McGladrey & Pullen
Certified Public Accountants

STATE OF ILLINOIS
STATE UNIVERSITIES RETIREMENT SYSTEM

FINANCIAL REPORT
YEAR ENDED JUNE 30, 2008

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, 2008

Contents

We will issue under a separate cover the Compliance Examination Report for the year ended June 30, 2008.

State of Illinois
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June 30, 2008

Summary

The audit of the accompanying financial statements of the State of Illinois, State Universities Retirement System (System) was performed by McGladrey & Pullen, LLP.

Based on their audit, the auditors expressed an unqualified opinion on the System's financial statements.

Summary of Findings

The auditors identified matters involving the System's internal control over financial reporting that they considered to be a significant deficiency. The significant deficiency is described on pages 32-34 as *Finding 08-1, Valuation of Alternative Investments.* The auditors also consider *Finding 08-1* to be a material weakness.

Exit Conference

The findings and recommendations appearing in this report were discussed with System personnel at an exit conference on January 16, 2009. Attending were:

	System
Judith A. Parker	Associate Executive Director
Dan L. Allen	Chief Investment Officer
Douglas Wesley	Deputy Chief Investment
Shelley Porter	Chief Financial Officer
Kelly Jenkins	General Counsel
Steven L. Hayward	Internal Auditor
W. Douglas Taylor	Internal Auditor
	McGladrey & Pullen, LLP
Joseph Evans	Partner
Josh Peacock	Supervisor
	Office of the Auditor General
Thomas L. Kizziah	Audit Manager

The responses to the recommendations were provided by Steven L. Hayward, in a letter dated January 21, 2009.

McGladrey & Pullen

Certified Public Accountants

INDEPENDENT AUDITOR'S REPORT

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

Board of Trustees, State Universities Retirement System of Illinois

As Special Assistant Auditors for the Auditor General, we have audited the accompanying Statement of Plan Net Assets of the State Universities Retirement System of Illinois (System), a component unit of the State of Illinois, as of June 30, 2008, and the related Statement of Changes in Plan Net Assets for the year then ended, as listed in the table of contents. 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 summarized comparative information has been derived from the System's 2007 financial statements, which were audited by other auditors whose report dated December 4, 2007 expressed an unqualified opinion on those statements.

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 plan net assets of the State Universities Retirement System of Illinois as of June 30, 2008, and the changes in plan net assets for the year then ended in conformity with accounting principles generally accepted in the United States of America.

As described in Note 1 to the financial statements, in fiscal year 2008 the System adopted provisions of Governmental Accounting Standards Board Statement No. 50, *Pension Disclosures – an amendment of GASB Statements No. 25 and No. 27.*

As described in Note 8 to the financial statements, the fair value of the investment portfolio as of June 30, 2008, has experienced a significant decline due to unprecedented unfavorable market conditions that have occurred subsequent to June 30, 2008. The information presented in Note 8 has not been subjected to the auditing procedures applied in the audit of the basic financial statements and, accordingly, we express no opinion on it.

In accordance with *Government Auditing Standards*, we have also issued our report dated January 21, 2009 on our consideration of the State of Illinois, State Universities Retirement System's internal control over financial reporting and 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 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.

The accompanying management's discussion and analysis and the schedules of funding progress and employer contributions are not a required part of the basic financial statements but are supplementary information required by accounting principles generally accepted in the United States of America. 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 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 2008 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, 2008, taken as a whole. The System's financial statements for the year ended June 30, 2007, which are not presented with the accompanying financial statements, were audited by other auditors whose report thereon dated December 4, 2007, expressed an unqualified opinion on those statements. Their report on the 2007 supporting schedules stated that, in their opinion, such information was fairly stated in all material respects in relation to the basic financial statements for the year ended June 30, 2007, taken as a whole.

McGladrey & Pullen, LLP

Schaumburg, Illinois
January 21, 2009

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, 2008, with comparative reporting entity totals for the year ended June 30, 2007.

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, 2008 and the Statement of Changes in Plan Net Assets for the year ended June 30, 2008. 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, 2008 and 2007. The Statement of Plan Net Assets presents the assets on hand as of June 30, 2008 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, 2008.
- 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, current schedule of funding progress, detailed presentations of major assets and liabilities, and subsequent events impacting the plan.
- Required supplementary information presents current and historical 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.

General Market Risk

SURS is exposed to general market risk. This general market risk is reflected in asset valuations fluctuating with market volatility. Any impact from market volatility on SURS investment portfolios depends in large measure on how deep the market downturn is, how long it lasts, and how it fits within fiscal year reporting periods. The resulting market risk and associated realized and unrealized gains and losses could significantly impact SURS financial condition. The readers of these financial statements are advised that financial markets continue to be volatile and are experiencing significant changes on almost a daily basis.

Financial Analysis of the System

The State Universities Retirement System serves 189,089 members in its defined benefit plan and 16,114 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 decreased from $16.6 billion as of June 30, 2007 to $15.2 billion as of June 30, 2008. This $1.4 billion change was chiefly due to a decrease in investments of $1.8 billion, offset by a decrease in the payables to brokers for unsettled trades of $.5 billion and a decrease in securities lending collateral of $.1 billion.

For fiscal year 2008 there was a net decrease in plan net assets of $1.4 billion. Contributions and investment income decreased from the prior year by $3.2 billion, resulting in total additions of ($20.8) million.

Benefits, refunds and administrative expenses increased from the prior year by $100.5 million, resulting in total deductions of $1.35 billion.

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)

	2008	2007	Change Amount	Change %
Cash and short-term investments	$ 797.6	$ 788.9	$ 8.7	1.1
Receivables and prepaid expenses	56.4	51.3	5.1	9.9
Pending investment sales	2,087.4	2,186.2	(98.8)	(4.5)
Investments and securities lending collateral	16,506.2	18,446.8	(1,940.6)	(10.5)
Capital assets, net	6.9	7.4	(0.5)	(6.8)
Total assets	19,454.5	21,480.6	(2,026.1)	(9.4)

Management's Discussion and Analysis

Payable to brokers-unsettled trades	2,184.5	2,725.2	(540.7)	(19.8)
Securities lending collatteral	2,046.5	2,163.0	(116.5)	(5.4)
Other liabilities	20.8	22.7	(1.9)	(8.4)
Total liabilities	4,251.8	4,910.9	(659.1)	(13.4)
Total plan net assets	$15,202.7	$16,569.7	($1,367.0)	(8.2)

Overall, plan net assets decreased by $1.37 billion, or 8.2%, chiefly due to the decrease in investments. Of this decrease, $.72 billion represents the use of investments to pay benefits, and the remainder is due to the negative return on investments of 4.5%. The investment allocation strategy for the plans making up the reporting entity as of June 30, 2008 and 2007 is as follows:

	2008	2007
Defined Benefit Plan		
Equities	68.0%	65.0%
Opportunity Fund	0.0	3.0
Fixed income	21.0	21.0
TIPS*	5.0	5.0
Real Estate Investment Trusts	4.0	4.0
Real Estate	2.0	2.0
Total	100.0%	100.0%
Self-Managed Plan		
Equities	75.0%	75.0%
Fixed income	25.0	25.0
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. Such rebalancing is necessary to reflect sizable cash flows and performance imbalances among investment managers who are hired to manage assets with a specified strategy. Although a strategy may be within a specified asset class, the manager may be authorized to utilize other instruments in another asset class. SURS' rebalancing policy calls for rebalancing, as soon as practical, if a strategy exceeds or falls below its target allocation by 3%. Ongoing rebalancing of the investment portfolio occurred as needed during the year with the assistance of System cash flows. The allocation of assets within the self-managed plan is totally determined by the individual participants, and also reflects losses over the past year.

Liabilities decreased by $.66 billion or 13.4%. This was primarily due to a decrease in the payable to brokers for unsettled trades at year end.

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)

	2008	2007	Change Amount	Change %
Employer contributions	$ 383.9	$ 294.4	$ 89.5	30.4
Participant contributions	310.1	304.0	6.1	2.0
Investment (loss)/income	(714.8)	2,597.9	(3,312.7)	(127.5)
Total additions	(20.8)	3,196.3	(3,217.1)	(100.6)
Benefits	1,279.2	1,180.6	98.6	8.4
Refunds	54.9	53.4	1.5	2.8
Administrative expense	12.1	11.7	.4	3.4
Total deductions	$ 1,346.2	1,245.7	100.5	8.1
Net (decrease)/increase in plan net assets	$ (1,367.0)	$1,950.6	$ (3,317.6)	(170.1)

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 2008, employer contributions increased by $89.5 million due to higher employer contributions from the State of Illinois as required by Public Act 88-0593. Participant contributions increased by $6.1 million, or 2% due to salary increases among active members.

The investment loss for fiscal year 2008 was $.7 billion for the System, representing a $3.3 billion decrease from the prior year. For the defined benefit plan, the overall loss was 4.5% (net of all investment management fees).

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	(4.5%)
3-year	8.1%
5-year	10.3%
10-year	6.2%
22-year	9.3%

The 22-year return corresponds to the average length of service for retiring members. The investment return for the longer time period of 9.3%, can be compared to the actuarial rate of return assumption, currently 8.5%. This assumed rate is determined every five years as part of the experience study performed by the System actuaries, and reviewed at least annually. Should market conditions or plan demographics of the System significantly deviate, the performance of an experience study in advance of the five-year period would be considered.

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 2008 were $1.35 billion, an increase of $100 million or 8.1% over expenses for 2007. This increase is primarily due to the $99 million increase in defined benefit plan retirement and survivor annuity payments, plus a $1.9 million increase in SMP benefit payments in the form of separation refunds. Administrative expenses remained relatively unchanged from fiscal year 2007 to 2008.

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 $252 million or 56% as the determination of projected state contributions for fiscal years 2010 and beyond are at levels required by the funding 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, 2008
With Comparative Reporting Entity Totals as of June 30, 2007

	2008			2007
	Defined Benefit Plan	Self-Managed Plan	Total	Total
Assets				
Cash and short-term investments	$ 797,620,497	$ –	$ 797,620,497	$ 788,901,518
Receivables				
Participants	11,008,328	1,883,245	12,891,573	14,625,450
Federal, trust funds, and other	2,106,418	1,085,990	3,192,408	1,937,728
Notes receivable, long-term	542,701	–	542,701	883,468
Pending investment sales	2,087,413,798	–	2,087,413,798	2,186,217,154
Interest and dividends	39,705,356	–	39,705,356	33,821,070
Total receivables	2,140,776,601	2,969,235	2,143,745,836	2,237,484,870
Prepaid expenses	8,000	–	8,000	14,237
Investments, at fair value				
Equity investments	8,697,596,058	34,208,427	8,731,804,485	10,242,225,544
Fixed income investments	4,796,631,614	16,812,218	4,813,443,832	5,180,583,996
Real estate investments	351,998,193	276,993	352,275,186	328,033,841
Mutual fund and variable annuities	–	562,118,120	562,118,120	533,000,506
Total investments	13,846,225,865	613,415,758	14,459,641,623	16,283,843,887
Securities lending collateral	2,046,536,507	–	2,046,536,507	2,162,980,971
Capital assets, at cost, net of accumulated depreciation of $16,053,476 and $15,182,624, respectively	6,931,226	–	6,931,226	7,444,568
Total assets	**18,838,098,696**	**616,384,993**	**19,454,483,689**	**21,480,670,051**
Liabilities				
Benefits payable	5,436,697	–	5,436,697	7,036,909
Refunds payable	2,899,940	–	2,899,940	3,053,323
Securities lending collateral	2,046,536,507	–	2,046,536,507	2,162,980,971
Payable to brokers for unsettled trades	2,184,482,162	–	2,184,482,162	2,725,185,889
Administrative and investment expenses payable	12,417,935	–	12,417,935	12,662,376
Total liabilities	**4,251,773,241**	–	**4,251,773,241**	**4,910,919,468**
Net assets held in trust for pension benefits	**$14,586,325,455**	**$616,384,993**	**$ 15,202,710,448**	**$16,569,750,583**

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, 2008
With Comparative Reporting Entity Totals For the Year Ended June 30, 2007

	2008			2007
	Defined Benefit Plan	Self-Managed Plan	Total	Total
Additions				
Contributions				
Employer	$ 344,945,238	$ 38,954,066	$ 383,899,304	$ 294,451,464
Participant	264,149,354	45,951,911	310,101,265	303,992,601
Total contributions	609,094,592	84,905,977	694,000,569	598,444,065
Investment (loss) income				
Net appreciation (depreciation) in fair value of investments	(899,179,819)	(39,127,004)	(938,306,823)	2,249,927,509
Interest	60,706,695	–	60,706,695	225,548,765
Dividends	187,602,637	–	187,602,637	155,508,304
Securities lending	14,161,232	–	14,161,232	4,958,036
	(636,709,255)	(39,127,004)	(675,836,259)	2,635,942,614
Less investment expense				
Asset management expense	37,659,805	–	37,659,805	37,104,488
Securities lending expense	1,353,062	–	1,353,062	1,007,138
Net investment (loss) income	(675,722,122)	(39,127,004)	(714,849,126)	2,597,830,988
Total additions	**(66,627,530)**	**45,778,973**	**(20,848,557)**	**3,196,275,053**
Deductions				
Benefits	1,275,713,711	3,459,031	1,279,172,742	1,180,574,674
Refunds of contributions	44,984,290	9,955,302	54,939,592	53,407,456
Administrative expense	12,079,244	–	12,079,244	11,704,567
Total deductions	**1,332,777,245**	**13,414,333**	**1,346,191,578**	**1,245,686,697**
Net increase (decrease)	**(1,399,404,775)**	**32,364,640**	**(1,367,040,135)**	**1,950,588,356**
Net assets held in trust for pension benefits				
Beginning of year	15,985,730,230	584,020,353	16,569,750,583	14,619,162,227
End of Year	**$14,586,325,455**	**$616,384,993**	**$15,202,710,448**	**$16,569,750,583**

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

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 and those differences could be material. The System uses an actuary to determine the actuarial accrued liability for the defined benefit plan and to determine the actuarially required contribution.

D. Risks and Uncertainties

The System invests in various investment securities. Investment securities are exposed to various risks such as interest rate, market, and credit risk. Due to the level of risk associated with certain investment securities, it is at least reasonably possible that changes in the values of investment securities will occur in the near term and those such changes could materially affect the amounts reported in the Statement of Plan Net Assets.

E. Description of Plans

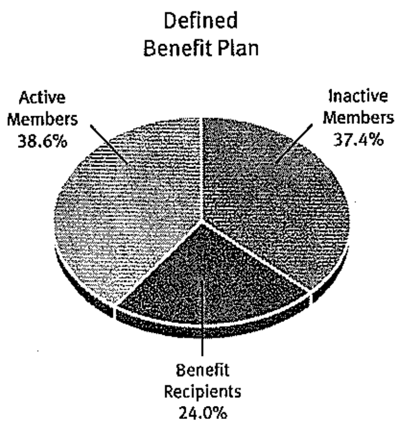
Legislation effective January 1, 1998 required State Universities Retirement System (SURS or the System) to introduce a portable benefit package to the existing defined benefit plan and to offer a defined contribution plan. The portable benefit package and the defined contribution plan are available to all participants whose employers elect to make the options available. As of June 30, 2008, 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, 2008, 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

Notes to the Financial Statements

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' 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, 2008 and 2007, the number of participating employers was:

	2008	2007
Universities	**12**	12
Community Colleges	**39**	39
Allied Agencies	**15**	15
State of Illinois	**2**	2
	68	68

At June 30, 2008 and 2007, defined benefit plan membership consisted of:

	2008	2007
Benefit Recipients	**45,346**	43,395
Active Members	**73,086**	72,092
Inactive Members	**70,657**	69,726
	189,089	185,213

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.

Notes to the Financial Statements

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.

c. Funded status and funding progress

The funded status of the plan as of June 30, 2008, the most recent actuarial valuation date, is as follows (in millions):

Net Assets	Accrued Actuarial Liabilities	Unfunded Accrued Actuarial Liabilities	Funding Ratio	Covered Payroll	UAAL as % of Covered Payroll
$14,586.3	$ 24,917.7	$10,331.4	58.5%	$3,303.2	312.8%

The schedule of funding progress, presented as required supplementary information (RSI) following the notes to the financial statements, presents multi-year trend information about whether the plan assets are increasing or decreasing over time relative to the actuarial accrued liabilities for benefits.

Additional information as of the latest actuarial valuation follows:

Valuation date	June 30, 2008
Actuarial cost method	Projected unit credit
Amortization method	Level percent, open
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 and cost-of-living adjustments of 1.25%.

Notes to the Financial Statements

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, 2008 and 2007, the number of SMP participating employers was:

	2008	2007
Universities	12	12
Community Colleges	39	39
Allied Agencies	13	13
State of Illinois	1	1
	65	65

At June 30, 2008 and 2007, the SMP membership consisted of:

	2008	2007
Annuity Benefit Recipients	62	48
Active Members	9,988	9,599
Inactive Members	6,064	5,535
	16,114	15,182

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.

Notes to the Financial Statements

F. Cash and Short-Term Investments

Included in the $797,620,497 of cash and short-term investments presented in the Statement of Plan Net Assets is $354,716,712 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.

G. 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.

H. Capital Assets

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

I. 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.

J. 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, 2007, from which the summarized comparative information was derived.

Notes to the Financial Statements

K. New Accounting Pronouncements

The Governmental Accounting Standards Board Statement 51 has been issued and is effective for all reporting periods beginning after June 15, 2009. This pronouncement establishes accounting and financial reporting requirements for intangible assets including easements, water rights, timber rights, patents, trademarks, and computer software. SURS plans to follow these reporting requirements for fiscal year 2010 according to this Statement.

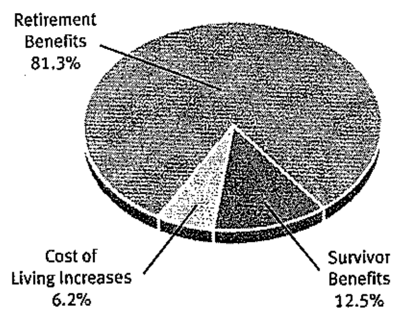
The Governmental Accounting Standards Board Statement 53 has been issued and is effective for all reporting periods beginning after June 15, 2009. This pronouncement addresses the recognition, measurement, and disclosure of information regarding derivative instruments entered into by state and local governments. The guidance in this Statement improves financial reporting by requiring governments to measure derivative instruments, with the exception of synthetic guaranteed investment contracts that are fully benefit-responsive, at fair value. The disclosures provide a summary of the government's derivative instrument activity and the information necessary to assess the government's objectives for derivative instruments. SURS plans to follow these reporting requirements for fiscal year 2010 according to this Statement.

The Governmental Accounting Standards Board Statement 50, *Pension Disclosures–an amendment of GASB Statements No. 25 and No. 27*, 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 System implemented this Statement for the year ended June 30, 2008.

II. Contributions and Net Assets Designations

A. Defined Benefit Plan

Member Contributions



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.

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, 2008, 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 years 2007 and 2008. As of July 1, 2008, the rate will be 8.5%. 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.

Notes to the Financial Statements

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 actuarial assumptions are also reviewed at least annually by the System. The last actuarial experience study was performed during fiscal year 2007. 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 2007. This public act authorizes the following changes. First, it eliminated the money purchase calculation formula for Illinois higher education institution employees hired after June 30, 2005. Second, it transferred 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, 2008 are as follows:

Employee contributions	$ 5,426,801,501
Benefits from employee and employer contributions	9,159,523,954
Total Net Assets	**$ 14,586,325,455**

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, 2008 in Federal National Mortgage Association (FNMA) obligations that represent 10.53% of the System's total investments.

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.

Notes to the Financial Statements

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 2008, the investment loss credited to these balances was $2,273,544.

Balances in these designated accounts as of June 30, 2008 are as follows:

Employee contributions	$ 565,087,355
Disability benefits	43,068,578
Employer forfeitures	8,229,060
Total Net Assets	**$ 616,384,993**

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, 2008, the carrying amount of cash was $442,903,785 and the bank balance was $449,680,771, of which $6,290,701 was foreign currency deposits and was exposed to custodial credit risk. The remaining $354,716,712 was made up of short-term invested funds which are considered to be investments for the purpose of assessing custodial credit risk.

Notes to the Financial Statements

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.

Investment Commitments

Private Equity Investment portfolios consist of passive interests in limited partnerships. The System had outstanding commitments to these limited partnerships of approximately $494.6 million and $535.5 million as of June 30, 2008 and 2007, respectively.

Investments

The carrying values of investments by type at June 30, 2008 are summarized below:

Equity investments	
U.S. equities	$ 5,665,036,468
Non-U.S. equities	2,130,624,675
U.S. private equity	1,035,890,139
Non-U.S. private equity	79,657,943
Equity futures	(179,404,740)
Fixed income investments	
U.S. government obligations	380,980
U.S. agency obligations	2,006,718,718
U.S. corporate fixed income	2,383,724,817
U.S. fixed income, other	121,049,412
Non-U.S. fixed income securities	208,940,633
U.S. fixed income derivatives	255,538,365
Non-U.S. fixed income derivatives	(231,468,648)
U.S. fixed income futures	(256,978,211)
Non-U.S. fixed income futures	231,468,648
U.S. short-term investments	792,149,116
Non-U.S. short-term investments	(44,639,371)
U.S. swaps and options	44,070,467
Non-U.S. swaps and options	5,506,991
Real estate investments	
Real estate	352,275,186
Mutual funds and variable annuities	
Self-managed plan mutual funds and variable annuity funds	562,118,120
Total investments	**$ 15,162,659,707**

(a) Fixed income investments presented in this table include $354,716,712 of short-term investments with maturities of less than 90 days, and $348,301,372 of investments in the form of cash and cash-equivalents. Both 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 $5,795,460 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, 2008, 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.

Notes to the Financial Statements

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, 2008, SURS had investments in Federal National Mortgage Association (FNMA) obligations totaling $1,542,187,032 that represented 10.53% 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, 2008 are as follows:

Quality Rating: Standard & Poor's	Domestic**	International	Total
AAA	$ 3,153,660,997	$ 22,785,149	$ 3,176,446,146
AA+	567,489,140	10,141,817	577,630,957
AA	88,731,571	20,701,585	109,433,156
AA-	161,736,486	23,631,738	185,368,224
A+	230,010,883	39,287,213	269,298,096
A	149,377,350	13,017,483	162,394,833
A-	52,951,283	17,171,412	70,122,695
BBB+	88,221,727	48,346,225	136,567,952
BBB	109,211,825	16,170,459	125,382,284
BBB-	83,843,437	3,244,897	87,088,334
BB+	19,286,900	2,521,940	21,808,840
BB	34,287,778	5,147,335	39,435,113
BB-	50,955,307	155,500	51,110,807
B+	3,686,841	–	3,686,841
B	6,123,080	1,406,666	7,529,746
B-	22,691,738	–	22,691,738
CCC+	1,757,614	–	1,757,614
CCC	3,290,311	–	3,290,311
CCC-	951,002	–	951,002
CC	647,025	–	647,025
D	737,365	–	737,365
Not Rated	73,035,604	3,597,110	76,632,714
Total credit risk: debt securities	$ 4,902,685,264	$ 227,326,529	$ 5,130,011,793
U.S. Government Agencies *	12,293,406	–	12,293,406
Total Debt Securities Investments	$ 4,914,978,670	$ 227,326,529	$ 5,142,305,199

* Obligations of the U.S. government or obligations explicitly guaranteed by the U.S. government are not considered to have credit risk.
Includes $11,912,427 from self-managed plan mutual fund.

** Includes $46,349,255 from self-managed plan variable annuities and mutual funds.

Notes to the Financial Statements

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, 2008 the segmented time distribution of the various investment types of debt securities of the System are as follows:

		Maturities in Years				
Type	**2008 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	$ 2,208,304,289	$273,219,807	$(586,243,028)*	$ 260,325,042	$363,727,896	$1,897,274,572
U.S. Corporate Fixed Income	2,585,624,969	239,203,565	493,949,853	932,444,468	77,165,799	842,861,284
U.S. Fixed Income, Other	121,049,412	2,287,147	2,184,226	115,463,167	1,114,872	–
Non-U.S. Fixed Income	227,326,529	34,200,246	58,595,617	71,501,131	7,326,385	55,703,150
Total	$ 5,142,305,199	$548,910,765	$ (31,513,332)	$1,379,733,808	$449,334,952	$2,795,839,006

* The negative total for the 1-5 year maturity U.S. government and agency fixed income category at June 30, 2008, includes pending trades of short sales that settled after June 30.

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, 2008 the System's exposure to foreign currency risk is as follows:

Currency	Equity	Fixed Income*	Total
Australian dollar	$ 62,196,964	$ 3,572,844	$ 65,769,808
Brazilian real	4,083,023	22,546,725	26,629,748
British pound sterling	244,280,873	(50,945,132)	193,335,741
Canadian dollar	94,875,268	(2,977,368)	91,897,900
Chinese yuan renminbi	–	2,206,211	2,206,211
Czech koruna	10,617,255	–	10,617,255
Danish krone	2,938,194	3,099	2,941,293
Euro	504,531,215	(6,966,430)	497,564,785
Hong Kong dollar	65,304,026	283,528	65,587,554
Indian rupee	–	1,113,367	1,113,367
Indonesian rupiah	–	140,347	140,347
Japanese yen	263,421,411	(9,856,374)	253,565,037
Kuwaiti dinar	–	232,296	232,296
Malaysian ringgit	1,266,338	184,670	1,451,008
Mexican peso	990,200	378,305	1,368,505
New Israeli shekel	51,080	–	51,080
New Taiwan dollar	3,964,748	100,821	4,065,569
New Zealand dollar	2,295,582	151,077	2,446,659
Norwegian krone	18,990,332	38,494	19,028,826
Philippine peso	37,446	–	37,446
Polish zloty	–	844,036	844,036
Russian ruble (new)	–	4,227,636	4,227,636
Saudi riyal	–	222,801	222,801
Singapore dollar	27,766,876	7,915,186	35,682,062
South African rand	2,198,833	132,979	2,331,812
South Korean won	5,766,616	–	5,766,616
Swedish krona	13,516,343	1,395,082	14,911,425
Swiss franc	83,920,685	(494,928)	83,425,757
United Arab Emirates dirham	–	222,969	222,969
Total securities subject to foreign currency risk	**$ 1,413,013,308**	**$ (25,327,759)**	**$ 1,387,685,549**
Foreign investments denominated in U.S. Dollars	**797,269,310**	**195,136,012**	**992,405,322**
Total foreign investment securities	**$ 2,210,282,618**	**$ 169,808,253**	**$ 2,380,090,871**

* Includes Swaps, Options and Short-Term Investments

Notes to the Financial Statements

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, 2008, the carrying value of the System's CMO holdings totaled $419,858,060.

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, 2008, the carrying value of the System's TIPS holdings totaled $788,710,798.

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, 2008:

Derivative Contracts Outstanding

	Number of Contracts	Contractual Principal(a)	Carrying Value(b)
Domestic Index Products			
Equity futures purchased	523	$ 179,404,740	$ 179,404,740
Derivative offset	–	–	(179,404,740)
Domestic Interest Rate Products			
Fixed income futures purchased	9,026	6,054,900,000	1,772,894,694
Derivative offset	–	–	(1,722,894,694)
Fixed income futures sold	993	116,600,000	(142,564,283)
Derivative offset	–	–	142,564,283
Fixed income written put options	161,901,835	875,500,000	(5,258,001)
Fixed income written call options	13,001,274	235,800,000	(569,968)
Fixed income purchased put options	93,800,000	93,800,000	7,281,494
Fixed income purchased call options	184,300,457	326,300,000	2,579,915
International Interest Rate Products			
International fixed income futures purchased	852	738,910,656	202,139,918
Derivative offset	–	–	(202,139,918)
International fixed income futures sold	1,722	338,343,732	(285,640,881)
Derivative offset	–	–	285,640,881
International fixed income written call options	259	255,424,063	(199,736)
International fixed income written put options	3,300,000	5,199,315	(48,094)
Foreign Currency Products			
Foreign forward currency purchases	–	–	389,742,676
Foreign forward currency sales	–	–	(385,490,953)

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. 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.

Notes to the Financial Statements

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. Credit Suisse, New York Branch, the System's third party agent lender, lends securities in exchange for cash collateral at 102% for U.S. securities and 105% for international securities. Cash collateral is shown on 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 third party agent lender 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 1.69 days. Cash collateral is invested in the System's short-term investment pool, which at year end has a weighted average maturity of 30.64 days.

Loans outstanding as of June 30, 2008 *($ millions)*

Market value of securities loaned	$ 1,988.8
Market value of collateral received from borrowers	$ 2,046.5

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, 2008, the SMP had assets of $613,475,758. A detailed schedule (unaudited) of the funds and balances at June 30, 2008 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, 2008 was as follows:

	Beginning Balance	Additions	Disposals	Ending Balance
Land	$ 531,834	$ –	$ –	$ 531,834
Office building	6,362,571	–	–	6,362,571
Information system equipment & software	13,712,702	319,717	–	14,032,419
Furniture and fixtures	2,020,085	37,793	–	2,057,878
	22,627,192	357,510	–	22,984,702
Less accumulated depreciation:				
Office building	1,764,269	126,019	–	1,890,288
Information system equipment and software	11,673,969	648,005	–	12,321,974
Furniture and fixtures	1,744,386	96,828	–	1,841,214
	15,182,624	870,852	–	16,053,476
	$ 7,444,568	$ (513,342)	$ –	$ 6,931,226

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

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, 2008, the System had a liability of $1,034,463 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, 2008 was as follows:

	Beginning Balance	Additions	Reductions	Ending Balance	Estimate Amount Due Within One Year
Compensated Absences Payable	$ 926,119	$ 133,638	$ 25,294	$ 1,034,463	$ 30,000

Notes to the Financial Statements

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. There has been no significant reduction of insurance coverage from the prior year. The System has not had any insurance claims filed or paid in the past three fiscal years.

VII. Post-employment Benefits

The State provides health, dental, vision, and life insurance benefits for retirees and their dependents in a program administered by the Department of Healthcare and Family Services along with the Department of Central Management Services. Substantially all State employees become eligible for post-employment benefits if they eventually become annuitants of one of the State sponsored pension plans. Health, dental, and vision benefits include basic benefits for annuitants and dependents under the State's self-insurance plan and insurance contracts currently in force. Annuitants may be required to contribute toward health, dental, and vision benefits with the amount based on factors such as date of retirement, years of credited service with the State, whether the annuitant is covered by Medicare, and whether the annuitant has chosen a managed health care plan. Annuitants who retired prior to January 1, 1998, and who are vested in the State Universities Retirement System do not contribute toward health, dental, and vision benefits. For annuitants who retired on or after January 1, 1998, the annuitant's contribution amount is reduced five percent for each year of credited service with the State; therefore, those annuitants with twenty or more years of credited service do not have to contribute toward health, dental, and vision benefits. Annuitants also receive life insurance coverage equal to the annual salary of the last day of employment until age 60, at which time the benefit becomes $5,000.

The State pays the State Universities Retirement System's portion of employer costs for the benefits provided. The total cost of the State's portion of health, dental, vision, and life insurance benefits of all members, including post-employment health, dental, vision, and life insurance benefits, is recognized as an expenditure by the State in the Illinois Comprehensive Annual Financial Report. The State finances the costs on a pay-as-you-go basis. The total costs incurred for health, dental, vision, and life insurance benefits are not separated by department or component unit for annuitants and their dependents nor active employees and their dependents.

A summary of post-employment benefit provisions, changes in benefit provisions, employee eligibility requirements including eligibility for vesting, and the authority under which benefit provisions are established are included as an integral part of the financial statements of the Department of Healthcare and Family Services. A copy of the financial statements of the Department of Healthcare and Family Services may be obtained by writing to the Department of Healthcare and Family Services, 201 South Grand Ave., Springfield, Illinois, 62763-3838.

VIII. Subsequent Events (unaudited)

The System has suffered a decline in its investment portfolio subsequent to June 30, 2008. As of November 30, 2008, the market values of the assets have declined approximately $3,633,707,940, or 25.13%. These numbers represent the most current available information for both public and private market investments as compared to June 30, 2008. The decline in asset values is the result of a continued worldwide economic slowdown.

Required Supplementary Information

Defined Benefit Plan
Schedule of Funding Progress ($ millions)

Fiscal Year**	Net Assets	Accrued Actuarial Liabilities	Unfunded Accrued Actuarial Liabilities	Funding Ratio	Payroll	UAAL as % of Payroll
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%
2008	14,586.3	24,917.7	10,331.4	58.5%	3,303.2	312.8%

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
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%
2008	971.6	264.1	707.5	344.9	48.8%	62.7%

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

** The source of these schedules is the annual actuarial valuation which is performed as of June 30 for each fiscal year listed.

Supporting Schedules

Defined Benefit Plan
Summary Schedule of Administrative Expenses
For the Years Ended June 30, 2008 and 2007

	2008	2007
Personnel services		
Salary and wages	$ 6,179,016	$ 5,934,154
Retirement contributions	642,268	632,896
Insurance and payroll taxes	1,626,001	1,531,790
	8,447,285	8,098,840
Professional services		
Computer services	648,252	459,250
Medical consultation	38,513	31,764
Technical and actuarial	350,243	434,710
Legal services	159,930	186,636
	1,196,938	1,112,360
Communications		
Postage	287,219	261,240
Printing and copying	109,732	115,437
Telephone	87,166	94,095
	484,117	470,772
Other services		
Equipment repairs, rental and maintenance	64,238	74,519
Building operations and maintenance	274,750	246,772
Surety bonds and insurance	158,775	159,156
Memberships and subscriptions	36,412	43,330
Transportation, travel	158,889	161,750
Education	20,916	18,436
Supplies	86,198	110,348
	800,178	814,311
Self-managed plan administration		
Salary and wages	169,682	149,788
Retirement contributions	17,682	15,364
Insurance and payroll taxes	34,405	31,232
Technical and actuarial	12,580	7,500
Legal services	–	1,938
Postage	32,860	27,011
Printing	12,665	4,683
	279,874	237,516
Depreciation and amortization	870,852	970,768
Total administrative expenses	$ 12,079,244	$ 11,704,567

Supporting Schedules

Defined Benefit Plan
Summary Schedule of Consultant Payments
For the Years Ended June 30, 2008 and 2007

	2008	2007
Defined benefit plan		
Technical and actuarial services		
Berwyn Group	$ 3,342	$ 3,188
Cortex	–	24,767
James Dulebohn	–	1,900
Economic Research	4,306	4,306
Gabriel, Roeder, Smith & Co.	102,825	153,648
GII of Illinois	18,000	18,000
Government Consulting Solutions	36,000	36,000
ICS/Merrill	337	–
JP Morgan Chase	15,995	34,698
Lexis Nexis	6,460	–
McLagan	2,500	–
Miscellaneous	887	3,498
Morill & Associates	48,000	48,584
Smith Investigations	1,475	2,100
The Northern Trust	83,215	68,921
Position Search, Advertising and Relocation Costs	2,786	21,754
Woolard Marketing Consultants, Inc.	24,115	13,346
	350,243	434,710
Legal services		
Areawide Reporting Services	3,043	1,165
Burke, Burns & Pinelli	45,629	16,463
Claims Settlement	–	21,004
Investors Responsibility Support Services	25,000	25,000
Mayer, Brown, Rowe & Maw	39,008	86,165
Thomas, Mamer & Haughey	29,454	31,049
Winters, Featherstun, et al	17,796	5,790
	159,930	186,636
Self-managed plan		
Technical and actuarial services		
Ennis & Knupp, Investment Consulting	7,500	7,500
Gabriel, Roeder, Smith & Co.	5,080	–
	12,580	7,500
Legal services		
Mayer, Brown, Rowe & Maw	–	1,938
Total consultant payments	$ 522,753	$ 630,784

Supporting Schedules

Defined Benefit Plan
Summary Schedule of Investment Fees, Commissions, and Administrative Expenses
For the Years Ended June 30, 2008 and 2007

	2008	2007
Master trustee & custodian		
The Northern Trust Company	$ 1,003,906	$ 125,000
Investment manager firm		
Adams Street Partners	3,191,403	2,592,809
Ariel Capital Management	206,360	178,393
Barclays Global Investors	2,186,658	3,925,484
BlackRock Financial Management	951,107	1,072,048
Capital Guardian Trust Company	1,580,664	1,642,148
GlobeFlex Capital	755,476	648,107
ING Clarion Real Estate Securities	1,107,496	1,058,625
Jacobs Levy Equity Management	480,491	–
Manager Development Program	954,629	717,086
Martin Currie, Inc.	1,771,692	1,840,633
Metropolitan West Asset Management	414,522	626,104
Mondrian Investment Partners	647,664	687,621
Muller & Monroe	375,000	250,000
New Amsterdam Partners	–	302,985
Northern Trust Global Advisors	888,664	1,087,210
Northern Trust Investments	220,626	240,003
Pacific Investment Management Company	5,368,626	4,638,654
Pantheon Ventures	2,689,749	2,811,104
Paradigm Asset Management	115,932	139,140
Payden & Rygel	157,600	156,956
Piedmont Investment Advisors	107,194	–
Progress Investment Management Company	1,555,738	1,421,907
Pyramis Global Advisors Trust Company	1,373,609	685,655
Rasara Strategies	309,503	374,482
Rhumbline Advisors	188,931	167,712
Rosenberg Real Estate Equity Funds	3,830,564	5,178,877
T. Rowe Price	172,791	–
USB Realty Investors	1,288,944	1,042,377
Wellington Management Company	1,902,660	1,506,796
Western Asset Management	503,155	915,367
	35,297,448	35,908,283
Investment consultant, measurement & counsel		
Ennis, Knupp & Associates, Inc.	360,000	273,116
Mayer, Brown, Rowe & Maw	113,854	57,077
	473,854	330,193
Investment administrative expenses		
Personnel	699,100	604,998
Resources, board and travel	92,850	62,014
Performance measurement and database	92,647	74,000
	884,597	741,012
Total investment expenses	$ 37,659,805	$ 37,104,488

Supporting Schedules

Defined Benefit Plan
Summary Schedule of Cash Receipts and Disbursements
For the Year Ended June 30, 2008 ($ millions)

Beginning Cash and Short-Term Investments Balance	$ 788.9
Receipts	
Member contributions	$ 267.0
Employer contributions	345.0
Investment income (loss)	(642.6)
Investments redeemed	48,450.8
Total Receipts	$ 48,420.2
Disbursements	
Benefit payments	$ 1,277.5
Administrative expenses	12.5
Investment expenses	38.0
Fixed asset purchases	.3
Refunds	45.0
SMP balance transfers	1.6
Investments purchased	47,036.6
Total Disbursements	$ 48,411.5
Ending Cash and Short-Term Investments Balance	$ 797.6

McGladrey & Pullen
Certified Public Accountants

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

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

Board of Trustees
State Universities Retirement System
Springfield, Illinois

As Special Assistant Auditors for the Auditor General, we have audited the Statement of Plan Net Assets and Statement of Changes in Plan Net Assets of the State Universities Retirement System of Illinois (System), as of and for the year ended June 30, 2008, and have issued our report thereon dated January 21, 2009. 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.

Our consideration of internal control over financial reporting was for the limited purpose described in the preceding paragraph and would not necessarily identify all deficiencies in internal control that might be significant deficiencies or material weaknesses. However, as discussed below, we identified a deficiency in internal control over financial reporting that we consider to be a significant deficiency.

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 combination of control deficiencies, that adversely affects the entity's 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 entity's financial statements that is more than inconsequential will not be prevented or detected by the entity's internal control. We consider the deficiency described in the accompanying current findings section as Finding 08-1 to be a significant deficiency in internal control over financial reporting.

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

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 and, accordingly, would not necessarily disclose all significant deficiencies that are also considered to be material weaknesses. However, we believe the significant deficiency described in Finding 08-1 to be a material weakness.

Compliance and Other Matters

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

During our audit we noted certain other matters involving internal control and other operational matters which have been reported to the System's management in a separate letter dated January 21, 2009.

We also noted immaterial findings that have been excluded from the financial audit and compliance examination which have been reported to the System's management in a separate letter dated January 21, 2009.

The System's response to the findings identified in our audit is presented in the current findings section. We did not audit the System's response and, accordingly, we express no opinion 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, System management, and Board of Trustees, and is not intended to be and should not be used by anyone other than these specified parties.

McGladrey & Pullen, LLP

Schaumburg, Illinois
January 21, 2009

Current Findings – *Government Auditing Standards*

Finding No. 08-1 Valuation of Alternative Investments

The State Universities Retirement System (System) should enhance its accounting and reporting process for determining and reviewing the fair value measurements and disclosures, enhance documentation of valuation methods and significant supporting assumptions used for its alternative investments on a timely basis.

In conjunction with the audit for the year ended June 30, 2008, an analysis was performed on the System's alternative investments. As part of this process, it was discovered that the financial activity reported for certain alternative investments was not current as of the Statement of Plan Net Assets year-end. The amounts that were reported represented the values provided by their Investment Management Firms as of March 31st with cash activity through June 30th, but did not include the change in the underlying investments for the period from April 1st through June 30th. As a result, the System's beginning Plan Net Assets and Net Increase in Plan Net Assets were understated by approximately $85 million.

GAAP require the System to report their investments at fair value as of the Statement of Plan Net Assets date. Management has been unable to obtain more current financial data in time to prepare the June 30 financial statements. Errors occurred because management had historically used a March 31 cutoff date in the System's financial statements and they have not performed any retrospective look backs to determine that the values reported at March 31st were not materially different than the June 30th actual balances.

Alternative investments are defined as investments for which a readily determinable fair value does not exist. These are investments not listed on national exchanges or over-the-counter markets, or for which quoted market prices are not available from sources such as financial publications, the exchanges, or the National Association of Securities Dealers Automated Quotations System (NASDAQ). Alternative investments comprise approximately 10% of the System's total investments and include real estate and private equity as of June 30, 2008. Based on the organizational structure and limited staff of the System, they have traditionally relied on the due diligence and valuation procedures performed by external investment managers and the investment advisors. System management may look to the external investment managers and advisors for guidance, but management must have sufficient information to evaluate and independently challenge the information provided by the external investment managers and advisors.

In connection with the issuance of the Institute of Certified Public Accountants (AICPA) Practice Aid, *Alternative Investments – Audit Considerations*, management performed additional procedures and an evaluation of their alternative investment valuations. These procedures were a part of an ongoing comprehensive internal control process related to the valuation of alternative investments. However, there are certain areas within the alternative investments, for which management has limited available information on the underlying investments to provide for a timely valuation as of their financial statement date.

The AICPA Practice Aid states "Management is responsible for making the fair value measurements and disclosures included in the financial statements. As part of fulfilling its responsibility, management needs to establish an accounting and financial reporting process for determining the fair value measurements and disclosures, select appropriate valuation methods, identify and adequately support any significant assumptions used, prepare the valuation, and ensure that the presentation and disclosure of the fair value measurements are in accordance with

Current Findings – *Government Auditing Standards*

Finding No. 08-1 Valuation of Alternative Investments (Continued)

accounting principles generally accepted in the United States of America (GAAP). This responsibility cannot, under any circumstances, be outsourced or assigned to a party outside of the investor entity's management. Although the investor entity's management may look to the fund manager for the mechanics of the valuation, management must have sufficient information to evaluate and independently challenge the fund's valuation. Taking responsibility for the valuation of the alternative investments will necessitate that the management of the investor entity has a sufficient understanding of the nature of the underlying investments, the portfolio strategy of the alternative investments, and the method and significant assumptions used by the fund manager to value the underlying investments."

System officials stated that they have a process in place to monitor and evaluate all portfolio investments that utilizes evaluations performed by System management on an ongoing basis. However, when the AICPA Practice Aid was issued in July 2006, authoritative guidance was developed as to what evidence the System needed to produce to demonstrate that monitoring and due diligence are performed from an audit perspective.

Lack of establishing an adequate accounting and financial reporting process for alternative investments has resulted in the System improperly reporting the fair value of their alternative investments and could result in a material misstatement of the System's financial statements. (Finding Code No. 08-1)

Recommendation:

We recommend the System review its current process for determining the fair value measures and disclosures for alternative investments and develop written procedures related to the determination of fair value measurements, selecting appropriate valuation methods, identifying and adequately supporting assumptions used, and assignment of responsibilities. The System should also evaluate current staffing to determine whether appropriate resources exist and work with their external investment managers to obtain the necessary financial information on a timely basis.

The following are additional procedures provided in the AICPA Practice Aid that should be documented and performed by the System in order to better monitor and value their alternative investments:

- Management should update the alternative investment portfolio valuation from March 31 to include the June 30 valuation in the financial statements at the end of each fiscal year. The valuation should include both realized and unrealized gains or losses through the June 30 financial statement date.
- Management should perform a retrospective look back of all valuations to ensure any subsequent period data does not impact any recorded values.
- Management should perform a comparison of investment balances reported by their investment managers with the Master Trustee Custodian. Valuations should be reconciled to custodian reports and significant discrepancies investigated.
- Management should review annual audited financial statements for each of their alternative investments and reconcile amounts reported to their investment managers and their Master Trustee Custodian.

Current Findings – *Government Auditing Standards*

Finding No. 08-1 Valuation of Alternative Investments (Continued)

System Response:

SURS concurs with this finding. SURS will adjust the reporting and accounting schedules to allow the use of June valuation amounts for the alternative investments class. In addition, SURS will improve the documentation and review of valuation methods as well as the ongoing monitoring process of its investment managers.