference between the System's 2010 accrued liability and the market value of assets was \$20.1 billion and the funded ratio using market/fair value of assets was 31.4%. On June 30, 2009, the market/fair value of assets used by the actuaries in the 2009 valuation was \$8.5 billion. The difference between the System's 2009 accrued liability and the market/fair value of assets was \$16.8 billion and the funded ratio using market/fair value of assets was 33.5%.

The market/fair value of the assets of the fund, that were available for benefits, increased from \$8.5 billion as of June 30, 2009 to \$9.2 billion as of June 30, 2010. The increase is due to the favorable return on fund assets. The actuarial value of the assets of \$11.0 billion at June 30, 2010, is \$1.8 billion higher than the market/fair value of the assets due to recognition of 40% of the actuarial loss in fiscal year 2009 and 20% of the actuarial gain in fiscal year 2010.

The Governmental Accounting Standards Board (GASB) has promulgated Statements No. 25 and 27 that mandate, among other things, the use of market or market related (actuarial) asset value. Prior to the valuation as of June 30, 2009, it was agreed that market/fair value, without adjustment, would be used for all actuarial purposes. Under Public Act 96-0043, effective in the June 30, 2009 valuation, the contribution projections would be set based on the actuarial value of assets. Funding status determinations and the Annual Required Contributions (ARC) were calculated based on the actuarial value of assets.

**State Employees' Retirement System
of the State of Illinois**
Analysis of Operations
For the Years Ended June 30, 2010 and 2009

State required contributions to the System for the next five fiscal years are noted in the table below.

Year Ended June 30	Required State Contribution (in millions)
2010	\$ 1,098.3
2011	1,136.5
2012	1,184.5
2013	1,233.0
2014	1,281.2

The Schedule of Funding Progress (in millions) for fiscal years ending June 30, 2009 and 2010 are noted in the table below.

Actuarial Valuation Date	Actuarial Value of Assets*	Accrued Liability (AAL-Projected Unit Credit)	Funded Ratio	Unfunded Actuarial Accrued Liability (UAAL)	Covered Payroll	Unfunded Actuarial Accrued Liability as a Percentage of Covered payroll
6/30/09	\$ 11,000	\$ 25,294	43.5%	\$ 14,298	\$ 4,027	355.0%
6/30/10	10,962	29,309	37.4	18,348	4,119	445.40

*Five-year smoothing beginning in FY09

The Schedule of Employer Contributions (in millions) for the fiscal years ending June 30, 2009 and 2010 are noted in the table below.

Year Ended June 30	Employer Contributions	Annual Required Contribution per GASB Statement #25	Percentage Contributed	Annual Required Contribution per State Statute	Percentage Contributed
2009	\$ 774.9	\$ 1,003.4	77.2%	\$ 769.9	101%
2010	1095.5	1,177.3	93.1	1,093.1	100

The Government Accounting Standards Board (GASB) requires disclosure of the Annual Required Contribution (ARC) under a standard funding methodology. Amounts shown as the ARCs for each year are different from the contributions required by State statute. The cumulative difference between the ARC and the annual required contribution per State statute represents the net pension obligation (NPO). The NPO is \$1,933.3 million at June 30, 2010, which is an increase of \$118.8 million from the June 30, 2009 NPO of \$1,814.5 million.

**State Employees' Retirement System
of the State of Illinois
Analysis of Operations
For the Years Ended June 30, 2010 and 2009**

Rates of Return (Unaudited)

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 Investment (ISBI) and are held in the ISBI Commingled Fund. ISBI operates under a long-range investment plan with the objective to maximize the total rate of return. The objectives set forth are as follows:

At least equal to the assumed actuarial interest rate, currently 8.5% per year.

At least equal to the return of a composite benchmark of market indices in the same proportions as the Board's asset allocation policy targets

The overall rate of return for the Illinois State Board of Investment (ISBI) Commingled Fund was 9.1% for fiscal year 2010 compared to (20.1%) for fiscal year 2009. The ISBI's total fund performance lagged the composite benchmark by (1.1%) for the year ended June 30, 2010.

**State Employees' Retirement System
of the State of Illinois**
Analysis of Operations
For the Years Ended June 30, 2010 and 2009

System Employees

System Employees' Retirement System Trust Fund

The average number of employees (not including the General Revenue Fund -- Social Security Division) during the years ended June 30, 2010 and 2009 is summarized by functional classification as follows:

	<u>2010</u>	<u>2009</u>
Executive and administrative	15	14
Accounting, bookkeeping and clerical	28	28
Other office employees	26	26
Electronic data processing	<u>15</u>	<u>13</u>
Total	<u>84</u>	<u>81</u>

Social Security Contribution Fund

The Social Security Contribution Fund had one employee for both years ended June 30, 2010 and 2009.

Comparison of Administrative Expenses to Total Expenses

	<u>2010</u>	<u>2009</u>
Total expenses		
Benefits	\$1,390,641,192	\$1,300,213,675
Refunds of contributions, including transfers to reciprocating systems	15,274,174	14,859,487
Administrative expenses	<u>11,720,755</u>	<u>10,681,376</u>
	<u>\$1,417,636,121</u>	<u>\$1,325,754,538</u>
Administrative expenses as a percentage of total expenses	<u>0.8%</u>	<u>0.8%</u>

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

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

**State Employees' Retirement System
of the State of Illinois
Analysis of Operations
For the Years Ended June 30, 2010 and 2009**

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

The State Employees' Retirement System received their allocation of bond proceeds on July 1, 2003. The State Employees' Retirement System's portion of the allocation was \$1,385,895,278. The monies were deposited into the Master Trust Account with the Illinois State Board of Investment (Board) on July 2, 2003. The Board initially approved investing the pension bond proceeds in separate index funds. These index funds were subsequently liquidated and combined with the Board's other investments and invested in accordance with the asset allocation policy of the Board during the year ended June 30, 2004. The Board estimates return on the pension bond proceeds earned an annual rate of return of 9.1% during the year ended June 30, 2010, which is the same as the overall return for the Board's investment portfolio.

Schedule of Contributions/Deductions and Effect on Investments

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

	<u>2010</u>	<u>2009</u>
Contributions		
Participant Contributions	\$ 246,172,971	\$ 242,227,432
State of Illinois Employer Contributions	<u>1,095,545,856</u>	<u>774,910,344</u>
Total Contributions	<u>1,341,718,827</u>	<u>1,017,137,776</u>
Deductions		
Retirement Benefits	1,237,118,008	1,164,454,557
Survivor Benefits	89,516,980	73,697,450
Disability Benefits	48,312,629	46,513,406
Lump-Sum Death Benefits	15,693,575	15,548,262
Refunds (including transfers to reciprocating systems)	15,274,174	14,859,487
Administrative Expenses	<u>11,720,755</u>	<u>10,681,376</u>
Total Deductions	<u>1,417,636,121</u>	<u>1,325,754,538</u>
Investments Used to Pay Benefits and Expenses	<u>\$ (75,917,294)</u>	<u>\$ (308,616,762)</u>

**State Employees' Retirement System
of the State of Illinois**
Analysis of Operations
For the Years Ended June 30, 2010 and 2009

Service Efforts and Accomplishments (Unaudited)

	<u>2010</u>	<u>2009</u>
Membership data		
Coordinated members	81,673	83,365
Noncoordinated members	<u>2,982</u>	<u>3,091</u>
Total members	<u>84,655</u>	<u>86,456</u>
Active members	<u>64,143</u>	<u>65,599</u>
Benefit payments processed		
Recurring		
Retirement annuities	45,659	44,566
Survivors' annuities	10,325	10,236
Disability benefits	<u>2,408</u>	<u>2,297</u>
Total	<u>58,392</u>	<u>57,099</u>
Termination refunds processed	<u>1,420</u>	<u>1,387</u>
Retirement counseling		
Preretirement sessions		
Number of sessions	154	181
Number of attendees	6,239	6,847
Postretirement seminars		
Number of sessions	34	33
Number of attendees	1,315	1,217
Regional and other meetings		
Number of sessions	221	294
Number of attendees	4,706	8,283