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ILLINOIS STATE BOARD OF INVESTMENT
An Internal Investment Pool of the State of Illinois

Financial Statements

June 30, 2006 and 2005

(With Independent Auditors' Report Thereon)

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

Illinois State Board of Investment
An Internal Investment Pool of the State of Illinois

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FINANCIAL STATEMENT REPORT

SUMMARY

The audit of the accompanying financial statements of the Illinois State Board of Investment was performed by KPMG LLP.

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

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KPMG LLP
303 East Wacker Drive
Chicago, IL 60601-5212

Independent Auditors' Report

Honorable William G. Holland
Auditor General
State of Illinois

Board of Directors
Illinois State Board of Investment

As Special Assistant Auditors for the Auditor General, we have audited the accompanying statements of net assets of the Illinois State Board of Investment (Board), an internal investment pool of the State of Illinois, as of June 30, 2006 and 2005, and the related statements of changes in net assets for the years then ended. These financial statements are the responsibility of the Board's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits 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 consideration of internal control over financial reporting as a basis for designing audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Board's internal control over financial reporting. Accordingly, we express no such opinion. An audit also includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of the Illinois State Board of Investment as of June 30, 2006 and 2005, and the changes in its net assets for the years then ended, in conformity with U.S. generally accepted accounting principles.

In accordance with *Government Auditing Standards*, we have also issued our report dated February 2, 2007 on our consideration of the Board's internal control over financial reporting and on our tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements and other matters. The purpose of that report is to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing, and not to provide an opinion on the internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* and should be considered in assessing the results of our audit.

The accompanying management's discussion and analysis on pages 5 through 6 is not a required part of the basic financial statements but is supplementary information required by U.S. generally accepted accounting principles. 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.

KPMG LLP

Chicago, Illinois
February 2, 2007

KPMG LLP
303 East Wacker Drive
Chicago, IL 60601-5212

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

Board of Directors
Illinois State Board of Investment

As Special Assistant Auditors for the Auditor General, we have audited the basic financial statements of the Illinois State Board of Investment (the Board), an internal investment pool of the State of Illinois, as of and for the year ended June 30, 2006, and have issued our report thereon dated February 2, 2007. We conducted our audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States.

Internal Control over Financial Reporting

In planning and performing our audit, we considered the Board's internal control over financial reporting in order to determine our auditing procedures for the purpose of expressing our opinion on the financial statements and not to provide an opinion on the internal control over financial reporting. However, we noted certain matters involving the internal control over financial reporting and its operation that we consider to be a reportable condition. Reportable conditions involve matters coming to our attention relating to significant deficiencies in the design or operation of the internal control over financial reporting that, in our judgment, could adversely affect the Board's ability to initiate, record, process, and report financial data consistent with the assertions of management in the financial statements. The reportable condition is described in the following paragraph.

The Board does not have an adequate established accounting and financial reporting process for determining the fair value measurements and disclosures, selecting appropriate valuation methods, and identifying and adequately supporting significant assumptions used for its alternative investments. Alternative investments comprise over 20% of the Board's total investments and include real estate, private equity, and hedge funds. Based on the organizational structure and limited staff of the Board, they have traditionally relied on due diligence and valuation procedures performed by external investment managers and consultants. In connection with the issuance of recent guidance by the American Institute of Certified Public Accountants (AICPA) relating to auditing alternative investments and requests made from the auditors, management did perform extensive additional procedures and evaluation of investment valuations. However, theses procedures were performed primarily to address the current year audit requirements and were not part of an ongoing comprehensive internal control process related to the valuation of alternative investments. Additionally, there were certain areas, including hedge funds, with limited available information of the underlying investments.

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A material weakness is a reportable condition in which the design or operation of one or more of the internal control components does not reduce to a relatively low level the risk that misstatements caused by error or fraud in amounts that would be material in relation to the financial statements being audited may occur and not be detected within a timely period by employees in the normal course of performing their assigned functions. Our consideration of the internal control over financial reporting would not necessarily disclose all matters in the internal control that might be reportable conditions and, accordingly, would not necessarily disclose all reportable conditions that are also considered to be material weaknesses. However, we believe that the reportable condition described above is not a material weakness.

Compliance and Other Matters

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

We also noted certain other matters which we will report in a separate letter dated February 2, 2007.

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

KPMG LLP

Chicago, Illinois
February 2, 2007

The following Management Discussion and Analysis (MD&A) provides an introduction and overview of the Illinois State Board of Investment (ISBI or Board) financial activities for the fiscal years ended June 30, 2006 and 2005.

Financial Highlights
The net assets of the Board totaled approximately $11.3 billion at fiscal year ended June 30, 2006, compared to $10.9 billion at fiscal year ended June 30, 2005. The increase is a result of strong investment returns, but was tempered by member systems' withdrawals.

Overview of the Financial Statements
The Board's financial statements are prepared on an accrual basis in accordance with U.S. generally accepted accounting principles promulgated by the Governmental Accounting Standards Board and are comprised of the Statement of Net Assets, the Statement of Changes in Net Assets and Notes to Financial Statements.

The Statements of Net Assets presents information on the Board's assets and liabilities and the resulting net assets. This statement also reflects the Board's investments, at fair value, along with the cash and short-term investments, receivables and other assets and liabilities.

The increase in investments at June 30, 2006 is primarily a result of an investment gain of 11.0% for the fiscal year, net of expenses, offset by an increase in member systems' withdrawals, which are shown in the Statement of Changes in Net Assets. The gain reflects improvement in market environments, in particular real estate, private equity investments, international equity and fixed income. Distributions received from private equity and real estate partnerships resulted in an increase in the cash for fiscal year 2006. The increase in liabilities for fiscal 2006 compared with 2005 consisted mainly of security lending collateral obligations.

The increase in investments at June 30, 2005 was primarily a result of an investment gain of 10.1% for the fiscal year, net of expenses, offset by an increase in member systems' withdrawals, which are shown in the Statement of Changes in Net Assets. The gain reflected a significant improvement in market environments, in particular real estate, alternative investments and both the U.S. and international equity markets. Distributions received from private equity and real estate partnerships resulted in an increase in the cash for fiscal year 2005. The increase in liabilities for fiscal 2005 compared with 2004 consisted mainly of unsettled investment purchases.

The Statements of Changes in Net Assets presents information regarding changes during the fiscal years ended June 30, 2006, 2005 and 2004. This statement reflects additions, which include the investment income derived from realized and unrealized gains, member system contributions, and income received from securities lending activities. Also reflected in the statement are deductions, which include withdrawals from the member systems and operating expenses of the Board.

Condensed Summary of Net Assets

	June 30			2006/2005	2005/2004
	2006	2005	2004	Change	Change
	$	$	$	$	$
Cash	80,644,137	13,722,061	89,858	66,922,076	13,632,203
Receivables	184,529,093	294,208,301	188,503,767	(109,679,208)	105,704,534
Investments	11,434,818,360	10,959,676,010	10,663,805,594	475,142,350	295,870,416
Securities lending collateral	1,530,783,382	1,444,871,284	1,172,847,123	85,912,098	272,024,161
Capital assets	45,348	41,772	45,819	3,576	(4,047)
Prepaid expenses	18,984	0	0	18,984	0
Total assets	13,230,839,304	12,712,519,428	12,025,292,161	518,319,876	687,227,267
Liabilities	1,914,354,450	1,810,039,761	1,582,553,607	104,314,689	227,486,154
Total net assets	11,316,484,854	10,902,479,667	10,442,738,554	414,005,187	459,741,113

The net investment gains of the ISBI fund were the result of a positive movement in the securities markets. Member system withdrawals continued to increase. Fiscal year 2006 withdrawals were $759 million compared with $547.7 million in fiscal year 2005 and $420 million in fiscal year 2004. Withdrawals are determined by the member retirement systems based on the State's funding and the systems' benefit payment needs. Operating expenses increased in fiscal year 2006 over 2005 by $5.6 million, mainly due to the use of hedged fund of funds, with sizeable management fees, and the increased use of active managers, as opposed to passive managers, in fiscal year 2005.

The net investment gains of the ISBI fund in fiscal year 2005 were the result of a positive movement in the securities markets. There was a substantial increase in withdrawals by the member systems. Fiscal year 2005 withdrawals were $547.7 million compared with $420 million in fiscal year 2004. The increase in expenses for fiscal year 2005 versus 2004 was mainly a result of increased investment management fees due to additional assets under management as well as a change to active investment management from passive index funds.

The Notes to the Financial Statements provide additional information, which is necessary to fully understand the data, provided in the financial statements.

During fiscal year 2005, the Board continued to implement changes as a result of the asset allocation study. Asset allocation targets are reflected in Figure 1 of the Letter to Trustees. The structure changes resulting from this review began in fiscal year 2004 and continued during fiscal year 2005. As a result of these changes ISBI increased utilization of minority and female owned brokers, minority and female owned money managers and emerging managers. As of April 2006, ISBI had achieved a minimum goal of 5% of the total portfolio being managed by emerging minority managers.

Legislative Changes

On June 1, 2005, Public Act 94-0004 was enacted addressing the early retirement option, benefit changes and funding reductions. The legislation includes funding reductions of approximately $496.4 million and $429.4 million in fiscal years 2006 and 2007, respectively, for employer contributions to the State Employees', Judges' and General Assembly Retirement Systems. This resulted in an increase in member systems' withdrawals in fiscal year 2006 to meet their respective funding requirements for benefit obligations.

Condensed Summary of Changes in Net Assets

	Fiscal Years Ended June 30			2006/2005	2005/2004
	2006	2005	2004	Change	Change
	$	$	$	$	$
Additions:					
Net investment income	1,203,147,819	1,031,923,322	1,524,698,140	171,224,497	(492,774,818)
Member systems' contributions	0	0	1,554,924,744	0	(1,554,924,744)
Total additions	1,203,147,819	1,031,923,322	3,079,622,884	171,224,497	(2,047,699,562)
Deductions:					
Member systems' withdrawals	759,000,000	547,700,000	420,000,000	211,300,000	127,700,000
Administrative expenses	30,142,632	24,482,209	17,905,540	5,660,423	6,576,669
Total deductions	789,142,632	572,182,209	437,905,540	216,960,423	134,276,669
Net increase in net assets	414,005,187	459,741,113	2,641,717,344	(45,735,926)	(2,181,976,231)

STATEMENTS OF NET ASSETS

JUNE 30, 2006 AND 2005

	2006	2005
	$	$
ASSETS		
Cash	80,644,137	13,722,061
Receivables:		
Foreign taxes	775,140	863,925
Account receivables	757,957	690,481
Investments sold	146,174,012	257,790,471
Interest & dividends	36,821,984	34,863,424
Total receivables	184,529,093	294,208,301
Prepaid Expenses	18,984	0
Capital assets	45,348	41,772
Investments at fair value:		
Government and agency obligations	1,110,919,988	1,130,079,107
Foreign obligations	104,455,671	88,970,486
Corporate obligations	1,382,574,163	1,643,935,794
Convertible bonds	0	1,404,244
Common stock & equity funds	5,369,124,032	5,529,033,328
Preferred stock	1,057,334	1,593,391
Foreign equity securities	1,113,268,102	1,035,874,373
Hedge funds	416,462,183	0
Real estate investments	1,134,025,154	778,951,123
Private Equity	482,264,036	466,871,030
Money market instruments	320,641,552	283,461,008
Forward foreign currency contracts	26,145	(497,874)
Total investments	11,434,818,360	10,959,676,010
Securities lending collateral	1,530,783,382	1,444,871,284
Total assets	13,230,839,304	12,712,519,428
LIABILITIES		
Payables:		
Investments purchased	376,678,007	359,224,216
Operating expenses	6,893,061	5,944,261
Securities lending cash collateral obligation	1,530,783,382	1,444,871,284
Total liabilities	1,914,354,450	1,810,039,761
Net assets	11,316,484,854	10,902,479,667

See notes to financial statements, pages 9-19.

STATEMENTS OF CHANGES IN NET ASSETS

FISCAL YEARS ENDED JUNE 30, 2006 AND 2005

	2006	2005
	$	$
ADDITIONS		
Investment income		
Net increase in fair value of investments	892,599,986	766,090,763
Interest	183,047,403	142,444,438
Dividends	123,178,718	119,713,292
Securities lending income	64,090,764	27,969,384
Less securities lending rebates	(58,968,999)	(23,504,790)
Less securities lending expenses	(800,053)	(789,765)
Total net investment income	1,203,147,819	1,031,923,322
Member systems' contributions	0	0
Total additions	1,203,147,819	1,031,923,322
DEDUCTIONS		
Expenses:		
Salaries and benefits:		
Salaries	863,802	767,248
Benefits	309,578	315,097
Operating expenses:		
Rent and utilities	160,139	156,066
Audit	105,450	100,650
Other	147,616	118,101
External support:		
Custody	224,730	197,857
Consulting and professional	739,748	647,218
Investment advisors/managers	27,434,504	22,010,299
Investment services and research	157,065	169,673
Total expenses	30,142,632	24,482,209
Member systems' withdrawals	759,000,000	547,700,000
Total deductions	789,142,632	572,182,209
Increase in net assets	414,005,187	459,741,113
Net assets at beginning of year	10,902,479,667	10,442,738,554
Net assets at end of year	11,316,484,854	10,902,479,667

See notes to financial statements, pages 9-19.

Note A
Summary of Significant Accounting Policies

Reporting Entity
The Illinois State Board of Investment (ISBI or Board) is considered to be an internal investment pool of the State of Illinois, operating solely from investment income. The ISBI manages and invests the pension assets of three separate public employee retirement systems: General Assembly Retirement System, the Judges' Retirement System of Illinois, and State Employees' Retirement System of Illinois.

The assets of the member systems are accounted for in a single Commingled Fund. Separate information on each system's participation is presented in Note C.

Basis of Accounting
Accounting records are maintained on an accrual basis. Shares are allocated monthly to member systems based upon percentage of ownership. Management expenses are deducted monthly from income before distribution.

Valuation of Investments
Investments owned are reported at fair value as follows: (1) U.S. Government and Agency, Foreign and Corporate Obligations, Convertible Bonds – prices quoted by a major dealer in such securities; (2) Common Stock and Equity Funds, Convertible Preferred Stock, Preferred Stock, Foreign Equity Securities, Forward Foreign Currency Contracts and Options: (a) Listed – closing prices as reported on the composite summary of national securities exchanges; (b) Over-the-counter – bid prices; (3) Money Market Instruments – average cost which approximates fair values; (4) Real Estate Investments – fair values as determined by ISBI and it's investment managers; and (5) Alternative (Private Equity and Hedge Funds) Investments – fair values as determined by ISBI and it's investment managers.

Investment Transactions and Investment Income
Investment transactions are accounted for on a trade date (date order to buy or sell is executed) and dividend income is recognized on the ex-dividend date. Interest income is recognized on an accrual basis.

Custody and Investment Management Fees
Custody fees for the period July 1, 2004 through November 30, 2005 were computed quarterly with a base charge for all accounts. Subsequent to November 30, 2005, there were no base charges for custody fees.

Investment management fees for all accounts, except real estate and private equity, are computed quarterly as a percentage of each manager's portfolio market value. Management fees for real estate and alternative investments are not directly charged but are included in the investment income for these investments.

Risk Management
The ISBI, as part of the State, provides for risks of loss associated with workers' compensation and general liability through the State's self-insurance program. The ISBI obtains commercial insurance for fidelity and surety and property. There have been no commercial insurance claims in the past five years.

Risks and Uncertainties
ISBI invests in various investment securities. Investment securities are exposed to various risks such as interest rate, market, and credit risks. 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 that such changes could materially affect the amounts reported in the statement of net assets.

Use of Estimates
In preparing financial statements in conformity with U.S. generally accepted accounting principles, the Board makes estimates and assumptions that affect the reported amounts of assets and liabilities and disclosures of contingent assets and liabilities at the date of the financial statements, as well as the reported amounts of additions and deductions to net assets during the reporting period. Actual results could differ from those estimates and assumptions.

Reclassifications
Certain 2005 amounts have been reclassified to conform to the 2006 presentation. These reclassifications have not changed 2005 results.

Deposits

Custodial credit risk for deposits is the risk that, in the event of a financial institution failure, ISBI's deposits may not be returned. All non-investment related bank balances at year-end are insured or collateralized with securities held by the Illinois State Treasurer or agents in the name of the State Treasurer. Cash held in the investment related bank account is neither insured nor collateralized for amounts in excess of $100,000. There is no related deposit policy for custodial risk. These assets are under the custody of State Street Bank and Trust. State Street Bank and Trust has a AA long-term Deposit/Debt rating by Standards & Poor and a Aa2 rating by Moody. Certain investments of ISBI with maturities of 90 days or less would be considered cash equivalents; these consist of short-term investment funds and U.S. Treasury bills with maturities of 90 days or less. For financial statement presentation and investment purposes, ISBI reports its cash equivalents as Money Market Instruments in the Statements of Net Assets.

	2006	2005
Carrying amounts at June 30		
Cash	$80,644,137	$13,722,061
Bank balances at June 30		
Total	$80,724,748	$13,729,252
Amount exposed to custodial credit risk	$80,566,513	$13,501,974

Investment Policy

ISBI's investment authority and responsibilities are specified in the Illinois Compiled Statutes, 40ILCS 5/22A. These statutes provide ISBI with the authority to manage and invest the assets of any Illinois pension or education fund.

As described in Note A, ISBI currently manages and invests the assets of the General Assembly Retirement System, Judges' Retirement System, and State Employees' Retirement System. All investments undertaken by ISBI are governed by 40ILCS 5 adopted by the General Assembly in 1982, and other standards codified in the above reference to the statutes.

40ILCS 5/1-109 requires all members of the Board and other fiduciaries to "...discharge his or her duties with respect to the retirement system or pension fund solely in the interest of the participants and beneficiaries and: With the care, skill, prudence and diligence... By diversifying the investments of the retirement system or pension fund so as to minimize the risk of large losses..."

Investment Commitments

Real estate and private equity investment portfolios consist of passive interests in limited partnerships. ISBI had outstanding commitments to these limited partnerships of approximately $400 million and $524 million, as of June 30, 2006 and 2005, respectively. Also, at the end of fiscal year 2006, the Board had an outstanding commitment of $567 million to separate real estate accounts.

Note B (continued)
Deposits, Investments, and Investment Risk Disclosures

Investment Summary
The following table presents a summary of the Fund's investments at fair value by type at June 30, 2006 and 2005:

	2006	2005
	$	$
Government and agency obligations	1,110,919,988	1,130,079,107
Foreign obligations	104,455,671	88,970,486
Corporate obligations	1,382,574,163	1,643,935,794
Convertible bonds	0	1,404,244
Common stock & equity funds	5,369,124,032	5,529,033,328
Preferred stock	1,057,334	1,593,391
Foreign equity securities	1,113,268,102	1,035,874,373
Hedge Funds	416,462,183	0
Real estate investments	1,134,025,154	778,951,123
Private Equity	482,264,036	466,871,030
Money market instruments	320,641,552	283,461,008
Forward foreign currency contracts	26,145	(497,874)
Total investments	11,434,818,360	10,959,676,010

Custodial Credit Risk for Investments
The custodial credit risk for investments is the risk that, in the event of the failure of the counterparty to a transaction, ISBI will not be able to recover the value of investments or collateral securities that are in the possession of an outside party. As of June 30, 2006 and 2005, the following investments were uninsured and unregistered, with securities held by the counterparty or by its trust department or agent but not in the Board's name:

	2006	2005
	$	$
Common stock	7,540,275	2,283,261
Government and agency obligations	43,932,397	16,885,000
Corporate obligations	4,649,641	4,725,000
Total	56,122,313	23,893,261

Concentration of Credit Risk and Credit Risk for Investments
The portfolio is managed by professional investment management firms. These investment management firms are required to maintain diversified portfolios. Each investment manager must comply with risk management guidelines individually assigned to them as part of their investment management agreement. The Board did not have any single issuer investment that exceeded 5% of the total net assets of the fund as of June 30, 2006 and 2005. The following table presents the quality ratings of debt securities held by ISBI as of June 30, 2006 and 2005:

	Moody's Quality Rating	2006 $	2005 $
Government and agency obligations			
U.S. Government obligations	AAA	457,091,471	556,169,172
Federal agency obligations	AAA	651,140,066	570,050,982
Municipal	AAA	2,688,451	3,858,953
Total Government and agency obligations		1,110,919,988	1,130,079,107
Foreign obligations	AAA	16,124,526	15,399,251
	AA	4,040,041	3,307,170
	A	16,276,367	3,845,152
	BAA	27,419,722	18,565,417
	BA	12,024,660	9,027,386
	B	19,290,811	4,172,675
	CAA	1,274,200	0
	Not rated	8,005,344	34,653,435
Total foreign obligations		104,455,671	88,970,486
Corporate obligations	AAA	324,130,117	196,072,210
	AA	144,481,958	137,477,375
	A	148,904,618	165,820,135
	BAA	115,363,940	165,909,475
	BA	238,778,065	161,802,497
	B	274,358,266	269,923,855
	CAA	14,129,168	6,874,324
	CA	682,031	660,671
	C	461,236	0
	Not rated	121,284,764	539,395,252
Total corporate obligations		1,382,574,163	1,643,935,794
Convertible bonds	AAA	0	1,111,744
	BAA	0	292,500
Total convertible bonds		0	1,404,244

Note B (continued)
Deposits, Investments, and Investment Risk Disclosures

Interest Rate Risk
ISBI manages its exposure to fair value losses arising from interest rate risk by diversifying the debt securities portfolio and maintaining the debt securities portfolio to an effective weighted average rate between 80 and 120 percent of the benchmark index.

Duration is a measure of a debt investment's exposure to fair value changes arising from changing interest rates. It uses the present value of cash flows, weighted for those cash flows as a percentage of the investment's full price. The effective duration measures the sensitivity of market price to parallel shifts in the yield curve. ISBI benchmarks its debt security portfolio to Lehman Brothers Aggregate. At June 30, 2006 the effective duration of the Lehman Brothers Aggregate was 3.6 years. At the same point in time, the effective duration of the ISBI debt security portfolio was 3.8 years. The effective duration of the ISBI portfolio at June 30, 2005 was 3.9 years.

	2006		2005	
	Fair Value	Effective Weighted Duration Years	Fair Value	Effective Weighted Duration Years
Investment Type	$		$	
Government & agency obligations				
U.S. Government	457,091,471	4.4	556,169,172	4.5
Federal Agency	651,140,066	3.3	570,050,982	2.8
Municipal	2,688,451	4.8	3,858,953	3.5
Foreign Obligations	104,455,671	5.1	88,970,486	6.1
Corporate Obligations				
Bank and Finance	306,124,824	3.4	309,725,184	2.5
Collateralized Mortgage Obligations	211,686,803	2.13	97,392,369	3.0
Industrials	580,581,651	4.7	655,888,086	4.8
Commingled	40,713,286	NA	341,540,499	NA
Other	243,467,599	5.5	239,389,656	3.97
Convertible Bonds	0	N/A	1,404,244	N/A
	2,597,949,822		2,864,389,631	

Foreign Currency Risk
The international portfolio is constructed on the principles of diversification, quality growth and value. Risk of loss arises from changes in currency exchange rates. International managers may also engage in transactions to hedge currency at their discretion. The following table presents the foreign currency risk by type of investment as of June 30, 2006 and 2005:

	2006		2005	
	Foreign Equity Securities	Foreign Obligations	Foreign Equity Securities	Foreign Obligations
	$	$	$	$
Australian Dollar	45,031,863	0	47,593,913	0
Canadian Dollar	27,309,690	0	32,554,284	0
Danish Krone	11,811,080	0	11,599,786	0
English Pound Sterling	208,671,160	0	202,953,950	0
Euro Currency	298,835,278	2,773,684	281,227,718	4,417,066
Hong Kong Dollar	48,639,162	0	44,843,103	0
Japanese Yen	272,057,458	0	228,925,686	4,569,663
Mexican Peso	0	147,648	0	2,573,969
New Zealand Dollar	767,645	2,205,864	519,315	2,741,363
Norwegian Krone	9,864,745	0	5,641,688	0
Singapore Dollar	9,200,224	0	9,859,570	0
South Korean Won	22,537,972	0	21,372,559	0
Swedish Krona	29,340,607	0	29,822,230	0
Swiss Franc	54,417,316	0	52,437,404	0
Foreign investments denominated in U.S. dollars	74,783,902	99,328,475	66,523,167	74,668,425
Total	1,113,268,102	104,455,671	1,035,874,373	88,970,486

Note B (continued)
Deposits, Investments, and Investment Risk Disclosures

Securities Lending
ISBI participates in a securities lending program with State Street who acts as securities lending agent. Securities are loaned to brokers and, in return, the Board has rights to a portion of a collateral pool. All of the securities are eligible for the securities lending program. Collateral consists solely of cash, letters of credit, commercial paper and government securities having a fair value equal to or exceeding 102% of the value of the loaned securities (105% for non-U.S. securities). In the event of borrower default, State Street provides ISBI with counterparty default indemnification. ISBI had no credit risk as a result of its securities lending program as the collateral held exceeded the fair value of the securities lent. As of June 30, 2006 and 2005, there were outstanding loaned investment securities having fair values of $1,568,683,721 and $1,442,715,435 respectively; against which collateral was received with a fair value of $1,597,656,445 and $1,476,263,962 respectively. Collateral received at June 30, 2006 and 2005 consisted of $1,530,783,382 and $1,444,871,284, respectively, in cash and $66,873,063 and $31,392,678, respectively, in securities for which the ISBI does not have the ability to pledge or sell.

Derivative Securities
Some of the ISBI managers invest in derivative securities. A derivative security is an investment whose payoff depends upon the value of other assets such as bond and stock prices, a market index, or commodity prices. ISBI's investments in derivatives are not leveraged. Obligations to purchase (long a financial future or a call option) are held in cash or cash equivalents. In the case of obligations to sell (short a financial future or a put option), the reference security is held in the portfolio. Derivatives 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. The Board and senior management approve these limits, and the risk positions of the investment managers are reviewed on a regular basis to monitor compliance with the limits.

During the year, derivative investments included forward foreign currency contracts, collateralized mortgage obligations (CMO's), futures and options. The remaining derivative securities are used to improve the yields or to hedge changes in interest rates.

Forward foreign currency contracts are used to hedge against the currency risk in ISBI's foreign stock and fixed income portfolios. Forward foreign currency contracts are agreements to buy or sell specific amounts of a foreign currency at a specified delivery or maturity date for an agreed upon price. As the fair value of the forward contracts varies, the Board records an unrealized gain or loss. Forward foreign currency contracts represent an off-balance sheet obligation, as there are no balance sheet assets or liabilities associated with those contracts. The fair value of forward foreign currency contracts outstanding at June 30, 2006and 2005, was as follows:

	Cost $	Fair Value $	Gain/Loss $
June 30, 2006			
Forward currency purchases	3,956,106	4,008,201	52,095
Forward currency sales	7,860,622	7,886,572	(25,950)
Total gain (loss)			26,145
June 30, 2005			
Forward currency purchases	41,391,551	40,355,914	(1,035,637)
Forward currency sales	47,581,929	47,044,166	537,763
Total gain (loss)			(497,874)

ISBI also invests in mortgage-backed securities to maximize yields and to hedge against a rise in interest rates. These securities are based on cash flows from principal and interest payments on underlying mortgages. Therefore, they are sensitive to prepayments by mortgagees, which may result from a decline in interest rates. As of June 30, 2006 and 2005, the fair value of the Board's CMO holdings totaled $211,686,803 and $97,392,369, respectively.

ISBI investment managers utilize financial futures to replicate an underlying security they desire to hold (sell) in the portfolio. In certain instances, it may be beneficial to own a futures contract rather than the underlying security (arbitrage). Financial future contracts are also used to improve the yield or adjust the duration of the portfolio. Financial futures contracts are agreements to buy or sell a specified amount at a specified delivery or maturity date for an agreed upon price. The fair values of the futures contracts vary from the original contract price, a gain or loss is recognized and paid to or received from the clearinghouse. Financial futures represent an off-balance sheet obligation, as there are no balance sheet assets or liabilities associated with those contracts. The cash or securities to meet these obligations are held in the investment portfolio.

The Board's investment managers utilize options in an effort to add value to the portfolio (collect premiums) or protect (hedge) a position in the portfolio. Options are agreements that give one party the right, but not the obligation, to buy or sell a specific amount of an asset for a specific price (called the strike price) on or before a specified expiration date. As the writer of financial options, ISBI receives a premium at the outset of the agreement and bears the risk of an unfavorable change in the price of the instrument underlying the option. As the purchaser, ISBI 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.

The following table shows the futures and options positions held by ISBI as of June 30, 2006 and 2005:

	2006		2005	
	Number of Contracts	Contract Principal* $	Number of Contracts	Contract Principal* $
Equity futures purchased	2,667	190,210,548	847	141,009,225
Fixed income futures purchased	1,605	269,684,894	689	131,827,288
Fixed income futures sold	355	37,149,313	630	74,051,321
Fixed income written put options	71	7,100,000	158	15,800,000
Fixed income written call options	320	122,900,000	18,150,179	36,050,000
Eurocurrency purchased call options	23,550,000	23,550,000	0	0
Fixed income purchased call options	58	58,000,000	278	138,500,000
Fixed income purchased put options	0	0	131	77,000,000

* Contract principal amounts shown represent the fair value of the underlying assets the contracts control. These are shown to present the volume of the transactions but do not reflect the extent to which positions may offset one another. These amounts do not represent the much smaller amounts potentially subject to risk. Contract principal values also do not represent recorded values.

Note C *Member Systems' Participation*	General Assembly	Judges'	State Employees'	Combined*
Member Systems' Income and Expenses Fiscal Year Ended June 30, 2006	$	$	$	$
Interest and dividends	2,137,981	15,763,229	288,324,911	306,226,121
Net securities lending income	30,173	222,464	4,069,075	4,321,712
Net increase in fair value of investments	5,786,233	46,320,241	840,493,512	892,599,986
Management expenses	(210,447)	(1,551,615)	(28,380,570)	(30,142,632)
Net investment income	7,743,940	60,754,319	1,104,506,928	1,173,005,187
Member Systems' Changes in Net Assets Fiscal Year Ended June 30, 2006				
Net assets at beginning of year	80,772,801	550,350,071	10,271,356,795	10,902,479,667
Member systems' net (withdrawals)	(9,500,000)	(28,500,000)	(721,000,000)	(759,000,000)
Net investment income	7,743,940	60,754,319	1,104,506,928	1,173,005,187
Net assets at end of year	79,016,741	582,604,390	10,654,863,723	11,316,484,854

The source of net assets of the member systems since inception at June 30, 2006, is as follows:

Member systems' net (withdrawals)	(30,159,495)	(17,932,730)	(234,086,756)	(282,178,981)
Accumulated net investment income	109,176,236	600,537,120	10,888,950,479	11,598,663,835
Net assets at fair value	79,016,741	582,604,390	10,654,863,723	11,316,484,854

****Combined column for the member systems is presented for information purposes only and does not indicate that the assets of one system may be used for another system.***

Note C *Member Systems' Participation*	General Assembly	Judges'	State Employees'	Combined*
Member Systems' Income and Expenses Fiscal Year Ended June 30, 2005	$	$	$	$
Interest and dividends	1,972,498	13,156,830	247,028,402	262,157,730
Net securities lending income	27,650	184,428	3,462,751	3,674,829
Net increase in fair value of investments	5,768,602	38,466,043	721,856,118	766,090,763
Management expenses	(183,631)	(1,230,222)	(23,068,356)	(24,482,209)
Net investment income	7,585,119	50,577,079	949,278,915	1,007,441,113
Member Systems' Changes in Net Assets Fiscal Year Ended June 30, 2005				
Net assets at beginning of year	81,287,682	521,372,992	9,840,077,880	10,442,738,554
Member systems' net (withdrawals)	(8,100,000)	(21,600,000)	(518,000,000)	(547,700,000)
Net investment income	7,585,119	50,577,079	949,278,915	1,007,441,113
Net assets at end of year	80,772,801	550,350,071	10,271,356,795	10,902,479,667

The source of net assets of the member systems since inception at June 30, 2005, is as follows:

Member systems' net contributions (withdrawals)	(20,659,495)	10,567,270	486,913,244	476,821,019
Accumulated net investment income	101,432,296	539,782,801	9,784,443,551	10,425,658,648
Net assets at fair value	80,772,801	550,350,071	10,271,356,795	10,902,479,667

** Combined column for the member systems is presented for information purposes only and does not indicate that the assets of one system may be used for another system.*

Note D
Pensions

Plan Description
All of the ISBI employees participate in the State Employees' Retirement System (SERS), which is a pension trust fund in the State of Illinois reporting entity. The SERS is a single-employer, defined-benefit, public employee retirement system (PERS) in which State employees participate, except those covered by the State Universities, Teachers', General Assembly, and Judges' Retirement Systems. The financial position and results of operations of the SERS for fiscal years 2006 and 2005 are included in the State of Illinois' Comprehensive Annual Financial Report (CAFR). The SERS also issues a separate CAFR that may be obtained by writing to the SERS, 2101 Veterans Parkway, Springfield, IL 62794-9255 or by calling 217/785-7202. The State of Illinois CAFR may be obtained by writing to the State Comptroller's Office, Financial Reporting Department, 325 West Adams Street, Springfield, IL 62704-1858 or by calling 217/782-2053.

A summary of SERS' 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 SERS' CAFR. Also included is a discussion of employer and employee obligations to contribute, and the authority under which those obligations are established.

Funding Policy
ISBI pays employer retirement contributions based upon an actuarially determined percentage of payroll. For fiscal years 2006 and 2005 the employer contribution rates were 7.792% and 16.107% respectively. Effective for pay periods beginning after December 31, 1991, the State opted to pay the employee portion of retirement for most State agencies with employees covered by the State Employees' and Teachers' Retirement Systems. Generally, this "pickup" of employee retirement was part of the budget process and was, in part, a substitute for salary increases. The pickup is subject to sufficient annual appropriations and those employees covered may vary across employee groups and State agencies. Currently, State officers, judges, general assembly members, and State university employees are not eligible for the employee pickup.

Post-retirement Benefits
In addition to providing pension benefits, the State provides certain health, dental and life insurance benefits to annuitants who are former State employees. This includes annuitants of the ISBI. Substantially all State employees may become eligible for post-employment benefits if they eventually become annuitants. Health and dental benefits include basic benefits for annuitants under the State's self-insurance plan and insurance contracts currently in force. Life insurance benefits are limited to five thousand dollars per annuitant age 60 and older.

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