State of Illinois
State Universities Retirement System

(A Component Unit of the State of Illinois)

Auditors' Report and Financial Audit

For the Year Ended June 30, 2007

Performed as Special Assistant Auditors
for the Auditor General, State of Illinois

State of Illinois
State Universities Retirement System

Financial Audit

For the Year Ended June 30, 2007

Contents

We will issue under a separate cover the Compliance Examination Report for the Year Ended June 30, 2007.

State of Illinois
State Universities Retirement System

Financial Statement Report Summary

June 30, 2007

The audit of the accompanying financial statements of the State of Illinois, State Universities Retirement System was performed by BKD, LLP.

Based on their audit, the auditors expressed an unqualified opinion on the State of Illinois, State Universities Retirement System's financial statements.

BKD LLP

Independent Accountants' Report

The Honorable William G. Holland
Auditor General
State of Illinois

Board of Trustees
State Universities Retirement System

As Special Assistant Auditors for the Auditor General, we have audited the accompanying statement of plan net assets of the State of Illinois, State Universities Retirement System (System), a component unit of the State of Illinois, as of June 30, 2007, and the related statement of changes in plan net assets for the year then ended. These financial statements are the responsibility of the System's management. Our responsibility is to express an opinion on these financial statements based on our audit. The prior year comparative information has been derived from the System's financial statements as of June 30, 2006 and for the year then ended, on which we expressed an unqualified opinion in our report dated October 25, 2006.

We conducted our audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audit provides a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of the System as of June 30, 2007, and the changes in its financial position for the year then ended in conformity with accounting principles generally accepted in the United States of America.

In accordance with *Government Auditing Standards*, we have also issued our report dated December 4, 2007 on our consideration of the State of Illinois, State Universities Retirement System's internal control over financial reporting and on our tests of its compliance with certain provisions of laws, regulations, contracts and grant agreements and other matters. The purpose of that report is to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing, and not to provide an opinion on the internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* and should be considered in assessing the results of our audit.

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The accompanying management's discussion and analysis and schedules of funding progress and employer contributions as listed in the table of contents are not a required part of the basic financial statements but are supplementary information required by the Governmental Accounting Standards Board. We have applied certain limited procedures, which consisted principally of inquiries of management regarding the methods of measurement and presentation of the required supplementary information. However, we did not audit the information and express no opinion on it.

Our audit was conducted for the purpose of forming an opinion on the financial statements that comprise the System's basic financial statements. The accompanying supporting schedules are presented for purposes of additional analysis and are not a required part of the basic financial statements. The 2007 supporting schedules have been subjected to the auditing procedures applied in the audit of the basic financial statements and, in our opinion, are fairly stated, in all material respects, in relation to the basic financial statements as of and for the year ended June 30, 2007, taken as a whole. We also have previously audited, in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States, the System's basic financial statements as of and for the year ended June 30, 2006, which are not presented with the accompanying financial statements. In our report dated October 25, 2006, we expressed an unqualified opinion on those basic financial statements. In our opinion, the 2006 supporting schedules are fairly stated, in all material respects, in relation to the basic financial statements as of and for the year ended June 30, 2006, taken as a whole.

BKD, LLP

December 4, 2007

Management's Discussion and Analysis

This section presents management's discussion and analysis of the State Universities Retirement System's (SURS or the System) financial statements and the major factors affecting the operations and investment performance of the System during the year ended June 30, 2007, with comparative reporting entity totals for the year ended June 30, 2006.

Overview of Financial Statements and Accompanying Information

- The financial statements presented in this report are the Statement of Plan Net Assets as of June 30, 2007 and the Statement of Changes in Plan Net Assets for the year ended June 30, 2007. These statements present separate totals for the defined benefit plan and the self-managed plan, with reporting entity totals for the years ended June 30, 2007 and 2006. The Statement of Plan Net Assets presents the assets on hand as of June 30, 2007 and available to be used in the payment of benefits. The Statement of Changes in Plan Net Assets presents the additions to and deductions from the plan net assets during the year ended June 30, 2007.

- The notes to the financial statements are an integral part of the financial statements and provide facts and detailed information to assist the reader in understanding the statements. Disclosures include the description of the plan, summary of significant accounting policies, detailed presentations of major assets and liabilities, and discussions of pending litigation and subsequent events impacting the plan.

- Required supplementary information presents schedules related to employer contributions and the funding of the plan.

- Other supplementary schedules consist of detailed information supporting administrative and investment expenses, fees paid to consultants, and a summary of cash receipts and disbursements.

Financial Analysis of the System

The State Universities Retirement System serves 185,213 members in its defined benefit plan and 15,182 members in its self-managed plan. The funds needed to finance the benefits provided by SURS are accumulated through the collection of member and employer contributions and through income on investments. The total net assets of the System increased from $14.6 billion as of June 30, 2006 to $16.6 billion as of June 30, 2007. This change was chiefly due to an increase in net investment income of $1.03 billion. The increase of $96 million in contributions was offset by an increase in benefit payments of $94 million.

Plan Net Assets

The summary of plan net assets for the System is presented below:

Condensed Statement of Plan Net Assets
Reporting Entity Total (in millions)

	2007	2006	Change Amount	Change %
Cash and short-term investments	$ 788.9	$ 934.7	$ (145.8)	(15.6)
Receivables and prepaid expenses	51.3	47.9	3.4	7.1
Pending investment sales	2,186.2	248.4	1,937.8	780.1
Investments and securities lending collateral	18,446.8	15,836.9	2,609.9	16.5
Capital assets, net	7.4	8.1	(0.7)	(8.6)
Total assets	21,480.6	17,076.0	4,404.6	25.8
Payable to brokers–unsettled trades	2,725.2	643.5	2,081.7	323.5
Securities lending collatteral	2,163.0	1,791.4	371.6	20.7
Other liabilities	22.7	21.9	0.8	3.6
Total liabilities	4,910.9	2,456.8	2,454.1	99.9
Total plan net assets	$16,569.7	14,619.2	1,950.5	13.3

Overall, plan net assets increased by $1.95 billion, or 13.3%, chiefly due to investment income and plan contributions of $3.2 billion, offset by benefit payments, refunds, and operating expenses of $1.25 billion. The allocation of investment assets for the plans making up the reporting entity as of June 30, 2007 and 2006 is as follows:

	2007	2006
Defined Benefit Plan		
Equities	65.0%	65.5%
Opportunity Fund	3.0	2.5
Fixed income	21.0	22.0
TIPS*	5.0	4.0
Real Estate Investment Trusts	4.0	4.0
Direct Real Estate	2.0	2.0
Total	100.0%	100.0%
Self-Managed Plan		
Equities	75.0%	73.0%
Fixed income	25.0	27.0
Total	100.0%	100.0%

*TIPS denotes Treasury Inflation Protected Securities

Proper implementation of the investment policy requires that a periodic adjustment, or rebalancing, of assets be made to ensure conformance with policy target levels. SURS rebalancing policy calls for an immediate rebalancing if an asset class exceeds or falls below its target allocation by 3%. The fund did not require a formal rebalancing during the year as the portfolio was kept within its strategic bounds through the use of System cash flows. The allocation of assets within the self-managed plan is totally determined by the individual participants, and also reflects gains over the past year.

The $2.5 billion increase in liabilities is due to a $2.1 billion increase in payments due to brokers for unsettled trades, and an increase in securities lending collateral value as of June 30, 2007 of $0.4 billion.

Changes in Plan Net Assets

The summary of changes in plan net assets for the System is presented below:

Condensed Statement of Changes in Plan Net Assets
Reporting Entity (in millions)

	2007	2006	Change Amount	Change %
Employer contributions	$ 294.4	$ 209.6	$ 84.8	40.5
Participant contributions	304.0	292.4	11.6	4.0
Investment income	2,597.9	1,566.8	1,031.1	65.8
Total additions	3,196.3	2,068.8	1,127.5	54.5
Benefits	1,180.6	1,086.5	94.1	8.7
Refunds	53.4	51.4	2.0	3.9
Administrative expense	11.7	12.2	(0.5)	(4.1)
Total deductions	$ 1,245.7	1,150.1	95.6	8.3
Net increase in plan net assets	$ 1,950.6	$ 918.7	$ 1,031.9	112.3

Management's Discussion and Analysis

Additions

Additions to plan net assets are in the form of employer and participant contributions and investment income or losses. For fiscal year 2007, employer contributions increased by $85 million due to higher employer contributions from the State of Illinois as required by Public Act 94-004. Participant contributions increased by $11.6 million, or 4% due to salary increases among active members.

The investment income for fiscal year 2007 was $2.6 billion for the System, of which $2.52 billion is attributable to the defined benefit plan and $80 million to the self-managed plan. For the defined benefit plan, this represents an increase of $1.03 billion and is a result of the improvement in the overall investment return (net of management fees) from 11.7% in fiscal year 2006 to 18.3% in fiscal year 2007.

Given the long-term orientation of the SURS defined benefit investment program, it is important to track investment returns over several time periods to correctly assess performance, especially given recent market volatility. The defined benefit plan returns are as follows:

Time Period	Annualized Return
1-year	18.3%
3-year	13.4%
5-year	11.9%
10-year	8.5%

Deductions

The expenses of the Retirement System relate to the provision of retirement annuities and other benefits, refunds to terminated employees, and the cost of administering the System. These expenses for fiscal year 2007 were $1.25 billion, an increase of $95.6 million or 8.3% over expenses for 2006. This increase is primarily due to the $92 million increase in defined benefit plan retirement and survivor annuity payments which is made up of a 4.4% increase in the number of benefit recipients, and a 4.3% increase in the average annuity paid. Administrative expenses remained relatively unchanged from fiscal year 2006 to 2007.

Future Outlook

Participant contributions are expected to grow in the future, at least at the pace of wage inflation experienced by the employers. The employer contribution, mainly provided by the State of Illinois, will increase by approximately $88 million or 25% as the determination of projected state contributions for fiscal years 2008 and beyond are to return to the plan set out by Public Act 88-0593. Under this plan contributions will be at levels sufficient to fund the employer normal cost while amortizing the unfunded accrued actuarial liability for the period of 2011 to 2045, allowing the System to reach a funding ratio of 90%.

Benefit payments are expected to continue to grow at a rate of approximately 8 – 10 % annually as a result of increasing numbers of retirees and the impact of annual salary increases at the participating agencies. Even with the increase in the employer contributions as discussed above, the projected deficit of contributions over expenditures will continue in future years, forcing the System to continue to liquidate investments in order to pay current benefits. SURS will continue to structure its portfolio with the objective of maximizing returns over the long term, taking advantage of investment income to help offset the shortages in employer contributions.

Financial Statements

Statement of Plan Net Assets as of June 30, 2007
With Comparative Reporting Entity Totals as of June 30, 2006

	2007			2006
	Defined Benefit Plan	Self-Managed Plan	Total	Total
Assets				
Cash and short-term investments	$ 788,901,518	$ –	$ 788,901,518	$ 934,742,836
Receivables				
Participants	13,321,253	1,304,197	14,625,450	15,884,075
Federal, trust funds, and other	731,845	1,205,883	1,937,728	1,553,538
Notes receivable, long-term	883,468	–	883,468	616,685
Pending investment sales	2,186,217,154	–	2,186,217,154	248,418,707
Interest and dividends	33,821,070	–	33,821,070	29,784,816
Total receivables	2,234,974,790	2,510,080	2,237,484,870	296,257,821
Prepaid expenses	14,237	–	14,237	18,367
Investments, at fair value				
Equity investments	10,209,825,650	32,399,894	10,242,225,544	9,692,422,530
Fixed income investments	5,164,684,235	15,899,761	5,180,583,996	3,816,079,807
Real estate investments	327,823,729	210,112	328,033,841	131,569,925
Mutual fund and variable annuities	–	533,000,506	533,000,506	405,332,778
Total investments	15,702,333,614	581,510,273	16,283,843,887	14,045,405,040
Securities lending collateral	2,162,980,971	–	2,162,980,971	1,791,458,483
Capital assets, at cost, net of accumulated depreciation of $15,182,624 and $16,161,192 respectively	7,444,568	–	7,444,568	8,142,980
Total assets	**20,896,649,698**	**584,020,353**	**21,480,670,051**	**17,076,025,527**
Liabilities				
Benefits payable	7,036,909	–	7,036,909	6,451,829
Refunds payable	3,053,323	–	3,053,323	5,045,192
Securities lending collateral	2,162,980,971	–	2,162,980,971	1,791,458,483
Payable to brokers for unsettled trades	2,725,185,889	–	2,725,185,889	643,514,461
Administrative and investment expenses payable	12,662,376	–	12,662,376	10,393,335
Total liabilities	**4,910,919,468**	–	**4,910,919,468**	**2,456,863,300**
Net assets held in trust for pension benefits	**$15,985,730,230**	**$584,020,353**	**$ 16,569,750,583**	**$14,619,162,227**

A Schedule of Funding Progress is presented on page 26.
The accompanying notes are an integral part of the financial statements.

Financial Statements

Statement of Changes in Plan Net Assets For the Year Ended June 30, 2007 With Comparative Reporting Entity Totals For the Year Ended June 30, 2006

	2007			2006
	Defined Benefit Plan	Self-Managed Plan	Total	Total
Additions				
Contributions				
Employer	$ 261,142,635	$ 33,308,829	$ 294,451,464	$ 209,651,367
Participant	262,350,838	41,641,763	303,992,601	292,392,188
Total Contributions	523,493,473	74,950,592	598,444,065	502,043,555
Investment Income				
Net appreciation in fair value of investments	2,169,592,566	80,334,943	2,249,927,509	1,281,932,946
Interest	225,548,765	–	225,548,765	183,792,025
Dividends	155,508,304	–	155,508,304	126,245,756
Securities lending	4,958,036	–	4,958,036	4,525,486
	2,555,607,671	80,334,943	2,635,942,614	1,596,496,213
Less investment expense				
Asset management expense	37,104,488	–	37,104,488	28,813,142
Securities lending expense	1,007,138	–	1,007,138	872,700
Net investment income	2,517,496,045	80,334,943	2,597,830,988	1,566,810,371
Total additions	**3,040,989,518**	**155,285,535**	**3,196,275,053**	**2,068,853,926**
Deductions				
Benefits	1,177,348,076	3,226,598	1,180,574,674	1,086,565,418
Refunds of contributions	41,353,881	12,053,575	53,407,456	51,422,635
Bond interest expense	–	–	–	179,640
Administrative expense	11,704,567	–	11,704,567	11,982,284
Total deductions	**1,230,406,524**	**15,280,173**	**1,245,686,697**	**1,150,149,977**
Net increase	**1,810,582,994**	**140,005,362**	**1,950,588,356**	**918,703,949**
Net assets held in trust for pension benefits				
Beginning of year	14,175,147,236	444,014,991	14,619,162,227	13,700,458,278
End of Year	**$15,985,730,230**	**$584,020,353**	**$16,569,750,583**	**$14,619,162,227**

The accompanying notes are an integral part of the financial statements.

Notes to the Financial Statements

I. Summary of Significant Accounting Policies

A. Reporting Entity

The System is a component unit of the State of Illinois. As defined by accounting principles generally accepted in the United States of America established by the Governmental Accounting Standards Board (GASB), the financial reporting entity consists of a primary government, as well as its component units, which are legally separate organizations for which the elected officials of the primary government are financially accountable, or for which the nature and significance to the primary government are such that exclusion would cause the reporting entity's financial statements to be misleading or otherwise incomplete. Financial accountability is defined as:

1. Appointment of a voting majority of the component unit's board and either (a) the ability to impose will by the primary government or (b) the possibility that the component unit will provide a financial benefit to or impose a financial burden on the primary government; or

2. Fiscal dependency on the primary government.

Based upon the required criteria, the System has no component units.

B. Measurement Focus and Basis of Accounting

For both the defined benefit plan and the Self Managed Plan (SMP), the financial transactions are recorded using the economic resources measurement focus and accrual basis of accounting. Member and employer contributions are recognized as revenue when due pursuant to statutory or contractual requirements. Benefits and refunds are recognized as expenses when due and payable in accordance with the terms of the plans.

C. Use of Estimates

The preparation of the System's financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities, and changes therein, and disclosure of contingent assets and liabilities. Actual results could differ from those estimates.

D. Description of Plans

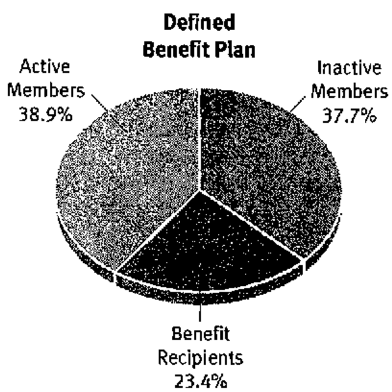
Legislation effective January 1, 1998 required State Universities Retirement System (SURS or the System) to introduce a portable benefit package to the existing defined benefit plan and to offer a defined contribution plan. The portable benefit package and the defined contribution plan are available to all participants whose employers elect to make the options available. As of June 30, 2007, the defined benefit plan has two options available. These options are known as the traditional benefit package and the portable benefit package. The defined contribution plan is known as the self-managed plan. The membership, contributions, and benefit provisions related to these plans are presented in the following summary of the provisions of SURS in effect as of June 30, 2007, as defined in the Illinois Compiled Statutes. Interested parties should refer to the SURS Member Guide or the Statutes for more complete information.

1. Defined Benefit Plan

SURS is the administrator of a cost-sharing, multiple-employer public employee retirement system established July 21, 1941 to provide retirement annuities and other benefits for staff members and employees of the state universities, certain affiliated organizations, and certain other state educational and scientific agencies and for survivors, dependents, and other beneficiaries of such employees. SURS is included in the State of Illinois' financial reports as a component unit. SURS is governed by Chapter 40, Act 5, Article 15, of the *Illinois Compiled Statutes*. These statutes assign the authority to establish and amend the benefit provisions of the plan to the State Legislature. Operation of the System and the direction of its policies are the responsibility of the Board of Trustees of the System. It is also these statutes that define the scope of SURS'

Notes to the Financial Statements

reporting entity. There are no statutory provisions for termination of the System. The Illinois Constitution provides that the pension obligation of the state *shall be an enforceable contractual relationship, the benefits of which shall not be diminished or impaired.*



At June 30, 2007 and 2006, the number of participating employers was:

	2007	2006
Universities	**12**	12
Community Colleges	**39**	39
Allied Agencies	**15**	15
State of Illinois	**2**	2
	68	68

At June 30, 2007 and 2006, defined benefit plan membership consisted of:

	2007	2006
Benefit Recipients	**43,395**	41,638
Active Members	**72,092**	71,759
Inactive Members	**69,726**	67,743
	185,213	181,140

a. Membership

Participation is required as a condition of employment. Employees are ineligible to participate if (a) employed less than full-time and attending classes with an employer; (b) receiving a retirement annuity from SURS; or (c) excluded by subdivision (a)(7)(f) or (a)(19) of Section 210 of the Federal Social Security Act from the definition of employment given in that Section.

b. Benefit Provisions

Public Act 90-448 was enacted effective January 1, 1998 which established an alternative defined benefit program known as the portable benefit package. This option is offered in addition to the existing traditional benefit option. New employees are allowed 6 months from their date of hire to make an irrevocable election. The benefit provisions for these two defined benefit plan packages are as follows:

SURS provides retirement, disability, death and survivor benefits as authorized in Chapter 40, Act 5, Article 15, of the Illinois Compiled Statutes.

Retirement benefits are payable to participants meeting minimum vesting requirements of 5 years of service credit at age 62, 8 years of service credit at age 55, or 30 years of service credit regardless of age. Under both defined benefit options, the annuity is the larger of (a) a percentage of the average of the highest 4 consecutive years earnings, with the percentage based upon total service credit, or (b) an actuarially determined benefit based upon the total employee and employer contributions and the individual's age at time of retirement. Retirement benefits are payable for life and are subject to a 3 percent compounded increase each January 1.

Disability benefits are payable to all participants with at least 2 years of service credit if they are unable to reasonably perform the duties of their assigned position due to a physical or mental impairment as certified by a physician. The benefit becomes payable when sick leave payments are exhausted or after 60 days of the disability, whichever is later. The benefit is payable at a rate of 50% of the monthly rate of compensation on the date the disability began. Disability benefits are reduced by any payments received under the Workers' Compensation or the Occupational Diseases Act. If a participant remains disabled after receiving the maximum benefits due, they may be eligible for a disability retirement annuity equal to 35% of the monthly rate of compensation on the date the disability began.

Upon termination of service, a lump sum refund is available to all members. Under the traditional benefit package, this refund consists of all member contributions and interest at 4-1/2%. Under the portable benefit package, this refund consists of all member contributions and total interest credited, plus for those members with greater than or equal to 5 years of service credit, an equal amount of employer contributions. Under both defined benefit plan options, a member with 5 or more years of service credit who does not apply for a refund may apply for a normal retirement benefit payable at age 62.

Death benefits are payable to named beneficiaries upon the death of any participant of this System. Under the traditional benefit package, monthly survivor benefits may be paid to eligible survivors if the participant established a minimum of 1.5 years of service credit prior to the date of death. If no qualified survivor exists at the date of retirement, the member is paid a refund of all survivor contributions plus interest. Under the portable benefit package, survivor benefits are available through a reduction of the retirement annuity calculated as described above. No refund of survivor contributions is available if there is no qualified survivor at the time of retirement. These provisions are designed to allow the impact of the portable benefit package's enhanced refund opportunity to be cost neutral.

Upon the death of an annuitant, SURS will pay either a death benefit to a non-survivor beneficiary or a monthly survivor benefit to an eligible survivor. The amount of the monthly survivor benefit will differ depending upon whether the annuitant had selected the traditional benefit package or the portable benefit package.

2. **Self-Managed Plan**

SURS is the plan sponsor and administrator of a defined contribution plan established as of January 1, 1998 by the Illinois General Assembly as an amendment to the Illinois Pension Code through Illinois Public Act 90-448. This plan is referred to as the self-managed plan (SMP) and is offered to employees of all SURS employers who elect to participate. This plan is a qualified money purchase pension plan under Section 401(a) of the Internal Revenue Code. The assets of the SMP are maintained under a trust administered by the SURS Board of Trustees in accordance with the Illinois Pension Code.

At June 30, 2007 and 2006, the number of SMP participating employers was:

	2007	2006
Universities	**12**	12
Community Colleges	**39**	39
Allied Agencies	**13**	13
State of Illinois	**1**	1
	65	65

At June 30, 2007 and 2006, the SMP membership consisted of:

	2007	2006
Annuity Benefit Recipients	**48**	29
Active Members	**9,599**	9,110
Inactive Members	**5,535**	4,863
	15,182	14,002

a. Membership

A member may elect participation in the SMP if (a) all participation criteria for the defined benefit plan are met; (b) the employer has elected through Board action to offer the self-managed plan; (c) the employee is on active status at the plan offering date; and (d) the employee is not eligible to retire as of the employer plan offering date. The member election is irrevocable. New employees are allowed 6 months from the date of hire in which to make their election. If no election is received, members are considered to be part of the defined benefit plan, under the traditional benefit option.

b. Benefit Provisions

The SMP provides retirement, disability, death, and survivor benefits as authorized in Chapter 40, Act 5, Article 15, of the *Illinois Compiled Statutes*, and amended by Public Act 90-448.

Retirement benefits are payable to participants meeting minimum vesting requirements of 5 years of service credit at age 62, 8 years of service credit at age 55, or 30 years of service credit regardless of age. The distribution options available upon reaching retirement eligibility are the following: a lump sum distribution consisting of all employee and employer contributions and related investment earnings; a single life annuity; a 50% or 100% joint and survivor annuity; a single life annuity with a guaranteed period of 10, 15, or 20 years as elected by the participant; and a 50% or 100% joint and survivor annuity with a guaranteed period of 10, 15, or 20 years as elected by the participant.

Disability benefits are payable to all participants with at least 2 years of service credit if they are unable to reasonably perform the duties of their assigned position due to physical impairment as certified by a physician. The benefit becomes payable when sick leave payments are exhausted or after 60 days of the disability, whichever is later. The benefit is payable at a rate of 50% of the monthly rate of compensation on the date the disability began. Disability benefits are reduced by any payments under the Workers' Compensation or the Occupational Diseases Act.

Upon termination of service with less than 5 years of service credit, a lump sum distribution is available which consists of employee contributions and related investment earnings. The employer contributions and related investment earnings are forfeited. Upon termination of service with greater than 5 years of service credit but where the participant is not yet eligible for retirement, a lump sum distribution is available which consists of employee and employer contributions and related investment earnings.

Death benefits are payable to named beneficiaries upon the death of any participant of this plan. If the participant has less than 1.5 years of service credit, the death benefit payable is the employee contributions and related investment earnings. If the participant has 1.5 or more years of service credit, the death benefit payable is the employee and employer contributions and related investment earnings.

E. Cash and Short Term Investments

Included in the $788,901,518 of cash and short-term investments presented in the statement of plan net assets is $275,749,799 of short-term investments with less than 90 days maturity. For purposes of the various data tables presented in Note III, this group of short-term investments is included as part of fixed income investments. Short-term investments are generally reported at cost, which approximates fair value.

F. Investments

Investments are governed by Chapter 40, Act 5, Articles 1 and 15, of the *Illinois Compiled Statutes*. The most important aspect of the statutes is the prudent expert rule, which establishes a standard of care for all fiduciaries. (A fiduciary is any person who has authority or control with respect to the management or administration of plan assets.) The prudent expert rule states that fiduciaries must discharge their duties with the care, skill, prudence, and diligence that a prudent person acting in a like capacity and familiar with such matters would use under conditions prevailing at the time.

For the defined benefit plan, investments are reported at fair value. Marketable securities (stocks, bonds, warrants, and options) are traded on public exchanges. The Northern Trust Company, SURS' custodial bank, establishes these prices using third-party pricing services. Generally, these prices are reported at the last reported sales price. Certain investments that do not have an established market value are reported at estimated fair value obtained from a custodial bank or investment management firm. These investments include commingled investment pools, where the underlying assets are individually marked to market (i.e., estimated fair value) on a daily basis and individually traded on publicly recognized exchanges. The investment manager, using methods approved by the CFA Institute (formerly known as the Association for Investment Management Research) or other industry standards, values non-marketable securities (real estate and venture capital). These methods generally include detailed property level appraisals and discounted cash flow analysis.

For the SMP, investments are reported at fair value by the Service Providers. These investments include both mutual and variable annuity funds where the underlying assets are marked to market (i.e., estimated fair value) on a daily basis and individually traded on publicly recognized exchanges. Generally, the prices on the underlying investments are reported at the last reported sales price. Purchases and sales of securities are recorded on a trade-date basis. Interest income is reported on the accrual basis. Dividends are recorded on the ex-dividend date.

G. Capital Assets

Capital assets are depreciated over the estimated useful life of each asset. Annual depreciation is computed using the straight-line method.

H. Administrative Expenses

System administrative expenses (which include amounts for both the defined benefit and self-managed plans) are budgeted and approved by the System's Board of Trustees. Funding for these expenses is included in the employer contribution as determined by the annual actuarial valuation and appropriated by the State of Illinois. This funding is included in the allocation of the state employer contribution recognized in the defined benefit plan. Therefore, expenses to administer the self-managed plan are recognized as administrative expenses in the defined benefit plan in these financial statements.

I. Prior Year Comparative Information

The basic financial statements include certain prior-year summarized comparative information in total but not at the level of detail required for a presentation in conformity with accounting principles generally accepted in the United States of America. Accordingly, such information should be read in conjunction with the System's financial statements as of and for the year ended June 30, 2006, from which the summarized comparative information was derived.

J. New Accounting Pronouncements

The Governmental Accounting Standards Board Statement 50 has been issued and is effective for all reporting periods beginning after June 15, 2007. This pronouncement guides the preparation of the pension disclosures included in the notes to the financial statements of defined benefit pension plans. The purpose of this Statement is to more closely align the financial reporting requirements for pensions with those for other post employment benefits. The result will be the enhancement of the information disclosed in the notes to the financial statements or presented as required supplementary information by pension plans and by employers that provided pension benefits. SURS plans to prepare notes to the financial statements and required supplementary information for fiscal year 2008 according to this Statement.

Notes to the Financial Statements

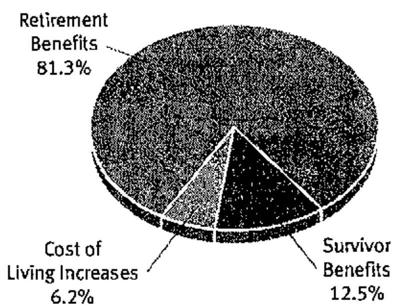
II. Contributions and Net Assets Designations

A. Defined Benefit Plan

1. Membership Contributions

In accordance with Chapter 40, Act 5, Article 15, of the Illinois Compiled Statutes, members of the traditional benefit package contribute 8% of their gross earnings; 6-1/2% of those are designated for retirement annuities, 1/2% for post-retirement increases, and 1% for survivor benefits. Police officers and fire fighters contribute 9-1/2% of earnings; the additional 1-1/2% is a normal retirement contribution. Members of the portable benefit package contribute 8% of their gross earnings; 6-1/2% of those are designated for retirement annuities, 1/2% for post-retirement increases, and 1% for enhanced refund benefits. Police officers and fire fighters contribute 9-1/2% of earnings; the additional 1-1/2% is a normal retirement contribution. These statutes assign the authority to establish and amend the contribution provisions of the plan to the State Legislature. The member contributions are picked up by the employer and treated as employer contributions for income tax purposes. Retirement contributions are based on the gross earnings before the employer pick-up and are included in earnings.

Member Contributions



All contributions on pre-1981 earnings and service credit payments, plus future other public employment, prior service, refund repayments, leave payments, military service payments, and the employee portion of Early Retirement Option payments are considered as previously taxed, unless qualifying funds are rolled over to SURS to make these purchases, or unless the payments are made in installments through employer deductions from payroll. Previously taxed contributions will be recovered tax-free when distributed to the employee in the form of benefits or payments or to his or her beneficiary as a death and/or survivor benefit.

2. Interest Credited on Member Contributions

For the traditional and portable benefit packages, the interest rate credited is fixed by the Board of Trustees and is currently 8.5%. As of July 1, 2007, the rate will remain at 8.5%. For purposes of lump sum refunds to former members, the traditional benefit package offers an interest rate of 4-1/2%, compounded annually, and the portable benefit package offers an interest rate equal to the credited rate, compounded annually. A change brought forth by the enactment of Public Act 94-0004 and effective July 1, 2005 calls for the Comptroller of the State of Illinois to set the interest rate credited to member contribution balances for purposes of the calculation of retirement annuities under the money purchase formula. The Comptroller set that rate at 8.5% for fiscal year 2006, and at 8.0% for fiscal year 2007. Members certified after July 1, 2005 will not be eligible for the money purchase formula calculation. Rather, their retirement annuity will be calculated using the general formula.

3. Employer Contributions

On an annual basis, an actuarial valuation is performed in order to determine the amount of statutorily required contributions from the State of Illinois. An actuarial experience study is performed every 5 years to determine the assumptions to be used in the annual valuation. The last actuarial experience study was performed in December 2006, taking effect with the June 30, 2007 valuation. To determine the funding method, Public Act 88-0593 was passed by the Illinois General Assembly in 1994. This act, which took effect on July 1, 1995, provides a 15-year phase-in to a 35-year plan that requires the state to make continuing appropriations to meet the normal actuarially-determined cost of the System, plus amortize the unfunded accrued liability. Under this plan, the System is expected to be 90% funded by fiscal year 2045.

On June 1, 2005, Governor Blagojevich signed Public Act 94-0004 which impacted state funding and retirement benefit calculations in fiscal year 2006 and beyond. This public act authorizes the following changes. First, it eliminates the money purchase calculation formula for Illinois higher education institution employees hired after June 30, 2005. Second, it transfers responsibility for determining the annual effective rate of interest to be used for the money purchase formula calculation from the SURS Board of Trustees to the State Comptroller. Finally, it required lower state contributions than the prior funding plan for the fiscal years 2006 and 2007. The decrease in state contributions was $158 million for fiscal year 2006, and $140 million for fiscal year 2007.

4. Net Asset Accounts

The System maintains two designated accounts that reflect the assignment of net assets to employee and benefit accounts:

a. The Employee Contribution Account records the pension assets contributed by each employee and the interest income earned by those contributions.

b. The Benefits from Employee and Employer Contributions Account records the net assets available for annuities in force and available for future retirement, death and disability benefits, the undistributed investment income, the unexpended administrative expense allocation, and the variations in actuarial assumptions.

Balances in these designated accounts as of June 30, 2007 are as follows:

Employee contributions	$ 5,239,872,131
Benefits from employee and employer contributions	10,745,858,099
Total Net Assets	**$ 15,985,730,230**

5. Ownership of Greater than 5 Percent of Net Assets Available for Benefits

In addition to U.S. Government and agency bond issues and treasury notes, there are investments as of June 30, 2007 in Federal National Mortgage Association (FNMA) obligations that represent 7.79% of the System's net assets available for benefits.

B. Self-Managed Plan

1. Membership Contributions

In accordance with Chapter 40, Act 5, Article 15, of the *Illinois Compiled Statutes*, members contribute 8% of their gross earnings. These statutes assign the authority to establish and amend the contribution provisions of the plan to the State Legislature.

The member contributions are picked up by the employer and treated as employer contributions for income tax purposes. Retirement contributions are based on the gross earnings before the employer pick-up and are included in earnings.

Service credit purchase payments are considered as previously taxed, unless qualifying funds are rolled over to SURS to make these purchases. Previously taxed contributions will be recovered tax-free when distributed to the employee in the form of benefits or refunds or to his or her beneficiary as a death and/or survivor benefit.

2. Employer Contributions

In accordance with Chapter 40, Act 5, Article 15, of the *Illinois Compiled Statutes*, employer contributions credited to the SMP participant are at a rate of 7.6% of the participant's gross earnings, less the amount retained by SURS (currently 1%) to provide disability benefits to the participant. The amounts credited are paid into the participant's account. The State of Illinois shall make the employer contribution to SURS on behalf of the SMP participants.

3. Net Asset Accounts

The SMP maintains three designated accounts that reflect the assignment of net assets to employee contributions, disability benefits, and employer forfeiture accounts:

a. The Employee Contribution Account records the pension assets contributed by each employee and the corresponding employer contribution, and the investment income earned by those contributions.

b. The Disability Benefits Account reflects the pension assets contributed by the employer and held to fund member disability benefits.

c. The Employer Forfeiture Account reflects the pension assets contributed by the employer but forfeited from member accounts due to termination prior to reaching 5 years of service. Future employer contributions are reduced by the total forfeitures held by the defined contribution plan.

The assets related to disability benefits and employer forfeitures are commingled with the investment assets of the defined benefit plan. Investment income or loss is credited to these balances based upon the annual investment return or loss of the commingled assets. For fiscal year 2007, the investment income credited to these balances was $7,334,208.

Balances in these designated accounts as of June 30, 2007 are as follows:

Employee contributions	$ 535,510,586
Disability benefits	40,002,133
Employer forfeitures	8,507,634
Total Net Assets	**$ 584,020,353**

4. Ownership of Greater than 5 Percent of Net Assets Available for Benefits

There are no significant investments in any one organization that represent 5% or more of net assets available for benefits.

III. Deposits and Investments

Custodial Credit Risk for Deposits

Custodial credit risk for deposits is the risk that in the event of a financial institution failure, State Universities Retirement System deposits may not be returned. Cash held in the investment related bank account in excess of $100,000 is uninsured and uncollateralized. SURS has no deposit policy for custodial credit risk. Deposits are under the custody of The Northern Trust Company which has a AA- Long Term Deposit/Debt rating by Standard & Poor's, an Aa3 rating by Moody's and an AA/AA- rating by Fitch. At June 30, 2007, the carrying amount of cash was $513,151,719 and the bank balance was $516,372,595, of which $36,565,820 was foreign currency deposits and was exposed to custodial credit risk. The remaining $275,749,799 was made up of short-term invested funds which are considered to be investments for the purpose of assessing custodial credit risk.

Investment Policies

Investments are governed by Chapter 40, Act 5, Articles 1 and 15, of the *Illinois Compiled Statutes*. The most important aspect of the statutes is the prudent expert rule, which establishes a standard of care for all fiduciaries. (A fiduciary is any person who has authority or control with respect to the management or administration of plan assets.) The prudent expert rule states that fiduciaries must discharge their duties with the care, skill, prudence, and diligence that a prudent person acting in a like capacity and familiar with such matters would use under conditions prevailing at the time. The SURS Board of Trustees has adopted a Statement of Investment Guidelines that contains general guidelines for investments. Within the prudent expert framework, the SURS Board of Trustees establishes specific investment guidelines in the investment management agreement of each individual investment management firm.

Summary of Investment Guidelines

During fiscal year 2007, minor modifications to the SURS asset allocation targets were implemented. The allocation to the Private Equities asset class increased during the year from 4.5% to 5.0% and the allocation to the Opportunity Fund asset class increased from 2.5% to 3.0% with funding provided through a corresponding reduction in U.S. equities. The allocation to Treasury Inflation Protected Securities (TIPS) increased from 4.0% to 5.0% with a corresponding decrease in fixed income.

As of June 30, 2007, SURS current investment policy targets are: 36.5% of the total fund invested in U.S. equities, 18.5% in non-U.S. equities, 5% in global equities, 5% in private equities, 21% in fixed income, 5% in treasury inflation protected securities (TIPS), 6% in real estate investment trusts and direct real estate (through fund of funds), and 3% in the Opportunity Fund.

Investment Objectives

The investment objective of the total portfolio is to produce annualized investment returns, net of all management fees, which exceed the return of a composite market benchmark or policy portfolio. The policy portfolio is comprised of market indices, which are consistent with the overall investment policy. The policy portfolio reflects a passive implementation of the investment policy. The current policy portfolio is comprised of 36.5% of the Wilshire 5000 Stock Index, 18.5% of the Morgan Stanley All Country World Ex-US Index, 5% of the Morgan Stanley World Index, 5% of the Wilshire 5000 Stock Index +5%, 21% of the Lehman Brothers Aggregate Bond Index, 5% of the Lehman Brothers U.S. TIPS Index, 4% of a blend of the Wilshire Real Estate Securities Index, the FTSE European Public Real Estate Association/National Association of Real Estate Investment Trusts (EPRA/NAREIT) Global Real Estate Ex-US Index and the FTSE EPRA/NAREIT Global Real Estate Index, 2% of the National Council of Real Estate Investment Fiduciaries (NCREIF) Open End Diversified Core Equity Index, and 3% of the combined benchmarks of the investments in the Opportunity Fund.

Comparisons of total fund performance are also made with a universe of public pension funds implementing generally comparable investment policies. The public pension fund index used for comparative purposes is the Russell/Mellon Public Funds Index.

Notes to the Financial Statements

Investments

The carrying values of investments by type at June 30, 2007 are summarized below:

Equity investments	
U.S. equities	$ 7,148,015,622
Non-U.S. equities	2,340,741,912
U.S. private equity	878,375,700
Non-U.S. private equity	63,139,906
Equity futures	(188,047,595)
Fixed income investments	
U.S. government obligations	722,136,767
U.S. agency obligations	1,728,478,046
U.S. corporate fixed income	2,302,528,860
U.S. fixed income, other	133,598,629
Non-U.S. fixed income securities	164,484,496
U.S. fixed income derivatives	(28,789,943)
Non-U.S. fixed income derivatives	496,093,284
U.S. fixed income futures	24,288,734
Non-U.S. fixed income futures	(496,093,284)
U.S. short-term investments	320,807,750
Non-U.S. short-term investments	63,515,282
U.S. swaps and options	8,688,983
Non-U.S. swaps and options	16,596,191
Real estate investments	
Real estate	328,033,840
Mutual funds and variable annuities	
Self-managed plan mutual funds and variable annuity funds	533,000,506
Total investments	**$ 16,559,593,686**

(a) Fixed income investments presented in this table include $275,749,799 of short-term investments with maturities of less than 90 days which are included in the cash and short-term investments total on the financial statements.
(b) U.S. short-term investments principally consist of money market funds and options.
(c) Fixed income investments presented in this table include $7,637,627 of short-term bills and notes with maturities greater than 90 days.

Custodial Credit Risk

Custodial credit risk for investments is the risk that, in the event of a failure of the counterparty to a transaction, the System will not be able to recover the value of its investment or collateral securities that are in the possession of an outside party. SURS has not adopted a formal policy specific to custodial credit risk. At June 30, 2007, no investments were uninsured and unregistered, with securities held by the counterparty or by its trust department or agent but not in the System's name.

Concentration of Credit Risk

Concentration of credit risk is the risk of loss that may be attributed to the magnitude of the System's investment in a single issue. SURS has not adopted a formal policy specific to concentration of credit risk. However, this area is addressed with each of the relevant investment managers in the Investment Management Agreement between the parties. The System's investment portfolios are managed by professional investment management firms. These firms must maintain diversified portfolios and must comply with risk management guidelines specific to each of their investment management agreements. Excluding U.S. government and agency issues, the portfolios are limited to a 5% allocation in any single investment grade U.S. issuer. Allocation limits also apply to international issuers. At June 30, 2007, SURS had investments in Federal National Mortgage Association (FNMA) obligations totaling $1,249,376,424 that represented 7.79% of the System's total investments.

Credit Risk of Debt Securities

Credit risk is the risk that the issuer or other counterparty to an investment will not fulfill obligations. SURS has not adopted a formal policy specific to credit risk of debt securities. However, this area is addressed with each of the relevant investment managers in the Investment Management Agreement between the parties. The quality ratings of investments in fixed income securities of the System as described by Standard & Poor's rating agency at June 30, 2007 are as follows:

Quality Rating: Standard & Poor's	Domestic**	International	Total
AAA	$ 2,885,304,492	$ 17,996,779	$ 2,903,301,271
AA+	616,708,760	8,496,297	625,205,057
AA	210,490,912	14,752,050	225,242,962
AA-	115,396,054	13,299,495	128,695,549
A+	138,269,879	41,454,133	179,724,012
A	53,678,263	16,781,231	70,459,494
A-	34,038,521	6,311,557	40,350,078
BBB+	82,748,859	45,797,947	128,546,806
BBB	64,827,642	17,316,907	82,144,549
BBB-	37,286,175	2,346,162	39,632,337
BB+	27,073,545	1,789,167	28,862,712
BB	41,613,746	3,317,754	44,931,500
BB-	36,340,746	91,650	36,432,396
B+	21,413,423	667,944	22,081,367
B	18,927,141	471,063	19,398,204
B-	706,339	103,275	809,614
CCC+	1,092,565	–	1,092,565
CCC	2,527,726	–	2,527,726
CCC-	736,805	–	736,805
D	112,706	–	112,706
Not Rated	58,939,101	7,730,176	66,669,277
Total credit risk: debt securities	**$ 4,448,233,400**	**$ 198,723,587**	**$ 4,646,956,987**
U.S. Government Agencies *	729,462,739	–	729,462,739
Total Debt Securities Investments	**$ 5,177,696,139**	**$ 198,723,587**	**$ 5,376,419,726**

* Obligations of the U.S. government or obligations explicitly guaranteed by the U.S. government are not considered to have credit risk.
Includes $7,325,972 from self-managed plan mutual fund.

** Includes $34,479,529 from self-managed plan variable annuities and mutual funds.

Interest Rate Risk

Interest rate risk is the risk that changes in interest rates will adversely affect the fair value of an investment. The State Universities Retirement System manages its exposure to fair value loss arising from increasing interest rates by diversifying the debt securities portfolio. The System has not adopted a formal policy specific to interest rate risk. However, this area is addressed with each of the relevant investment managers in the Investment Management Agreement between the parties.

At June 30, 2007 the segmented time distribution of the various investment types of debt securities of the System are as follows:

		Maturities in Years				
Type	**2007 Fair Value**	**Less than 1 year**	**1 to 5 years**	**6 to 10 years**	**10 to 20 years**	**More than 20 years**
U.S. Gov't & Agency Fixed Income	$ 2,571,378,687	$280,669,755	$333,501,322	$166,918,964	$ 318,010,912	$1,472,277,734
U.S. Corporate Fixed Income	2,472,718,823	192,162,424	573,550,060	260,724,806	95,898,715	1,350,382,818
U.S. Fixed Income, Other	133,598,629	22,104,086	2,567,008	107,768,535	1,159,000	–
Non-U.S. Fixed Income	198,723,587	64,566,998	50,088,876	26,111,054	18,307,550	39,649,109
Total	**$ 5,376,419,726**	**$559,503,263**	**$959,707,266**	**$561,523,359**	**$433,376,177**	**$2,862,309,661**

Notes to the Financial Statements

Foreign Currency Risk

Foreign currency risk is the risk that changes in currency exchange rates will adversely affect the fair value of an investment or a deposit. SURS has not adopted a formal policy specific to foreign currency risk. However, this area is addressed with each of the relevant investment managers in the Investment Management Agreement between the parties. International investment management firms maintain portfolios with diversified foreign currency risk for SURS. The System's exposure to foreign currency risk derives from its positions in foreign currency and foreign currency-denominated equity and fixed income investments. At June 30, 2007 the System's exposure to foreign currency risk is as follows:

Currency	Equity	Fixed Income*	Total
Australian dollar	$ 68,066,837	$ 2,394,077	$ 70,460,914
Brazilian reel	571,167	40,256,399	40,827,566
British pound sterling	241,680,416	(6,086,017)	235,594,399
Canadian dollar	58,831,847	483,829	59,315,676
Chinese yuan renminbi	–	4,896,653	4,896,653
Czech koruna	8,744,656	–	8,744,656
Danish krone	14,191,164	152,037	14,343,201
Euro	576,474,158	4,652,421	581,126,579
Hong Kong dollar	53,421,314	554,976	53,976,290
Indonesian rupiah	–	143,837	143,837
Japanese yen	295,148,723	1,444,596	296,593,319
Malaysian ringgit	–	145,782	145,782
Mexican peso	–	1,329,771	1,329,771
New Taiwan dollar	4,290,183	(8,736,969)	(4,446,786)
New Zealand dollar	3,338,386	404,980	3,743,366
Norwegian krone	16,342,742	3,680,259	20,023,001
Polish zloty	–	536,445	536,445
Russian ruble (new)	–	6,479,451	6,479,451
Singapore dollar	24,487,672	3,776,526	28,264,198
South African rand	1,937,863	–	1,937,863
South Korean won	4,394,428	2,607,769	7,002,197
Swedish krona	26,503,582	4,575,103	31,078,685
Swiss franc	126,344,326	85,360	126,429,686
Total securities subject to foreign currency risk	**$1,524,769,464**	**$ 63,777,285**	**$ 1,588,546,749**
Foreign investments denominated in U.S. Dollars	**879,112,354**	**180,818,684**	**1,059,931,038**
Total foreign investment securities	**$2,403,881,818**	**$ 244,595,969**	**$ 2,648,477,787**

* Includes Swaps, Options and Short-Term Investments

Derivative Securities

The System invests in derivative securities. A derivative security is an investment whose payoff depends upon the value of other assets such as commodity prices, bond and stock prices, or a market index. The System's investments in derivatives are not leveraged. In the case of an obligation to purchase (long a financial future or a call option), the full value of the obligation is held in cash or cash equivalents. For obligations to sell (short a financial future or a put option), the reference security is held in the portfolio. Derivative transactions involve, to varying degrees, credit risk and market risk. Credit risk is the possibility that a loss may occur because a party to a transaction fails to perform according to terms. Market risk is the possibility that a change in interest or currency rates will cause the value of a financial instrument to decrease or become more costly to settle. The market risk associated with derivatives, the prices of which are constantly fluctuating, is regulated by imposing strict limits as to the types, amounts, and degree of risk that investment managers may undertake. These limits are approved by the Board of Trustees and senior management, and the risk positions of the investment managers are reviewed on a periodic basis to monitor compliance with the limits. During the year, SURS' derivative investments included foreign currency forward contracts, collateralized mortgage obligations (CMOs), treasury inflation protected securities (TIPS), options, futures, and swaps.

Foreign currency forward contracts are used to hedge against the currency risk in SURS' foreign stock and fixed income security portfolios. A foreign currency forward contract is an agreement to buy or sell a specific amount of a foreign currency at a specified delivery or maturity date for an agreed-upon price. Fluctuations in the market value of foreign currency forward contracts are marked to market on a daily basis.

SURS fixed income managers invest in CMOs to improve the yield or adjust the duration of the fixed income portfolio. As of June 30, 2007, the carrying value of the System's CMO holdings totaled $439,295,182.

Treasury inflation protected securities (TIPS) are used by SURS fixed income managers to provide a real return against inflation (as measured by the Consumer Price Index). In addition, SURS employs TIPS at the total fund level in order to utilize their diversification benefits. As of June 30, 2007, the carrying value of the System's TIPS holdings totaled $640,175,800.

SURS investment managers use financial futures to replicate an underlying security they wish to hold (sell) in the portfolio. In certain instances, it may be beneficial to own a futures contract rather than the underlying security (arbitrage). Additionally, SURS investment managers use futures contracts to improve the yield or adjust the duration of the fixed income portfolio. A financial futures contract is an agreement to buy or sell a specific amount at a specified delivery or maturity date for an agreed-upon price. Financial future positions are recorded with a corresponding offset, which results in a carrying value equal to zero. As the market value of the futures contract varies from the original contract price, a gain or loss is recognized and paid to or received from the clearinghouse. The cash or securities to fulfill these obligations are held in the investment portfolio.

SURS investment managers use options in an attempt to add value to the portfolio (collect premiums) or protect (hedge) a position in the portfolio. Financial options are an agreement that gives one party the right, but not the obligation, to buy or sell a specific amount of an asset for a specified price, called the strike price, on or before a specified expiration date. As a writer of financial options, the System receives a premium at the outset of the agreement and bears the risk of an unfavorable change in the price of the financial instrument underlying the option. All written financial options are recognized as a liability on the System's financial statements. As a purchaser of financial options, the System pays a premium at the outset of the agreement and the counterparty bears the risk of an unfavorable change in the price of the financial instrument underlying the option.

Notes to the Financial Statements

The following table presents the derivative positions held by SURS as of June 30, 2007:

Derivative Contracts Outstanding

	Number of Contracts	Contractual Principal(a)	Carrying Value(b)
Domestic Index Products			
Equity futures purchased	487	$ 188,047,595	$ 188,047,595
Derivative offset	–	–	(188,047,595)
Equity written put options	67	6,700,000	(431,750)
Equity written call options	69	6,900,000	(150,075)
Domestic Interest Rate Products			
Fixed income futures purchased	3,818	381,800,000	680,889,750
Derivative offset	–	–	(680,889,750)
Fixed income futures sold	4,559	455,900,000	(615,779,909)
Derivative offset	–	–	615,779,909
Fixed income written put options	9,072	907,200,00	(3,573,641)
Fixed income written call options	291,002,075	498,500,000	(1,319,012)
Fixed income purchased put options	13	1,300,000	1,219
Fixed income purchased call options	5,801,011	106,900,000	390,226
International Interest Rate Products			
International fixed income futures purchased	13,381	11,130,149,206	3,027,437,060
Derivative offset	–	–	(3,027,437,060)
International fixed income futures sold	1,082	787,976,361	(45,339,867)
Derivative offset	–	–	45,339,867
International fixed income written call options	4,100,267	271,100,000	(21,273)
International fixed income purchased put options	114,792,500	114,792,500	2,750,441
International fixed income purchased call options	89,001,055	1,144,000,000	5,073,488
Foreign Currency Products			
Foreign forward currency purchases	–	–	222,281,526
Foreign forward currency sales	–	–	(221,083,715)

a) The contractual principal amounts listed above represent the market value of the underlying assets the derivative contracts control. Contractual principal amounts are often used to express the volume of the transactions but do not reflect the extent to which positions may offset one another. These amounts do not represent the much smaller amounts potentially subject to risk. Contractual principal values do not represent actual recorded values.

b) Carrying value for futures in the table above, while shown as zero, is recorded in the financial statements as an asset in an amount equal to the contractual principal and is offset by a corresponding liability.

Securities Lending

The SURS Board of Trustees policies permit the System to lend its securities to broker-dealers and other entities with a simultaneous agreement to return the collateral for the same securities in the future. The Northern Trust Company, the System's custodian, lends securities of the type on loan at year end for collateral in the form of cash, irrevocable letters of credit or other securities of 102%, and international securities for collateral of 105%. Cash collateral is shown in the System's financial statements. Securities lent are included in the Statement of Plan Net Assets. At year end, the System had no credit risk exposure to borrowers because the amount the System owes to the borrowers exceeds the amounts the borrowers owe to the System. The contract with the System's custodian requires it to indemnify the System if the borrowers fail to return the securities (and if the collateral is inadequate to replace the securities lent) or fail to pay the System for income distributions by the securities' issuers while the securities are out on loan.

All securities loans can be terminated on demand by either the System or the borrower, although the average term of the loans is 111 days. Cash collateral is invested in the lending agent's short-term investment pool, which at year end has a weighted average maturity of 37 days. The relationship between the maturities of the investment pool and the System's loans is affected by the maturities of the securities loans made by other entities that use the agent's pool, which the System cannot determine. The System cannot pledge or sell collateral securities received unless the borrower defaults.

Loans outstanding as of June 30, 2007 *($ millions)*

Market value of securities loaned	$ 2,109.70
Market value of collateral received from borrowers	$ 2,163.00

Self-Managed Plan

The SMP participants have the ability to invest their account balances in 47 mutual and variable annuity funds. These funds are offered by two providers: Fidelity Investments and Teachers Insurance and Annuity Association College Retirement Equities Fund (TIAA-CREF). As of June 30, 2007, the SMP had investments of $581,510,273. A detailed schedule (unaudited) of the funds and balances at June 30, 2007 is located in the Investment Section of The Comprehensive Annual Financial Report.

Notes to the Financial Statements

IV. Capital Assets

Capital assets activity for the year ended June 30, 2007 was as follows:

	Beginning Balance	Additions	Disposals	Ending Balance
Land	$ 531,834	$ –	$ –	$ 531,834
Office building	6,323,910	38,661	–	6,362,571
Information system equipment & software	15,405,304	213,295	1,905,897	13,712,702
Furniture and fixtures	2,043,124	20,400	43,439	2,020,085
	24,304,172	272,356	1,949,336	22,627,192
Less accumulated depreciation:				
Office building	1,638,250	126,019	–	1,764,269
Information system equipment, software, furniture and fixtures	14,522,942	844,749	1,949,336	13,418,355
	16,161,192	970,768	1,949,336	15,182,624
	$ 8,142,980	$ (698,412)	$ –	$ 7,444,568

The average estimated useful lives for depreciable capital assets are as follows:

Office building	40 years	Information systems equipment	3 years
Information systems software	10 years	Furniture and fixtures	3 years

V. Compensated Absences and Postemployment Benefits

The System is obligated to pay employees at termination for unused vacation and sick time. The maximum time for which any individual may be paid is 448 hours of vacation and one-half of unused sick time earned between January 1, 1984 and December 31, 1997. No sick time earned after December 31, 1997 will be compensable at termination. At June 30, 2007, the System had a liability of $926,119 for compensated absences, based upon the vesting method used for calculation of sick leave payable. The annual increase or decrease in liability is reflected in the financial statements as an increase or decrease in salary expense.

Compensated absences payable for the year ended June 30, 2007 was as follows:

	Beginning Balance	Additions	Reductions	Ending Balance	Estimate Amount Due Within One Year
Compensated Absences Payable	$ 927,104	$ 42,017	$ 43,002	$ 926,119	$ 30,000

SURS employees are members of the State Universities Retirement System. In addition to providing pension benefits, the State of Illinois provides certain health, dental, and life insurance benefits to annuitants who are former State employees. This includes annuitants of the State Universities Retirement System. Most State employees, including the System's employees, may become eligible for postemployment benefits if they eventually become annuitants. Health and dental benefits include basic benefits for annuitants under the State's self-insurance plan currently in force. Life insurance benefits for annuitants under age 60 are equal to their annual salary at the time of retirement; for annuitants age 60 or older, life insurance benefits are limited to $5,000 per annuitant.

Currently, the State does not segregate payments made to annuitants from those made to current employees for health, dental, and life insurance benefits. The cost of health, dental, and life insurance benefits is recognized on a pay-as-you-go basis.

VI. Insurance Coverage

The System is exposed to various risk of loss related to torts; theft of, damage to, and destruction of assets; errors and omissions; injuries to employees; and natural disasters. The System has minimized the risk of loss through private insurance carriers for commercial, business owners, and automobile policies. The deductible for this insurance coverage ranges from $250 to $500 per occurrence. The System has not experienced a material fluctuation between insurance claims filed and paid in the past three fiscal years.

Required Supplementary Information

Defined Benefit Plan

Schedule of Funding Progress ($ millions)

Fiscal Year	Assets	Accrued Actuarial Liabilities	Unfunded Accrued Actuarial Liabilities	Funding Ratio	Payroll	UAAL as % of Payroll
1998	$ 9,792.0	$ 11,416.1	$ 1,624.1	85.8%	$ 2,377.6	68.3%
1999	10,761.7	12,617.5	1,855.8	85.3%	2,411.1	77.0%
2000	12,063.9	13,679.0	1,615.1	88.2%	2,424.2	66.6%
2001	10,753.3	14,915.3	4,162.0	72.1%	2,474.6	168.2%
2002	9,814.7	16,654.0	6,839.3	58.9%	2,607.2	262.3%
2003	9,714.5	18,025.0	8,310.5	53.9%	2,763.4	300.7%
2004	12,586.3	19,078.6	6,492.3	66.0%	2,814.1	230.7%
2005	13,350.3	20,349.9	6,999.6	65.6%	2,939.1	238.1%
2006	14,175.1	21,688.9	7,513.8	65.4%	3,054.1	246.0%
2007	15,985.7	23,362.1	7,376.4	68.4%	3,181.0	231.9%

Schedule of Employer Contributions ($ millions)

Fiscal Year	Total ARC*	Member Contributions	Net ER/State ARC	Actual ER/State Contribution	State Contributions as % of Net ARC	Total Contributions as % of Total ARC
1998	$ 512.1	$ 221.7	$ 290.4	$ 227.7	78.4%	87.8%
1999	509.2	213.0	296.2	237.9	80.3%	88.6%
2000	547.8	222.5	325.3	241.1	74.1%	84.6%
2001	548.1	221.6	326.5	247.1	75.7%	85.5%
2002	686.9	250.0	436.9	256.1	58.6%	73.7%
2003	843.8	246.3	597.5	285.3	47.7%	63.0%
2004	934.8	243.8	691.0	1,757.5	254.4%	214.1%
2005	859.7	251.9	607.8	285.4	47.0%	62.5%
2006	914.9	252.9	662.0	180.0	27.2%	47.3%
2007	968.3	262.4	705.9	261.1	37.0%	54.1%

* Annual Required Contribution as defined in GASB Statement No. 25, "Financial Reporting for Defined Benefit Pension Plans and Note Disclosures for Defined Contribution Plans."

Notes to Trend Data

Valuation date	June 30, 2007
Actuarial cost method	Projected unit credit
Amortization method	Level percent of payroll
Remaining amortization period	30 years, open
Asset valuation method	Market value
Actuarial assumptions:	
Investment rate of return	8.5%
Projected salary increases*	5.0% - 10.0%
Postretirement benefits	3.0%

* Includes inflation at cost-of-living adjustments of 1.25%.

Supporting Schedules

Defined Benefit Plan
Summary Schedule of Administrative-Expenses
For the Years Ended June 30, 2007 and 2006

	2007	2006
Personnel services		
Salary and wages	$ 5,934,154	$ 5,704,875
Retirement contributions	632,896	605,751
Insurance and payroll taxes	1,531,790	1,467,340
	8,098,840	7,777,966
Professional services		
Computer services	459,250	431,948
Medical consultation	31,764	55,073
Technical and actuarial	434,710	491,754
Legal services	186,636	208,309
	1,112,360	1,187,084
Communications		
Postage	261,240	272,041
Printing and copying	115,437	134,924
Telephone	94,095	90,890
	470,772	497,855
Other services		
Equipment repairs, rental and maintenance	74,519	106,216
Building operations and maintenance	246,772	232,748
Surety bonds and insurance	159,156	34,081
Memberships and subscriptions	43,330	31,304
Transportation, travel and conferences	161,750	153,325
Education and employee training	18,436	19,928
Supplies	110,348	92,716
	814,311	670,318
Self-managed plan administration		
Salary and wages	149,788	195,705
Retirement contributions	15,364	20,201
Insurance and payroll taxes	31,232	45,476
Technical and actuarial	7,500	52,020
Legal services	1,938	8,992
Postage	27,011	25,780
Printing	4,683	13,759
	237,516	361,933
Depreciation and amortization	970,768	1,487,128
Total administrative expenses	**$ 11,704,567**	**$ 11,982,284**

Supporting Schedules

Defined Benefit Plan
Summary Schedule of Consultant Payments
For the Years Ended June 30, 2007 and 2006

	2007	2006
Defined benefit plan		
Technical and actuarial services		
Berwyn Group	$ 3,188	$ 1,743
Cortex	24,767	-
DHR International, Inc.	-	81,782
James Dulebohn	1,900	14,200
Economic Research	4,306	2,973
Gabriel, Roeder, Smith & Co.	153,648	164,051
GII of Illinois	18,000	-
Government Consulting Solutions	36,000	-
International Foundation for Retirement Education	-	1,425
JP Morgan Chase	34,698	34,326
Mayer, Brown, Rowe & Maw	-	45,826
Miscellaneous	3,498	1,122
Morill & Associates	48,584	-
Northern Illinois University	-	500
Smith Investigations	2,100	2,982
Sorling, Northrup, Hanna, Cullen & Cochran, Ltd.	-	36,010
The Northern Trust	68,921	60,820
Position Search, Advertising and Relocation Costs	21,754	24,115
Video Production	-	5,000
Woolard Marketing Consultants, Inc.	13,346	14,879
	434,710	491,754
Legal services		
Areawide Reporting Services	1,165	-
Burke, Bums & Pinelli	16,463	-
Claims Settlement	21,004	-
Investors Responsibility Support Services	25,000	25,000
Mayer, Brown, Rowe & Maw	86,165	114,475
Thomas, Mamer & Haughey	31,049	51,790
Winters, Featherstun, et al	5,790	17,044
	186,636	208,309
Self-managed plan		
Technical and actuarial services		
Fidelity	-	43,875
Ennis & Knupp, Investment Consulting	7,500	6,990
Inquisite	-	1,155
	7,500	52,020
Legal services		
Mayer, Brown, Rowe & Maw	1,938	8,992
Total consultant payments	**$ 630,784**	**$ 761,075**

Supporting Schedules

Defined Benefit Plan
Summary Schedule of Investment Fees, Commissions, and Administrative-Expenses
For the Years Ended June 30, 2007 and 2006

	2007	2006
Master trustee & custodian		
The Northern Trust Company	$ 125,000	$ 125,000
Investment manager firm		
Adams Street Partners	2,592,809	2,095,057
Ariel Capital Management	178,393	120,973
Barclays Global Investors	3,925,484	2,616,944
BlackRock Financial Management	1,072,048	1,392,363
Capital Guardian Trust Company	1,642,148	1,442,715
Pyramis Global Advisors Trust Company (formerly Fidelity Management Trust Company)	685,655	310,227
Genesis Asset Management	–	4,484
GlobeFlex Capital	648,107	504,030
ING Clarion Real Estate Securities	1,058,625	889,818
Manager Development Program	717,086	557,454
Martin Currie, Inc.	1,840,633	1,657,326
Metropolitan West Asset Management	626,104	380,522
Mondrian Investment Partners	687,621	443,919
Muller & Monroe	250,000	250,000
New Amsterdam Partners	302,985	350,512
Northern Trust Global Advisors	1,087,210	1,027,441
Northern Trust Investments	240,003	251,518
Pacific Investment Management Company	4,638,654	3,136,751
Pantheon Ventures	2,811,104	2,570,339
Paradigm Asset Management	139,140	57,139
Payden & Rygel	156,956	167,467
Progress Investment Management Company	1,421,907	1,263,650
Rasara Strategies	374,482	358,886
Rhumbline Advisors	167,712	134,349
Rosenberg Real Estate Equity Funds	5,178,877	3,276,914
UBS Realty Investors	1,042,377	–
Van Wagoner	–	239,824
Wellington Management Company	1,506,796	1,496,181
Western Asset Management	915,367	814,394
	35,908,283	27,811,197
Investment consultant, measurement & counsel		
Ennis, Knupp & Associates, Inc.	273,116	252,954
Mayer, Brown, Rowe & Maw	57,077	62,185
	330,193	315,139
Investment administrative expenses		
Personnel	604,998	446,544
Resources, board and travel	62,014	58,567
Performance measurement and database	74,000	56,695
	741,012	561,806
Total investment expenses	**$ 37,104,488**	**$ 28,813,142**

Supporting Schedules

Defined Benefit Plan
Summary Schedule of Cash Receipts and Disbursements
For the Year Ended June 30, 2007 ($ millions)

Beginning Cash and Short-Term Investments Balance	$ 934.7
Receipts	
Member contributions	$ 265.1
Employer contributions	261.1
Investment income	2,550.5
Investments redeemed	38,089.3
Total Receipts	$ 41,166.0
Disbursements	
Benefit payments	$ 1,178.8
Administrative expenses	9.7
Investment expenses	35.9
Refunds	41.4
SMP balance transfers	1.7
Investments purchased	40,044.3
Total Disbursements	$ 41,311.8
Ending Cash and Short-Term Investments Balance	**$ 788.9**

Independent Accountants' Report on Internal Control over Financial Reporting and on Compliance and Other Matters Based on the 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 Universities Retirement System (SURS)

As Special Assistant Auditors for the Auditor General, we have audited the financial statements of the State of Illinois, State Universities Retirement System (System), a component unit of the State of Illinois, as of and for the year ended June 30, 2007 and have issued our report thereon dated December 4, 2007. We conducted our audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States.

Internal Control Over Financial Reporting

In planning and performing our audit, we considered the System's internal control over financial reporting as a basis for designing our auditing procedures 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 over financial reporting. Accordingly, we do not express an opinion on the effectiveness of the System's internal control over financial reporting.

A control deficiency 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 misstatements on a timely basis. A significant deficiency is a control deficiency, or a combination of control deficiencies, that adversely affects the Systems' ability to initiate, authorize, record, process or report financial data reliably in accordance with generally accepted accounting principles such that there is more than a remote likelihood that a misstatement of the System's financial statements that is more than inconsequential will not be prevented or detected by the System's internal control.

A material weakness is a significant deficiency, or a combination of significant deficiencies, that results in more than a remote likelihood that a material misstatement of the financial statements will not be prevented or detected by the System's internal control.

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

<u>Compliance and Other Matters</u>

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

We are currently conducting a State compliance examination of the System as required by the Illinois State Auditing Act. The results of that examination will be reported to management under a separate cover.

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

BKD, LLP

December 4, 2007