

**State of Illinois**  
**State Employees' Retirement System**  
Compliance Examination  
For the Year Ended June 30, 2015  
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, 2015**

**Table of Contents**

	<u>Schedule</u>	<u>Page(s)</u>
<b>State Employees' Retirement System of Illinois Officials</b>	1	
<b>Management Assertion Letter</b>	2	
<b>Compliance Report</b>		
Summary	3	
Independent Accountants' Report on State Compliance, on Internal Control Over Compliance, and on Supplementary Information for State Compliance Purposes	5	
Independent Auditors' Report on Internal Control over Financial Reporting and on Compliance and Other Matters Based on an Audit of Financial Statements Performed in Accordance with <i>Government Auditing Standards</i>	9	
Schedule of Findings		
Current Findings – <i>Government Auditing Standards</i>	11	
Current Findings – State Compliance	15	
Prior Findings Not Repeated	16	
Financial Statement Report		
The System's financial statement report for the year ended June 30, 2015, which includes the Independent Auditor's Report, Management Discussion and Analysis, Basic Financial Statements and Notes to the Basic Financial Statements, Required Supplementary Information Other Than Management Discussion and Analysis, Supplementary Information, and the Independent Auditor's Report on Internal Control over Financial Reporting and on Compliance and Other Matters Based on an Audit of Financial Statements performed in accordance with <i>Government Auditing Standards</i> has been issued separately.		
<b>Supplementary Information for State Compliance Purposes</b>		
Summary	17	
Fiscal Schedules and Analysis		
Schedule of Appropriations, Expenditures and Lapsed Balances	1	18
Comparative Schedules of Net Appropriations, Expenditures and Lapsed Balances	2	20
Schedule of Changes in State Property	3	22
Comparative Schedule of Cash Receipts	4	23

**State Employees' Retirement System  
of the State of Illinois**  
**Compliance Examination**  
**For the Year Ended June 30, 2015**

	<b>Schedule</b>	<b>Page(s)</b>
Continued		
Reconciliation Schedule of Cash Receipts to Deposits Remitted to the State Comptroller	5	24
Analysis of Significant Variations in Expenses	6	25
Analysis of Significant Variations in Cash Receipts	7	26
Analysis of Significant Lapse Period Spending	8	27
Analysis of Significant Statement of Fiduciary Net Position Accounts	9	28
Analysis of Contributions Receivable	10	30
Analysis of Operations (Unaudited)		
System's Functions and Planning Program (Unaudited)	31	
Progress in Funding the System (Unaudited)	33	
Money-Weighted Rate of Return (Unaudited)	36	
Average Number of System Employees		
State Employees' Retirement System Trust Fund (Unaudited)	37	
Social Security Contribution Fund (Unaudited)	37	
Comparison of Administrative Expenses to Total Expenses (Unaudited)	38	
Schedule of Contributions/Deductions and Effect on Investments (Unaudited)	38	
Service Efforts and Accomplishments (Unaudited)	39	

**State Employees' Retirement System  
of the State of Illinois**  
**For the Year Ended June 30, 2015**

***System Officials***

Executive Secretary  
Accounting Division Manager  
Internal Auditor

Timothy B. Blair  
Alan Fowler, CPA  
Casey Evans (effective 10/1/14 – Present)

***Office Locations***

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

March 25, 2016

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

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 State Employees' Retirement System of Illinois (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, 2015. Based on this evaluation, we assert that during the year ended June 30, 2015 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. Money or negotiable securities or similar assets handled by the System on behalf of the State or held in trust by the System have been properly and legally administered, and the accounting and recordkeeping relating thereto is proper, accurate and in accordance with law.

Yours very truly,

State Employees' Retirement System of Illinois

*Timothy B. Blair*  
Timothy B. Blair, Executive Secretary

*Alan Fowler*  
Alan Fowler, CPA, Accounting Division Manager

# **Compliance Report**

**State Employees' Retirement System  
of the State of Illinois**  
**Compliance Report Summary**  
**For the Year Ended June 30, 2015**

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***

<b><u>Number of</u></b>	<b><u>Current Report</u></b>	<b><u>Prior Report</u></b>
Findings	3	3
Repeated findings	2	0
Prior recommendations implemented or not repeated	1	2

**Schedule of Findings**

<b><u>Item No.</u></b>	<b><u>Page</u></b>	<b><u>Description</u></b>	<b><u>Finding Type</u></b>
<b>Findings (<i>Government Auditing Standards</i>)</b>			
2015-001	11	Noncompliance with Fiscal Control and Internal Auditing Act	Significant Deficiency
2015-002	12	Controls over Census Data	Significant Deficiency
<b>Findings (State Compliance)</b>			
2015-003	15	Noncompliance with Ethics Training Requirements	Significant Deficiency and Noncompliance

**State Employees' Retirement System  
of the State of Illinois  
Compliance Report Summary  
For the Year Ended June 30, 2015**

In addition, the following findings which are reported as current findings relating to *Government Auditing Standards* also met the reporting requirements for State Compliance.

2015-001	11	Noncompliance with Fiscal Control and Internal Auditing Act	Significant Deficiency and Noncompliance
2015-002	12	Controls over Census Data	Significant Deficiency and Noncompliance

**Prior Findings Not Repeated**

- A.        16      Internally Generated Computer Software

***Exit Conference***

System officials waived a formal exit conference in correspondence dated January 27, 2016. Responses to the recommendations were provided by Alan Fowler, Accounting Division Manager, in correspondence dated February 11, 2016.

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

Honorable Frank J. Mautino  
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, 2015. 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. State revenues and receipts collected by the System are in accordance with applicable laws and regulations and the accounting and recordkeeping of such revenues and receipts is fair, accurate and in accordance with law.
- E. Money or negotiable securities or similar assets handled by the System on behalf of the State or held in trust by the System have been properly and legally administered and the accounting and recordkeeping relating thereto is proper, accurate and in accordance with law.

Our examination was conducted in accordance with attestation standards established by the American Institute of Certified Public Accountants; the standards applicable to attestation engagements contained in *Government Auditing Standards* issued by the Comptroller General of the United States; the Illinois State Auditing Act (Act); and the Audit Guide as adopted by the Auditor General pursuant to the Act; and, accordingly, included examining, on a test basis, evidence about the System's compliance with those requirements 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 compliance requirements listed in the first paragraph of this report during the year ended June 30, 2015. However, the results of our procedures disclosed instances of noncompliance with the requirements, which are required to be reported in accordance with criteria established by the Audit Guide, issued by the Illinois Office of the Auditor General and which are described in the accompanying schedule of findings as items 2015-001, 2015-002 and 2015-003.

#### Internal Control

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 to determine the examination procedures that are appropriate in the circumstances 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 internal control over compliance* exists when the design or operation of a control over compliance 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 in internal control over compliance* 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. A *significant deficiency in internal control over compliance* is a deficiency, or a combination of deficiencies, in internal control over compliance that is less severe than a material weakness in internal control over compliance, yet important enough to merit attention by those charged with governance.

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 material weaknesses or significant deficiencies and therefore, material weaknesses or significant deficiencies may exist that were not identified. We did not identify any deficiencies in internal control over compliance that we consider to be material weaknesses. However, we identified certain deficiencies in internal control over compliance, as described in the accompanying schedule of findings as items 2015-001, 2015-002 and 2015-003 that we consider to be significant deficiencies.

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

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

#### Supplementary Information for State Compliance Purposes

As Special Assistant Auditors for the Auditor General, we have audited the financial statements of the System as of and for the year ended June 30, 2015 (not presented herein), and have issued our report thereon dated December 18, 2015 which contained an unmodified opinion on those financial statements. Our audit was conducted for the purpose of forming an opinion on the financial statements that collectively comprise the System's basic financial statements. We did not audit the 2015 financial statements of the Illinois State Board of Investment, an internal investment pool of the State of Illinois, which statements represent 98 percent, 98 percent, and 25 percent, respectively of total assets, net position restricted for pension benefits, and total additions of the System. Those financial statements were audited by the other auditors whose report thereon has been furnished to us, and our opinion, insofar as it relates to the amounts included for the Illinois State Board of Investment is based solely on the report of the other auditors. We have not performed any procedures with respect to the audited financial statements subsequent to December 18, 2015. The accompanying supplementary information for the year ended June 30, 2015 in Schedules 1 through 10 is presented for purposes of additional analysis and is not a required part of the basic financial statements of the System. Such information is the responsibility of management and was derived from and relates directly to the underlying accounting and other records used to prepare the basic financial statements. The accompanying supplementary information for the year ended June 30, 2015 in Schedules 1 through 10 has been subjected to the auditing procedures applied in the audit of the basic financial statements and certain additional procedures, including comparing and reconciling such information directly to the underlying accounting and other records used to prepare the basic financial statements or to the basic financial statements themselves, and other additional procedures in accordance with auditing standards generally accepted in the United States of America. In our opinion, the accompanying supplementary information for the year ended June 30, 2015 in Schedules 1 through 10 is fairly stated in all material respects in relation to the basic financial statements as a whole for the year ended June 30, 2015.

We have also previously audited, in accordance with auditing standards generally accepted in the United States of America, the System's basic financial statements as of and for the years ended June 30, 2014 and 2013 (not presented herein) and have issued our reports thereon dated December 22, 2014 and December 20, 2013, respectively, which contained unmodified opinions on the respective financial statements. We did not audit the 2014 and 2013 financial statements of Illinois State Board of Investment, an internal investment pool of the State of Illinois, which statements represented 97 and 97 percent of total assets; 98 and 98 percent of net position restricted for pension benefits; and 52 and 46 percent of total additions to the System, respectively. Those financial statements were audited by other auditors whose report thereon has been furnished to us, and our opinion, insofar as it relates to the amounts included for the Illinois State Board of Investment is based solely on the report of the other auditors. The accompanying supplementary information for the years ended June 30, 2014 and 2013 in Schedules 2, 4 through 7, and 9 through 10 is the responsibility of management and was derived from and relates directly to underlying accounting and other records used to prepare the June 30, 2014 and 2013 financial statements. The accompanying supplementary information for the years ended June 30, 2014 and 2013 in Schedules 2, 4 through 7, and 9 through 10 has been subjected to the auditing procedures applied in the audits of the June 30, 2014 and 2013 basic financial statements and certain additional procedures, including comparing and reconciling such information directly to the underlying accounting

and other records used to prepare those basic financial statements or to those basic financial statements themselves, and other additional procedures in accordance with auditing standards generally accepted in the United States of America. In our opinion, the accompanying supplementary information for the years ended June 30, 2014 and 2013 in Schedules 2, 4 through 7, and 9 through 10 is fairly stated in all material respects in relation to the basic financial statements as a whole from which it has been derived.

The accompanying supplementary information in the Analysis of Operations Section is presented for the purposes of additional analysis and is not a required part of the basic financial statements. Such information has not been subjected to the auditing procedures applied in the audit of the basic financial statements, and accordingly, we do not express an opinion or provide any assurance on it.

This report is intended solely for the information and use of the Auditor General, the General Assembly, the Legislative Audit Commission, the Governor, the System's 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*

Decatur, Illinois

March 25, 2016, except for the Supplementary Information for State Compliance purposes, as to which the date is December 18, 2015

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

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

As Special Assistant Auditors for the Auditor General, we have audited, in accordance with the auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards* issued by the Comptroller General of the United States, the financial statements of the State Employees' Retirement System of the State of Illinois (System), as of and for the year ended June 30, 2015, and the related notes to the financial statements, which collectively comprise the System's basic financial statements, and have issued our report thereon dated December 18, 2015. Our report includes a reference to other auditors who audited the financial statements of the Illinois State Board of Investment, an internal investment pool of the State of Illinois, as described in our report on the System's financial statements. This report does not include the results of the other auditors' testing of internal control over financial reporting or compliance and other matters that are reported on separately by those auditors.

### **Internal Control Over Financial Reporting**

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

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

Our consideration of internal control was for the limited purpose described in the first paragraph of this section and was not designed to identify all deficiencies in internal control that might be material weaknesses or significant deficiencies and therefore, material weaknesses or significant deficiencies may exist that were not identified. Given these limitations, during our audit we did not identify any deficiencies in internal control that we consider to be material weaknesses. However, material weaknesses may exist that have not been identified. We did identify certain deficiencies in internal control, described in the accompanying schedule of findings as items 2015-001 and 2015-002 that we consider to be significant deficiencies.

### **Compliance and Other Matters**

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

### **State Employees' Retirement System's Response to Findings**

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

### **Purpose of this Report**

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

*BKD, LLP*

Decatur, Illinois  
December 18, 2015

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

## **Current Findings – *Government Auditing Standards***

**June 30, 2015**

### **2015-001. Finding – Noncompliance with the Fiscal Control and Internal Auditing Act**

The State Employees' Retirement System (System) was not in compliance with the Fiscal Control and Internal Auditing Act (the Act).

During the prior year's audit, we noted that the System was required by the Act (30 ILCS 10/2001) to have a full-time program of internal auditing. The System filled the Internal Auditor position in October 2014. Therefore this part of the prior year's finding is not repeated in the current fiscal year's audit.

The Act (30 ILCS 10/2003) also requires the chief executive officer to ensure that internal audits of all major systems of internal control are conducted at least once every two years. As a result of the vacancy in the Internal Auditor position during part of the fiscal year, only one of the seven internal audits of major systems planned for fiscal year 2015 were completed. Therefore, the System was not in compliance with this provision of the Act.

According to System officials the System was not able to fill the internal audit position sooner and therefore the current internal auditor did not have adequate time during the fiscal year to complete internal audits as planned.

Failure to comply with the Act increases the risk that fraud, misuse of funds, or internal control weaknesses would not be detected on a timely basis. (Finding Code No. 2015-001, 2014-001)

#### **Recommendation**

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

#### **System Response**

The System accepts the finding and will develop a plan to ensure that the internal audit function continues in the event of another vacancy within the position over a significant period of time.

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

**Current Findings – *Government Auditing Standards***  
**June 30, 2015**

## **2015-002. Finding - Controls over Census Data**

The State Employees' Retirement System of the State of Illinois (System) has weaknesses in controls over creditable earnings and member census data reported by its participating State agencies.

During our current fiscal year testing, we noted 2 errors in certain census data reported to the System out of 240 active members tested. In addition during a review of the System's internal controls over creditable earnings and member census data, it was noted that creditable earnings and member census data for the System is accumulated from multiple State agencies which increases the likelihood of errors within the data. The System's current processes and controls for verifying the data rely heavily on the reporting of the information by the participating State agencies and there are limited controls in place by the System to verify the creditable earnings and member census information.

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

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

System officials indicated they have added some additional controls to verify census data on an ad hoc basis, however the System is still working to determine the best method for it to conduct State agency audits to verify census data to personnel files.

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

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

**Current Findings – *Government Auditing Standards***  
**June 30, 2015**

## **2015-002. Finding - Controls over Census Data (continued)**

A misstatement of the NPL will also impact the allocation of the NPL and related pension activity to participating State agencies under GASB Statement No. 68 Accounting and Financial Reporting for Pensions – An Amendment of GASB Statement No. 27. (Finding Code No. 2015-002, 2014-002)

### Recommendation

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

### System Response

The System accepts the finding. Over the past year the System has put several new processes in place that, over time, will serve to independently validate the census data received from employing state agencies' payroll transactions. They are as follows:

- (1) A new payroll edit has been deployed to review incoming payroll transactions and flag the discrepancies if the gender or the date of birth does not match what our member database shows. These discrepancies are investigated through the review or collection of member-completed documentation of their gender or date of birth and result in an adjustment to the member database or notification to the agency to correct their payroll system.
- (2) A new Member Demographic Confirmation form has been developed and is made available to all members through member retirement seminars, private member counseling or walk-ins to SRS. Members are asked to review the form and indicate discrepancies in their census data (specifically, gender and date of birth). The form has a signature line so we can authenticate that the member has provided their gender / date of birth. The forms are scanned to the member's images so we can track how many members have reviewed their census data through this method and for the documentation of the changes being made to the data.
- (3) The member website has been launched and is continually being advertised to reach more of our membership. Some members have contacted us with this new view of their data in our system to inform us that their gender or date of birth are incorrect in our system. We review the account and perform due diligence and make the necessary changes based on the verification that we obtain. Additionally, the Member Demographic Confirmation form has been made available via the member website and reaches the user/members that are not coming to us in person, but are visiting their data on our site.

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

**Current Findings – *Government Auditing Standards***  
**June 30, 2015**

## **2015-002. Finding - Controls over Census Data (continued)**

- (4) Public Act 99-0450 was signed into law effective August 24, 2015, authorizing the SERS board to request information from any employing state agency that is necessary for the proper administration of the system. Rules are being drafted in relation to this new law to provide the authority to SERS to validate the census data elements contained within the personnel files of our members.

# **State Employees' Retirement System**

## **of the State of Illinois**

### **Current Findings – State Compliance**

**June 30, 2015**

#### **2015-003. Finding – Noncompliance with Ethics Training Requirements**

The State Employees' Retirement System of the State of Illinois (System) did not comply with the Ethics training provision of the Illinois Pension Code.

During current year examination testing, the auditors noted the System did not track the ethics training completed by its Board members and did not submit the required annual certification of compliance certifying ethics training completed by its Board members with the Department of Insurance.

The Illinois Pension Code (40 ILCS 5/1-113.18) states all board members of a retirement system must attend ethics training of at least 8 hours per year. Each board shall annually certify compliance with this Section and submit an annual certification to the Department of Insurance.

System officials stated ethics training is performed, however the amount of time completed is not tracked in order to submit the annual certification.

Failure by the System to track and certify the ethics training completed by its Board members increases the risk that its Board members will not complete the required 8 hours of annual ethics training required by the Illinois Pension Code. (Finding Code No. 2015-003)

#### **Recommendation**

We recommend the System develop a process to track ethics training completed by its Board members to insure its Board members complete 8 hours annually and submit the required annual certification to the Department of Insurance.

#### **System Response**

The System accepts the finding. The System is working on procedures to better track, report and certify the required ethics training of each of the members of the Board of Trustees.

**State Employees' Retirement System  
of the State of Illinois**  
**Prior Findings Not Repeated**  
**June 30, 2015**

**A. Finding – Internally Generated Computer Software**

The State Employees' Retirement System (System) did not have a policy covering the capitalization of internally generated computer software in accordance with Governmental Accounting Standards Board (GASB) Statement No. 51, Accounting and Financial Reporting for Intangible Assets. (Finding Code No. 2014-003)

During the current fiscal year audit, we noted that the System developed and implemented Accounting Procedure 90.A.05 that outlines the procedures for determining how to capture capitalized costs for internally generated computer software in accordance with GASB Statement No. 51.

**Supplementary Information  
for State Compliance Purposes**

**State Employees' Retirement System  
of the State of Illinois**  
**Supplementary Information for State Compliance Purposes**  
**Summary**  
**For the Year Ended June 30, 2015**

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
  - Schedule of Changes in State Property
  - Comparative Schedule of Cash Receipts
  - Reconciliation Schedule of Cash Receipts to Deposits Remitted to the State Comptroller
  - Analysis of Significant Variations in Expenses
  - Analysis of Significant Variations in Cash Receipts
  - Analysis of Significant Lapse Period Spending
  - Analysis of Significant Statement of Fiduciary Net Position Accounts
  - Analysis of Contributions Receivable
- Analysis of Operations (Unaudited):
  - System's Functions and Planning Program (Unaudited)
  - Progress in Funding the System (Unaudited)
  - Money-Weighted Rate of Return (Unaudited)
  - Average Number of System Employees (Unaudited)
  - Comparison of Administrative Expenses to Total Expenses (Unaudited)
  - Schedule of Contributions/Deductions and Effect on Investments (Unaudited)
  - 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 auditors' opinion, it is fairly stated in all material respects in relation to the basic financial statements as a whole from which it has been derived. The accountants' report also states the Analysis of Operations Section has not been subjected to the auditing procedures applied in the audit of the basic financial statements, and accordingly, they do not express an opinion or provide any assurance on it.

## **Fiscal Schedules and Analysis**

**Schedule 1**

**State Employees' Retirement System  
of the State of Illinois**

**Schedule of Appropriations, Expenditures and Lapsed Balances  
Appropriations for Fiscal Year 2015  
Fourteen Months Ended August 31, 2015**

	<b>Appropriations (Net After Transfers)</b>	<b>Expenditures Through June 30, 2015</b>	<b>Lapse Period Expenditures July 1, 2015</b>	<b>Total Expenditures</b>	<b>Balances Lapsed</b>
<b>Public Acts, 98-0679 &amp; 98-0680</b>					
<b>Appropriated Funds</b>					
General Revenue Fund - 0001					
Continuing appropriation for pension contributions	\$1,136,479,500	\$ 1,136,479,500	\$ —	\$ 1,136,479,500	\$ —
Continuing appropriation for fiscal year shortfall	12,130,930	12,130,929	—	12,130,929	1
Personal services	58,800	40,188	—	40,188	18,612
Employee retirement contributions paid by employer	10,000	—	10,000	10,000	—
Social security contributions	4,300	2,904	—	2,904	1,396
Contractual services	15,700	13,500	2,200	15,700	—
Travel	1,200	1,015	—	1,015	185
Commodities	100	100	—	100	—
Electronic data processing	500	—	500	500	—
Telecommunications	400	241	59	300	100
Total – All appropriated funds	<u>\$1,148,701,430</u>	<u>1,148,668,377</u>	<u>12,759</u>	<u>1,148,681,136</u>	<u>\$ 20,294</u>
<b>Nonappropriated Funds</b>					
Kanerva vs State Trust Fund – 0234					
Annuitant disbursement	\$ 34,749,730	\$ —	\$ —	\$ 34,749,730	
State Employees' Retirement System Fund – 0479					
Personal services	5,448,884	289,110		5,737,994	
Employee retirement contributions paid by employer	36,696	1,606		38,302	
Retirement contributions	2,308,680	122,550		2,431,230	
Social Security contributions	403,891	21,635		425,526	
Group insurance	1,408,453	58,709		1,467,162	
Contractual services	1,712,922	69,543		1,782,465	
Travel	14,385	1,268		15,653	
Commodities	17,995	634		18,629	
Printing	46,849	1,614		48,463	

**Schedule 1**

**State Employees' Retirement System  
of the State of Illinois**

**Schedule of Appropriations, Expenditures and Lapsed Balances  
Appropriations for Fiscal Year 2015  
Fourteen Months Ended August 31, 2015**

	<b>Appropriations (Net After Transfers)</b>	<b>Expenditures Through June 30, 2015</b>	<b>Lapse Period Expenditures July 1, 2015 through August 31, 2015</b>	<b>Total Expenditures</b>	<b>Balances Lapsed</b>
<b>Nonappropriated Funds (continued)</b>					
State Employees' Retirement System Fund – 0479					
(continued)					
Equipment	\$ 27,893	\$ 997	\$ 28,890		
Electronic data processing	5,178,628	323,471	5,502,099		
Telecommunications	73,235	97,341	170,576		
Automotive	9,349	504	9,853		
Nonrecurring refunds and distributions	15,102,856	(250)	15,102,606		
Payments to general obligations bond retirement and interest fund	25,303,693	3,673,775	28,977,468		
Pensions, annuities and benefits	2,011,632,687	(483,233)	2,011,149,454		
Permanent improvements	1,064	125,476	126,540		
Refunds of prior calendar year retirement contributions	284,377	11,822	296,199		
Refunds, not classified elsewhere	23,514,767	8,336	23,523,103		
Subtotal – Fund 0479	<u>2,092,527,304</u>	<u>4,324,908</u>	<u>2,096,352,212</u>		
State Employee Retirement System Excess Benefit Fund - 0788					
Pensions, annuities and benefits	340,941	—	340,941		
Total nonappropriated funds	<u>2,127,617,975</u>	<u>4,324,908</u>	<u>2,131,942,883</u>		
Grand total, all Funds	<u>\$ 3,276,286,352</u>	<u>\$ 4,337,667</u>	<u>\$ 3,280,624,019</u>		

Note 1: The above data was taken from records of the State Comptroller.

Note 2: Expenditure amounts are vouchers approved for payment by the System and submitted to the State Comptroller for payment to the vendor.

**Schedule 2**

**State Employees' Retirement System  
of the State of Illinois**

**Comparative Schedules of Net Appropriations,  
Expenditures and Lapsed Balances  
For the Years Ended June 30, 2015, 2014 and 2013**

	<b>Fiscal Year</b>		
	<b>2015</b>	<b>2014</b>	<b>2013</b>
	<b>P.A. 98-0679 and P.A. 98-0680</b>	<b>P.A. 098-0017, 098-0064 and 098-0642</b>	<b>P.A. 097-0685, 097-0727 and 098-0001</b>
<b>Appropriated Funds</b>			
<b>General Revenue Fund – 0001</b>			
Appropriations (net after transfer)	\$ 1,148,701,430	\$ 1,097,457,120	\$ 1,048,883,376
Expenditures			
Continuing appropriation for pension contributions	1,136,479,500	1,097,360,220	1,041,371,800
Continuing appropriation fiscal year shortfall	12,130,929	—	7,397,876
Personal services	40,188	70,574	30,606
Social Security contributions	2,904	5,260	2,328
Employee retirement contributions paid by employer	10,000	2,336	—
Contractual services	15,700	15,700	19,900
Travel	1,015	993	—
Commodities	100	—	—
Electronic data processing	500	500	—
Telecommunications	300	322	384
Total expenditures	<u>1,148,681,136</u>	<u>1,097,455,905</u>	<u>1,048,822,894</u>
Lapsed balances	\$ 20,294	\$ 1,215	\$ 60,482
<b>Grand Total – Appropriated Funds</b>			
Appropriations (net after transfers)	\$ 1,148,701,430	\$ 1,097,457,120	\$ 1,048,883,376
Total expenditures	<u>1,148,681,136</u>	<u>1,097,455,905</u>	<u>1,048,822,894</u>
Lapsed balances	\$ 20,294	\$ 1,215	\$ 60,482

**Schedule 2**

**State Employees' Retirement System  
of the State of Illinois**

**Comparative Schedules of Net Appropriations,  
Expenditures and Lapsed Balances  
For the Years Ended June 30, 2015, 2014 and 2013**

	<b>Fiscal Year</b>		
	<b>2015</b>	<b>2014</b>	<b>2013</b>
<b>Nonappropriated Funds</b>			
<b>Kanerva vs State Trust Fund – 0234</b>			
Expenditures			
Annuitant disbursement	\$ 34,749,730	\$ —	\$ —
<b>State Employees' Retirement System Fund – 0479</b>			
Expenditures			
Personal services	5,737,994	5,693,842	5,197,643
Employee retirement contributions paid by employer	38,302	32,985	36,532
Retirement contributions	2,431,230	2,308,642	1,971,920
Social Security contributions	425,526	420,432	390,523
Group insurance	1,467,162	1,505,367	1,629,448
Contractual services	1,782,465	2,062,621	2,628,497
Travel	15,653	18,083	19,765
Commodities	18,629	25,165	26,727
Printing	48,463	48,694	66,884
Equipment	28,890	181,368	13,100
Electronic data processing	5,502,099	5,404,834	5,212,094
Telecommunications	170,576	98,717	92,329
Automotive	9,853	7,788	10,164
Nonrecurring refunds and distributions	15,102,606	18,389,075	18,045,196
Payments to general obligation bond retirement and interest fund	28,977,468	29,456,449	27,690,883
Pensions, annuities and benefits	2,011,149,454	1,890,147,996	1,775,907,400
Permanent improvements	126,540	268,843	—
Refunds of prior calendar year retirement contributions	296,199	248,203	282,585
Refunds, not classified elsewhere	23,523,103	23,314,091	25,204,699
FY 13 Overpayment General Revenue Fund employer contribution	—	58,607,580	—
Total expenditures	<u>2,096,852,212</u>	<u>2,038,240,775</u>	<u>1,864,426,389</u>
<b>State Employee Retirement System Excess Benefit Fund – 0788</b>			
Pensions, annuities and benefits	<u>340,941</u>	<u>147,351</u>	<u>117,501</u>
Total nonappropriated expenditures	<u>2,131,942,883</u>	<u>2,038,388,126</u>	<u>1,864,543,890</u>
Grand total expenditures, all Funds	<u>\$ 3,280,624,019</u>	<u>\$ 3,135,844,031</u>	<u>\$ 2,913,366,784</u>

**Schedule 3****State Employees' Retirement System  
of the State of Illinois****Schedule of Changes in State Property****For the Year Ended June 30, 2015**

	<b>Beginning Balance</b>		<b>Additions</b>		<b>Deletions</b>		<b>Ending Balance</b>
<b>State Employees' Retirement System Trust</b>							
<b>Fund</b>							
Land	\$ 655,241	\$ —	\$ —	\$ —	\$ —	\$ —	\$ 655,241
Land improvements	315,779	—	—	—	—	—	315,779
Building	3,751,521	126,540	(18,241)	(290,345)	—	—	3,859,820
Furniture and equipment	2,588,280	100,972	(290,345)	—	—	—	2,398,907
Capitalized software costs	1,191,125	1,560,316	—	—	—	—	2,751,441
Total	8,501,946	1,787,828	(308,586)	—	—	—	9,981,188
Accumulated depreciation	(4,379,145)	(628,782)	299,292	(4,708,635)	—	—	—
Property and equipment – net	\$ 4,122,801	\$ 1,159,046	\$ (9,294)	\$ 5,272,553	—	—	—
<b>Social Security Contribution Fund</b>							
Furniture and Equipment	\$ 4,179	\$ —	\$ (435)	\$ 3,744	—	—	—

This summary schedule was prepared using State property records required by the Illinois Administrative Code. The capitalization policy in the Code is different than the capitalization policy established by the Office of the State Comptroller for financial reporting in accordance with generally accepted accounting principles.

**Schedule 4****State Employees' Retirement System  
of the State of Illinois****Comparative Schedule of Cash Receipts  
For the Years Ended June 30, 2015 and 2014**

	<b>2015</b>	<b>2014</b>
Receipts:		
Participant contributions	\$ 257,823,268	\$ 254,736,762
Employer contributions (net of bond principal and interest transfers)	599,464,616	634,208,477
General Revenue Fund/Pension Contribution Fund	1,174,448,039	1,109,491,149
Transfers from Illinois State Board of Investment	—	58,607,580
Interest income on cash balances	620,455	691,988
Claims receivable payments	6,172,253	6,211,988
Installment payments	3,258,283	3,348,080
Other	<u>184,875</u>	<u>160,942</u>
Total cash receipts, per book	<u>\$ 2,041,971,789</u>	<u>\$ 2,067,456,966</u>

**Schedule 5**

**State Employees' Retirement System  
of the State of Illinois**

**Reconciliation Schedule of Cash Receipts  
to Deposits Remitted to the State Comptroller  
For the Years Ended June 30, 2015 and 2014**

	<b>2015</b>	<b>2014</b>
Total cash receipts, per book	\$ 2,041,971,789	\$ 2,067,456,966
Add (deduct)		
Bond principal and interest payments collected and remitted to the State of Illinois	28,880,832	29,574,820
Interest on cash balances	(620,455)	(691,988)
Cancelled warrants and adjustment deposits classified by the comptroller as reductions of expenditures	(5,778,241)	(6,134,062)
“FY 2013 Overpayment” (GRF Employer Contributions) repaid and deposited into GRF during FY 2014 *	—	58,607,580
Intergovernmental Transfers submitted to the Comptroller’s Office but not yet released/deposited into the Trust Fund (Fund #479) **	47,353,314	45,723,343
Prior year intergovernmental payment vouchers deposited into the Trust Fund (Fund #479) during the current fiscal year **	(45,723,343)	—
Cash in transit		
Beginning of year	152,564	300,062
End of year	(272,411)	(152,564)
Deposits in transit		
Beginning of year	53,627	44,694
End of year	<u>(142,684)</u>	<u>(53,627)</u>
Deposits remitted to the State Comptroller for order into the State Treasury	<u>\$ 2,065,874,992</u>	<u>\$ 2,194,675,224</u>
Fund 788	\$ 450,169	\$ 156,438
Fund 479	2,065,424,823	2,135,911,206
Fund 001	<u>—</u>	<u>58,607,580</u>
	<u>\$ 2,065,874,992</u>	<u>\$ 2,194,675,224</u>

\* 40 ILCS 5/14-131(k)

\*\* Intergovernmental Transfers are GRF employer contributions that are deposited in Fund 479. The Comptroller posts them to the Revenue Report when the GRF payment voucher posts. SERS does not post the deposit until the voucher has been released for payment.

**Schedule 6****State Employees' Retirement System  
of the State of Illinois****Analysis of Significant Variations in Expenses****For the Year Ended June 30, 2015**

The System's expenditures, obtained from Schedule 2, have been analyzed for fluctuations greater than \$1 million and 20% from the previous year.

	<b>2015</b>	<b>2014</b>	<b>Increase (Decrease)</b>
Kanerva vs State Trust Fund Continuing appropriation fiscal year shortfall	\$ 34,749,730	\$ —	\$ 34,749,730 (1)
FY13 Overpayment General Revenue Fund employer contribution	\$ 12,130,929	\$ —	\$ 12,130,929 (2a)
	\$ —	\$ 58,607,580	\$ (58,607,580) (2b)

- (1) From July, 2013 through October, 2014, annuitants with more than 20 years of service started paying a portion of their health insurance as required by the pension reform law passed by the legislature in 2012. The Supreme Court later ruled that the 2012 pension reform law violated the state constitution's pension protection clause and, as a result, the premium payments were refunded to the annuitants. The increase represents the amount of retiree health insurance premiums refunded to annuitants during fiscal year 2015.
- (2) In accordance with the Illinois Pension Code (40 ILCS 5/14-131(k)), "Contributions by the State," the Illinois Office of the Comptroller provides the System a certification of personal services expenditures from the General Revenue Fund (GRF) upon the completion of the fiscal year (including lapse period).

The System compares the amount due for employer contributions based on the rate certified by the Board of Trustees for the fiscal year.

If the funds amount due exceed the amount paid, the "FY Shortfall" is paid to the System under the State Pension Funds Continuing Appropriations Act.

If the amount due is less than the amount paid, the "FY Overpayment" will be repaid the System to the General Revenue Fund.

- (a) During FY 2015, the "FY2014 Shortfall" of \$12.1 million was paid to and deposited by the System. There was no "FY2013 Shortfall" to be processed during FY 2014 which caused the variance (increase).
- (b) During FY 2014, the "FY2013 Overpayment" of \$58.6 million was repaid by the System to GRF. There was no "FY2014 Overpayment" to be paid back during FY 2015 which caused the variance (decrease).

**Schedule 7****State Employees' Retirement System  
of the State of Illinois****Analysis of Significant Variations in Cash Receipts  
For the Year Ended June 30, 2015**

The System's cash receipts, obtained from Schedule 4, have been analyzed for fluctuations greater than \$1 million and 20% from the previous year.

	<b>2015</b>	<b>2014</b>	<b>Increase</b>
Transfers from Illinois State Board of Investment	\$ —	58,607,580	\$ (58,607,580) (1)

- (1) During FY 2014, the "FY 2013 Overpayment" of GRF employer contributions was repaid by the System to GRF. This amount was transferred down from the ISBI in order to cover the repayment amount (\$58,607,580). There was no "FY 2014 Overpayment" to be paid back during FY 2015 which caused the variance (decrease) noted.

**Schedule 8**

**State Employees' Retirement System  
of the State of Illinois**

**Analysis of Significant Lapse Period Spending  
For the Year Ended June 30, 2015**

The System's lapse period spending, obtained from Schedule 1, has been analyzed for spending greater than \$200,000 and 20% in any appropriated line item.

There was no significant lapse period spending during fiscal year 2015.

**Schedule 9****State Employees' Retirement System  
of the State of Illinois****Analysis of Significant Statement of Fiduciary Net Position Accounts  
For the Years Ended June 30, 2015 and 2014*****Cash Balances***

	<b>2015</b>	<b>2014</b>
State Treasury	\$ 170,349,835	\$ 201,103,188
Vouchers in transit	(14,185)	(580,173)
Deposit and cash in transit	<u>310,739</u>	<u>228,958</u>
Petty cash fund	<u>170,646,339</u>	<u>200,751,973</u>
	<u>200</u>	<u>200</u>
	<u><u>\$ 170,646,589</u></u>	<u><u>\$ 200,752,173</u></u>

The cash balance decreased due to a decrease in receipts prior to the end of the fiscal year. The timing of receipts, as well as expenses, can fluctuate and variances in cash balances can occur.

***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 Investment (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.

**Schedule 9****State Employees' Retirement System  
of the State of Illinois****Analysis of Significant Statement of Fiduciary Net Position Accounts  
For the Years Ended June 30, 2015 and 2014*****Investments (continued)***

Comparison of the changes in the System's investments held in the ISBI Commingled Fund for the years ended June 30, 2015 and 2014 is summarized as follows:

	<b>2015</b>	<b>2014</b>
Balance at beginning of year, at fair value	\$ 14,286,499,013	\$ 12,176,459,191
Net cash added (withdrawn) to/from investments	<u>—</u>	<u>(58,607,580)</u>
	<u>14,286,499,013</u>	<u>12,117,851,611</u>
Investment income		
Interest, dividends and other	482,642,760	399,161,898
Expenses	<u>(42,184,943)</u>	<u>(40,473,085)</u>
	<u>440,457,817</u>	<u>358,688,813</u>
Net appreciation (depreciation) in fair value of investments		
Net realized gain (loss) on sales of investments	490,289,530	1,255,567,547
Net unrealized gain (loss) on investments	<u>(249,992,307)</u>	<u>554,391,042</u>
	<u>240,297,223</u>	<u>1,809,958,589</u>
Total net investment income	<u>680,755,040</u>	<u>2,168,647,402</u>
Balance at end of year, at fair value	<u>\$ 14,967,254,053</u>	<u>\$ 14,286,499,013</u>

Securities lending collateral decreased by \$19.2 million in fiscal year 2015 compared to the fiscal year 2014 ending balance from \$84.0 million to \$64.8 million. The State Treasurer lends securities to broker-dealers and other entities for collateral that will be returned for the same security in the future. Each year the Treasurer provides an allocation to the Comptroller to adjust each State Agency's financial statements to include their proportionate share of the securities lending transaction balances at year end. Securities lending activity can vary from year to year depending on market conditions and the availability of securities to lend.

**Schedule 10****State Employees' Retirement System  
of the State of Illinois****Analysis of Contributions Receivable  
For the Years Ended June 30, 2015 and 2014**

	<b>2015</b>	<b>2014</b>
Participants' contributions	\$ 14,152,324	\$ 17,207,484
Employing State agencies	109,810,082	79,511,794 (a)
Other accounts	<u>4,784,680</u>	<u>4,682,423</u>
	<u><u>\$ 128,747,086</u></u>	<u><u>\$ 101,401,701</u></u>

- (a) The difference in contributions from employing state agencies was primarily due to the increase in the accrual for the “FY 2015 Shortfall” over the “FY 2014 Shortfall” of GRF employer contributions. Additionally, the timing of the release of the GRF employer contribution will vary over fiscal year ends causing slight variances in the accrual.

Receivables included above represent amounts due from participants and the employers for contributions. Accounts are first analyzed by System personnel for collectability before being sent to the Attorney General's office for a final determination.

## **Analysis of Operations**

**State Employees' Retirement System  
of the State of Illinois**  
**Analysis of Operations (Unaudited)**  
**For the Years Ended June 30, 2015 and 2014**

***System's Functions and Planning Program (Unaudited)***

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, 2015, the System had approximately 63,300 active members and 68,000 benefit recipients.

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 96<sup>th</sup> 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 Division 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 remaining function of the Social Security Division is largely to act as a liaison between the Social Security Administration and local governments throughout the State. All necessary documentation pertaining to Section 218 agreements are initiated by the Division. The administrative expenses of the Social Security Division are appropriated by the General Assembly on a line item basis through the General Revenue Fund.

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 (Unaudited)**

**For the Years Ended June 30, 2015 and 2014**

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 2015. 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 2015 involved: the IT modernization project which included: new active member statements, changes to the retiree/survivor statements, new general statements, and a new active member web system; upgraded SRS-Central databases to SQL Server 2012 with encryption, VoIP Phone system upgrade; Office 2013 upgrade; new wireless LAN system, and full disaster recovery planning and testing.

The operational plan for fiscal year 2016 includes; conversion of mainframe IMS active member services to new SRS-Central system; refinements to the active member statements; the implementation of the new benefit setup and pension calculation process using the new system; complete work on the disability setup and accounts receivable / cash receipts in SRS-Central; upgrades to Office 2016 and Windows Servers to 2012; complete full disaster recovery planning and testing.

**State Employees' Retirement System  
of the State of Illinois**  
**Analysis of Operations (Unaudited)**  
**For the Years Ended June 30, 2015 and 2014**

***Progress in Funding the System (Unaudited)***

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 (Unaudited)**  
**For the Years Ended June 30, 2015 and 2014**

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.

Under the State's funding plan, the actuarial accrued liability of the System at June 30, 2015, amounted to approximately \$40.7 billion. The actuarial value of assets (at smoothed value) at June 30, 2015 amounted to approximately \$14.7 billion. The difference between the actuarial accrued liability and the actuarial value of assets of \$26.0 billion reflects the unfunded actuarial accrued liability of the System at June 30, 2015 under the State's funding plan. The System had a funded ratio (based on the State's funding plan) of 36.2% at June 30, 2015.

For financial reporting purposes, the System adopted GASB Statement No. 67, *Financial Reporting for Pension Plans* in the fiscal year ended June 30, 2014. GASB Statement No. 67 requires the use of the market value of assets rather than the actuarial value of assets (smoothed value) used under the State's funding plan in calculating the net pension liability. It also requires that the System use the entry age actuarial cost method rather than the projected unit costs method used under the State's funding plan for calculating the total pension liability. In addition it requires the System use a blended rate of return of 7.02% combining the assumed rate of return 7.25% and a municipal bond rate of 3.8% based on an index of 20 year general obligation bonds with an average AA rating for investments in the event the System's assets are exhausted in the future.

On June 30, 2015 the System reported for financial reporting purposes under GASB Statement No. 67 that the market value of assets was \$15.3 billion. The difference between the total pension liability of \$43.3 billion and the market value of assets was the net pension liability of \$28.0 billion and the funded ratio was 35.3%. On June 30, 2014, the market value of assets was \$14.6 billion. The difference between the System's June 30, 2014 total pension liability of \$41.7 billion and the market value of assets was the June 30, 2014 net pension liability of \$27.1 billion and the funded ratio was 35.0%.

The market value of the assets of the fund, that were available for benefits, increased from \$14.6 billion at June 30, 2014 to \$15.3 billion at June 30, 2015. This increase is due to the increased return on fund assets. The actuarial value of the assets of \$14.7 billion at June 30, 2015, is \$517.1 million lower than the market value of the assets due to recognition of 100% of the actuarial gain in fiscal year 2011, 80% of the actuarial loss in fiscal year 2012, 60% of the actuarial gain in fiscal year 2013, and 40% of the actuarial gain in fiscal year 2014 and 20% of the actuarial loss in 2015.

**State Employees' Retirement System  
of the State of Illinois**  
**Analysis of Operations (Unaudited)**  
**For the Years Ended June 30, 2015 and 2014**

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

<b>Year Ended June 30</b>	<b>Required State Contribution (in millions)</b>
2016	\$ 2,124.9
2017	2,097.4
2018	2,142.7
2019	2,179.7
2020	2,224.2

The Schedule of the State's Net Pension Liability (in billions) for fiscal years ending June 30, 2015 and 2014 are noted in the table below.

	<b>2015</b>	<b>2014</b>
Total pension liability	\$ 43.267	\$ 41.685
Plan fiduciary net position	<u>15.259</u>	<u>14.582</u>
State's net pension liability (asset)	<u>\$ 28.008</u>	<u>\$ 27.103</u>
Plan fiduciary net position as a percentage of the total pension liability	35.27%	34.98%
Covered employee payroll	\$ 4.454	\$ 4.416
State's net pension liability (asset) as a percentage of covered employee payroll	628.88%	613.74%

The Schedule of State Contributions (in millions) for the fiscal years ending June 30, 2015 and 2014 are noted in the table below.

<b>Year Ended June 30</b>	<b>Actuarially determined contribution</b>	<b>Contributions received</b>	<b>Contribution (deficiency) excess</b>	<b>Covered Employee Payroll</b>	<b>Contributions received as a percentage of covered employee payroll</b>
2015	\$ 2,045.3	\$ 1,804.3	\$ (241.0)	\$ 4,453.7	40.51%
2014	\$ 1,956.8	\$ 1,699.4	\$ (257.4)	\$ 4,416.2	38.48%

**State Employees' Retirement System  
of the State of Illinois**  
**Analysis of Operations (Unaudited)**  
**For the Years Ended June 30, 2015 and 2014**

***Notes to the Schedule of State Contributions***

Valuation date: June 30, 2015  
Notes: Actuarially determined contribution rates are calculated as of June 30, which is 12 months prior to the beginning of the fiscal year in which the contributions will be made.

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

Actuarial Cost Method:	Projected Unit Credit
Amortization Method:	Normal cost plus a level percentage of capped payroll amortization of the unfunded accrued liability.
Remaining Amortization Period:	30 years, open
Asset Valuation Method:	5 year smoothed market
Inflation:	3.00 percent
Salary Increases:	Salary increase rates based on age-related productivity and merit rates plus inflation.
Post-Retirement Benefits:	Post-retirement benefit increases of 3.00 percent, compounded, for Tier 1 and 3.00 percent or one-half of the annual increase in the Consumer Price Index whichever is less, simple, for Tier 2.
Investment Rate of Return:	7.25 percent
Retirement Age:	Experience-based table of rates that are specific to the type of eligibility condition. Last updated for the June 30, 2014, valuation pursuant to an experience study of the period July 1, 2009 to June 30, 2013.
Mortality:	105 percent of the RP2014 Healthy Annuitant table, sex distinct, with rates projected to 2015.

***Money-Weighted Rate 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 to 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:

**State Employees' Retirement System  
of the State of Illinois**  
**Analysis of Operations (Unaudited)**  
**For the Years Ended June 30, 2015 and 2014**

- At least equal to the assumed actuarial interest rate, currently 7.25% 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 time-weighted rate of return of the Illinois State Board of Investment (ISBI) Commingled Fund was 4.7% for fiscal year 2015. The ISBI's total fund performance was better than the composite benchmark of 4.0% for the year ended June 30, 2015.

The annual money-weighted rate of return, net of investment expense, as of June 30, 2015 and 2014 was as follows:

	<b>2015</b>	<b>2014</b>
Money-weighted return*	4.79%	17.9%

\* The money-weighted rate of return expresses the investment performance, net of investment expense, adjusted for changing amounts actually invested. This information is not available for fiscal years prior to 2014.

**Average Number of System Employees (Unaudited)**

**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, 2015, 2014 and 2013 is summarized by functional classification as follows:

	<b>2015</b>	<b>2014</b>	<b>2013</b>
Executive and administrative	23	26	29
Accounting, bookkeeping and clerical	38	38	35
Other office employees	15	12	15
Electronic data processing	<u>23</u>	<u>22</u>	<u>20</u>
Total	<u>99</u>	<u>98</u>	<u>99</u>

**Social Security Contribution Fund**

The Social Security Contribution Fund had one employee for the years ended June 30, 2015, 2014 and 2013.

**State Employees' Retirement System  
of the State of Illinois**  
**Analysis of Operations (Unaudited)**  
**For the Years Ended June 30, 2015, 2014 and 2013**

***Comparison of Administrative Expenses to Total Expenses (Unaudited)***

	2015	2014	2013
Total expenses			
Benefits	\$ 2,034,858,435	\$ 1,917,062,639	\$ 1,799,965,655
Refunds of contributions, including transfers to reciprocating systems	23,128,975	23,082,814	24,290,402
Administrative expenses	<u>16,547,823</u>	<u>16,615,105</u>	<u>17,471,327</u>
	<u>\$ 2,074,535,233</u>	<u>\$ 1,956,760,558</u>	<u>\$ 1,841,727,384</u>
Administrative expenses as a percentage of total expenses	<u>0.8%</u>	<u>0.8%</u>	<u>0.9%</u>

***Schedule of Contributions/Deductions and Effect on Investments (Unaudited)***

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.

	2015	2014	2013
<b>Contributions</b>			
Participant Contributions	\$ 266,139,156	\$ 269,232,241	\$ 248,169,706
State of Illinois Employer Contributions	<u>1,804,319,356</u>	<u>1,699,447,826</u>	<u>1,531,932,137</u>
<b>Total Contributions</b>	<u>2,070,458,512</u>	<u>1,968,680,067</u>	<u>1,780,101,843</u>
<b>Deductions</b>			
Retirement Benefits	1,833,999,371	1,720,825,103	1,614,596,770
Survivor Benefits	121,930,337	114,177,228	107,533,834
Disability Benefits	63,929,747	64,782,236	59,882,478
Lump-Sum Death Benefits	14,998,980	17,278,072	17,952,573
Refunds (including transfers to reciprocating systems)	23,128,975	23,082,814	24,290,402
Administrative Expenses	<u>16,547,823</u>	<u>16,615,105</u>	<u>17,471,327</u>
<b>Total Deductions</b>	<u>2,074,535,233</u>	<u>1,956,760,558</u>	<u>1,841,727,384</u>
<b>Contributions in Excess of Deductions (Investments Used to Pay Benefits and Expenses)</b>			
	\$ <u>(4,076,721)</u>	\$ <u>11,919,509</u>	\$ <u>(61,625,541)</u>

**State Employees' Retirement System  
of the State of Illinois**  
**Analysis of Operations (Unaudited)**  
**For the Years Ended June 30, 2015, 2014 and 2013**

***Service Efforts and Accomplishments (Unaudited)***

	<b>2015</b>	<b>2014</b>	<b>2013</b>
Membership data			
Coordinated members	86,022	84,020	82,718
Noncoordinated members	<u>2,559</u>	<u>3,003</u>	<u>2,811</u>
Total members	<u><u>88,581</u></u>	<u><u>87,023</u></u>	<u><u>85,529</u></u>
Active members	<u><u>63,273</u></u>	<u><u>62,844</u></u>	<u><u>61,545</u></u>
Benefit payments processed			
Recurring			
Retirement annuities	54,802	53,478	51,994
Survivors' annuities	10,889	10,819	10,669
Disability benefits	<u>2,263</u>	<u>2,312</u>	<u>2,387</u>
Total	<u><u>67,954</u></u>	<u><u>66,609</u></u>	<u><u>65,050</u></u>
Termination refunds processed	<u><u>2,293</u></u>	<u><u>2,467</u></u>	<u><u>2,080</u></u>
Retirement counseling			
Preretirement sessions <sup>(1)</sup>			
Number of sessions	86	69	143
Number of attendees	3,654	3,367	6,167
Postretirement seminars			
Number of sessions	28	31	26
Number of attendees	1,100	1,599	1,271
Regional and other meetings			
Number of sessions	4	24	48
Number of attendees	872	1,651	2,997
Retirement coordinator site visits <sup>(1)</sup>	18	20	104
One-on-one meetings	3,605	5,805	3,248

<sup>(1)</sup> During FY 2015, the regional meetings were reduced due to enhanced focus placed on individual counseling sessions at SERS facilities.