State Employees' Retirement System of the State of Illinois

Auditors' Report and Financial Audit

For the Year Ended June 30, 2009
Performed as Special Assistant Auditors for
the Auditor General, State of Illinois

BKD LLP
CPAs & Advisors

State Employees' Retirement System
of the State of Illinois
Financial Audit
For the Year Ended June 30, 2009

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Summary

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

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

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Independent Auditors' Report

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

As Special Assistant Auditors for the Auditor General, we have audited the accompanying statement of plan net assets of the State Employees' Retirement System of the State of Illinois (System), as of June 30, 2009 and 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. We did not audit the 2009 and 2008 financial statements of the Illinois State Board of Investment, an internal investment pool of the State of Illinois, which statements represent 97 percent, 97 percent, and 186 percent, respectively in 2009, and 97 percent, 97 percent, and (442) percent, respectively, in 2008 of total assets, net assets held in trust for pension benefits, and total additions of the System. Those financial statements were audited by other auditors whose report thereon has been furnished to us, and our opinion, insofar as it relates to the amounts included for the Illinois State Board of Investment is based on the report of the other auditors.

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 audits provide 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 System as of June 30, 2009 and 2008, and the changes in its plan net assets for the year then ended in conformity with accounting principles generally accepted in the United States of America.

In accordance with *Government Auditing Standards*, we have also issued our report dated February 2, 2010 on our consideration of the System's internal control over financial reporting and on our tests of its compliance with certain provisions of laws, regulations, contracts, 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 and schedules of funding progress and employer contributions and accompanying notes as listed in the table of contents 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 financial statements that comprise the System's basic financial statements. The supplementary financial information as noted in the table of contents is presented for purposes of additional analysis and is not a required part of the basic financial statements. The supplementary financial information has been subjected to the auditing procedures applied in the audit of the basic financial statements and, in our opinion, is fairly stated, in all material respects, in relation to the basic financial statements as of and for the years ended June 30, 2009 and 2008, taken as a whole.

BKD, LLP

February 2, 2010

This financial report is designed to provide a general overview of the State Employees' Retirement System's finances for all those with an interest in the System's finances.

This section presents management's discussion and analysis of the financial position and performance of the State Employees' Retirement Systems of Illinois (System) for the years ended June 30, 2009 and 2008. It is presented as a narrative overview and analysis.

The System is a defined benefit, single-employer public employee retirement system. It provides services to nearly 66,000 active state employees and over 57,000 benefit recipients. Throughout this discussion and analysis units of measure (i.e. billions, millions, thousands) are approximate, being rounded up or down to the nearest tenth of the respective unit value.

OVERVIEW OF THE FINANCIAL STATEMENTS

This discussion and analysis is intended to serve as an introduction to the System's financial reporting which is comprised of the following components:

1. Basic Financial Statements. For the fiscal years ended June 30, 2009 and 2008, basic financial statements are presented for the System. This information presents the net assets held in trust for pension benefits for the System as of June 30, 2009 and 2008. This financial information also summarizes the changes in net assets held in trust for pension benefits for the years then ended.

2. Notes to the Financial Statements. The notes to the Financial Statements provide additional information that is essential to achieve a full understanding of the data provided in the basic financial statements.

3. Required Supplementary Information. The required supplementary information consists of two schedules and related notes concerning actuarial information, funded status and required contributions for the System.

4. Other Supplementary Schedules. Other schedules include more detailed information pertaining to the System, including schedules of revenues by source, cash receipts and disbursements, and payments to consultants.

FINANCIAL HIGHLIGHTS

- The Systems' net assets decreased by $2,517.5 million and decreased by $1,083.5 million during fiscal years 2009 and 2008, respectively. The changes were primarily due to decreases of $2,453.2 million and $1,156.1 million in the System's investments, at fair value, for fiscal years 2009 and 2008, respectively.
- The System was actuarially funded at 43.5% as of June 30, 2009, compared to 46.1% as of June 30, 2008. For fiscal year 2008, the actuarial value of assets was equal to the fair value of assets. For fiscal year 2009, the actuarial value of assets was equal to the fair value of assets adjusted for any actuarial gains or losses from investment return incurred in the fiscal year recognized in equal amounts over the five year period following that fiscal year.
- The overall rate of return for the Illinois State Board of Investment (ISBI) Commingled Fund was (20.1)% for fiscal year 2009 compared to (6.2)% for fiscal year 2008.

PLAN NET ASSETS

The condensed Statements of Plan Net Assets reflect the resources available to pay benefits to members, including retirees and beneficiaries, at the end of the years reported. A summary of the System's Plan Net Assets is presented below.

Condensed Statements of Plan Net Assets
(in millions)

	As of June 30			Increase/(Decrease) from	
	2009	2008	2007	2008 to 2009	2007 to 2008
Cash	$ 232.7	$ 306.5	$ 249.9	$ (73.8)	$ 56.6
Receivables	57.4	48.5	30.9	8.9	17.6
Investments, at fair value	8,200.8	10,654.0	11,810.1	(2,453.2)	(1,156.1)
Property & equipment, net	2.6	2.7	2.7	(0.1)	-
Total assets	8,493.5	11,011.7	12,093.6	(2,518.2)	(1,081.9)
Liabilities	15.6	16.3	14.7	0.7	(1.6)
Total plan net assets	$ 8,477.9	$ 10,995.4	$ 12,078.9	$ (2,517.5)	$ (1,083.5)

ADDITIONS TO PLAN NET ASSETS

Additions to Plan Net Assets include employer and participant contributions and net income from investment activities. Participant contributions were approximately $242.2 million and $250.0 million for the years ended June 30, 2009 and 2008, respectively. Participant contribution rates are set by statute as a percentage of gross salary. Employer contributions increased to approximately $774.9 million in 2009 from approximately $587.7 million in 2008. This increase was the result of the State's funding plan.

DEDUCTIONS FROM PLAN NET ASSETS

Deductions from Plan Net Assets are primarily benefit payments. During 2009 and 2008, the System paid out approximately $1,315.1 million and $1,230.9 million, respectively, in benefits and refunds, an increase of approximately 6.8%. These higher payments were mainly due to a scheduled 3% increase in retirement and other benefit payments. The administrative costs of the System represented approximately 1% of total deductions in both 2009 and 2008.

FUNDED RATIO

The funded ratio of the plan measures the ratio of the actuarial value of assets against actuarially determined liabilities and is one indicator of the fiscal strength of a pension fund's ability to meet obligations to its members. An annual actuarial valuation is required by statute. The most recent available valuation showed the funded status of the System on June 30, 2009 decreased to 43.5% from 46.1% at June 30, 2008. The major reason for the decline was a significant decrease in investment revenues during Fiscal Year 2009. The amount by which actuarially determined liabilities exceeded the actuarial value of assets was $14.3 billion at June 30, 2009 compared to $12.8 billion at June 30, 2008.

The June 30, 2009 unfunded liability and funded ratio are based on a smoothed value of assets while the June 30, 2008 amounts are based on market value. Public Act 96-0043 requires the five state retirement systems to begin smoothing actuarial gains and losses on investments over a five-year period, beginning with the valuation for the year ended June 30, 2009. Without this change, the June 30, 2009 funded ratio would have been reported as 33.5 percent.

INVESTMENTS

Investments of the System are combined in a commingled investment pool with the Judges' Retirement System and the General Assembly Retirement System. Each system owns an equity position in the pool and receives proportionate investment income from the pool in accordance with respective ownership percentage. Investment gains or losses are reported in the Statement of Changes in Net Assets of each retirement system.

The net investment loss for the System totaled approximately $2,208.9 million during fiscal year 2009, versus a net investment loss of $680.8 million during fiscal year 2008, resulting in negative returns of 20.1% and 6.2%, respectively. For the three, five, and ten year period ended June 30, 2009, the ISBI Commingled Fund earned a compounded rate of return of (4.3)%, 1.4%, and 1.9%, respectively.

The ISBI 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 the ISBI's investment portfolio 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 the ISBI's 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.

Questions concerning any of the information provided in this report or requests for additional financial information should be addressed to the State Employees' Retirement System of Illinois, Accounting Division, 2101 S. Veterans Parkway, P. O. Box 19255, Springfield, Illinois 62794

CHANGES IN PLAN NET ASSETS

The condensed Statements of Changes in Plan Net Assets reflect the changes in the resources available to pay benefits to members, including retirees and beneficiaries.

Condensed Statements of Changes in Plan Net Assets
(In millions)

	For the Year Ended June 30,			Increase/(Decrease) from	
	2009	2008	2007	2008 to 2009	2007 to 2008
Additions					
Participant contributions	$ 242.2	$ 250.0	$ 224.7	$ (7.8)	$ 25.3
Employer contributions	774.9	587.7	358.8	187.2	228.9
Investment income/(loss)	(2,208.9)	(680.8)	1,779.9	(1,528.1)	(2,460.7)
Total additions/(deductions)	(1,191.8)	156.9	2,363.4	(1,348.7)	(2,206.5)
Deductions					
Benefits	1,300.2	1,214.1	1,161.3	86.1	52.8
Refunds	14.8	16.8	14.3	(2.0)	2.5
Administrative expenses	10.7	9.5	8.8	1.2	.7
Total deductions	1,325.7	1,240.4	1,184.4	85.3	56.0
Net increase/(decrease) in plan net assets	$ (2,517.5)	$(1,083.5)	$1,179.0	$(1,434.0)	$ (2,262.5)

STATE EMPLOYEES' RETIREMENT SYSTEM OF ILLINOIS

Statements of Plan Net Assets

June 30, 2009 and 2008

	2009	2008
Assets		
Cash	$ 232,679,069	$ 306,528,043
Receivables:		
Contributions:		
Participants	16,280,628	16,249,569
Employing state agencies	35,390,539	26,290,400
Other accounts	5,764,303	5,921,504
Total Receivables	57,435,470	48,461,473
Investments - held in the Illinois State Board of Investment Commingled Fund at fair value	8,200,755,918	10,653,973,521
Property and equipment, net of accumulated depreciation	2,574,759	2,720,676
Total Assets	8,493,445,216	11,011,683,713
Liabilities		
Benefits payable	3,852,764	3,896,411
Refunds payable	109,360	351,515
Administrative expenses payable	1,429,929	1,439,220
Participants' deferred service credit accounts	173,233	253,711
Due to the State of Illinois	10,027,842	10,376,371
Total Liabilities	15,593,128	16,317,228
Net assets held in trust for pension benefits	$ 8,477,852,088	$ 10,995,366,485

(A schedule of funding progress is presented on page 20.)

See accompanying notes to financial statements.

STATE EMPLOYEES' RETIREMENT SYSTEM OF ILLINOIS

Statements of Changes in Plan Net Assets
Years Ended June 30, 2009 and 2008

	2009	2008
Additions:		
Contributions:		
Participants	$ 242,227,432	$ 249,955,208
Employing State agencies and appropriations	774,910,344	587,732,407
Total Contributions	1,017,137,776	837,687,615
Investment income:		
Net investment income	224,823,314	274,524,210
Interest earned on cash balances	7,319,968	13,404,255
Net depreciation in fair value of investments	(2,441,040,917)	(968,688,184)
Total investment loss	(2,208,897,635)	(680,759,719)
Total Additions (Deductions)	(1,191,759,859)	156,927,896
Deductions:		
Benefits:		
Retirement annuities	1,164,454,557	1,089,743,632
Survivors' annuities	73,697,450	68,770,552
Disability benefits	46,513,406	43,086,065
Lump-sum benefits	15,548,262	12,515,378
Total Benefits	1,300,213,675	1,214,115,627
Refunds (including transfers to reciprocating systems)	14,859,487	16,817,433
Administrative	10,681,376	9,537,305
Total Deductions	1,325,754,538	1,240,470,365
Net Decrease	(2,517,514,397)	(1,083,542,469)
Net assets held in trust for pension benefits:		
Beginning of year	10,995,366,485	12,078,908,954
End of year	$ 8,477,852,088	$ 10,995,366,485

See accompanying notes to financial statements.

STATE EMPLOYEES' RETIREMENT SYSTEM OF ILLINOIS

Notes to Financial Statements June 30, 2009 and 2008

1. Reporting Entity

Generally accepted accounting principles require that the financial reporting entity include: 1) the primary government; 2) organizations for which the primary government is financially accountable; and 3) other organizations for which the nature and significance of their relationship with the primary government are such that exclusion would cause the reporting entity's financial statement to be misleading or incomplete.

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

Based on the criteria of the Governmental Accounting Standards Board Statement No. 14, there are no other state agencies, boards or commissions, or other organizations required to be combined with the System. However, the System is considered to be part of the State of Illinois financial reporting entity, and is to be combined and included in the State of Illinois' comprehensive annual financial report.

At June 30, 2009 and 2008, the number of participating state agencies, boards and commissions totaled:

	2009	2008
State agencies	39	38
State boards and commissions	43	41
TOTAL	82	79

At June 30, 2009 and 2008, SERS membership consisted of:

	2009	2008
Retirees and beneficiaries currently receiving benefits:		
Retirement annuities	44,566	43,781
Survivors' annuities	10,236	10,104
Disability benefits	2,297	2,226
TOTAL	57,099	56,111
Inactive employees entitled to benefits, but not yet receiving them	4,672	4,702
TOTAL	61,771	60,813
Current Employees:		
Vested: Coordinated with Social Security	46,159	45,176
Noncoordinated	2,052	2,099
Nonvested: Coordinated with Social Security	16,606	18,242
Noncoordinated	782	720
TOTAL	65,599	66,237

Operation of the System and the direction of its policies are the responsibility of the Board of Trustees of the System.

Pursuant to federal tax laws and regulations governing the administration of public employee pension plans, the System has established a separate fund for the sole purpose of disbursing benefits in accordance with Section 415 of the Internal Revenue Code. For fiscal years 2009 and 2008, receipts were approximately $63,400 and $41,200, respectively. For fiscal years 2009 and 2008 disbursements were approximately $45,400 and $48,800, respectively.

Due to the immaterial nature of the separate fund, these receipts and disbursements have been included in the financial statements of the System.

2. Plan Description

The System is the administrator of a single-employer, defined benefit public employee retirement system (PERS) established and administered by the State of Illinois to provide pension benefits for its employees.

a. Eligibility and Membership
Membership is automatic for most state employees who are not eligible for another state-sponsored retirement plan.

Generally, anyone entering state service, except those in positions subject to membership in certain other state sponsored retirement systems, persons employed after June 30, 1979 as public service employment program participants under the Federal CETA program, and other exceptions as indicated in state law, become members of the System upon completion of six months of service.

Employees appointed by the Governor and requiring confirmation by the State of Illinois Senate may elect to become members of the System.

b. Contributions
Participating members contribute specified percentages of their salaries for retirement annuities and survivors' annuities in accordance with Chapter 40, Section 5/14-133 of the Illinois Compiled Statutes (ILCS).

Contributions are excluded from gross income for Federal and State income tax purposes. The total contribution rate is 4% if the member is covered by Social Security and 8% if the member is not covered. Certain employment categories which are eligible for benefits under alternative formulas contribute at the rate of 8 1/2% or 12 1/2 % depending upon whether or not the employee is covered by Social Security. Participants' contributions are fully refundable, without interest, upon withdrawal from state employment.

The State of Illinois is obligated to make payment for the required departmental employer contributions, all allowances, annuities, any benefits granted under Chapter 40, Article 5/14 of the ILCS and all administrative expenses of the System to the extent specified in the ILCS. State law provides that the employer contribution rate be determined based upon the results of each annual actuarial valuation.

c. Benefits
The System is governed by Chapter 40, Article 5/14 of the ILCS. Vesting and benefit provisions of the System are defined in the ILCS. Employees who retire at or after age 60 with 8 years of credited service, at age 55 with at least 25 years of credited service with reduced benefits, or when an employee's age and service equal 85 years, are entitled to an annual retirement benefit, payable monthly for life, in an amount based upon final average compensation and credited service.

The retirement annuity is based on the member's final average compensation and the number of years of service credit that have been established. The retirement benefit formula available to general state employees is 1.67% for each year of covered service and 2.2% for each year of noncovered service. Alternative formula employees have a formula of 2.5% for covered service and 3.0% for noncovered service.

The maximum retirement annuity payable is 75% of final average compensation for regular employees and 80% for alternative formula employees. The minimum retirement annuity payable is $15.00 for each year of covered employment and $25.00 for each year of noncovered employment.

Occupational and nonoccupational (including temporary) disability benefits are available through the System. To be eligible for nonoccupational (including temporary) disability benefits, an employee must have at least eighteen months of credited service with the System.

The nonoccupational (including temporary) disability benefit is equal to 50% of the monthly rate of compensation of the employee on the date of removal from the payroll. Occupational disability benefits are provided when the member becomes disabled as a direct result of injuries or diseases arising out of and in the course of state employment. The monthly benefit is equal to 75% of the monthly rate of compensation on the date of removal from the payroll. This benefit amount is reduced by Workers' Compensation or payments under the Occupational Diseases Act.

Occupational and nonoccupational death benefits are also available through the System. Certain nonoccupational death benefits vest after eighteen months of credited service. Occupational death benefits are provided from the date of employment.

3. Summary of Significant Accounting Policies & Plan Asset Matters

a. Basis of Accounting
The financial transactions of the System are maintained and these financial statements have been prepared using the accrual basis of accounting in conformity with generally accepted accounting principles. Employee and employer contributions are recognized as revenues when due pursuant to statutory requirements.

Benefits and refunds are recognized as expenses when due and payable in accordance with the terms of the plan.

b. Cash
The System retains all of its available cash in a commingled investment pool managed by the Treasurer of the State of Illinois (Treasurer). All deposits are fully collateralized by the Treasurer.

"Available cash" is determined to be that amount which is required for the current operating expenditures of the System. The excess of available cash is transferred to the Illinois State Board of Investment (ISBI) for purposes of long-term investment for the System.

c. New Accounting Pronouncements
GASB Statement No. 51, Accounting and Financial Reporting for Intangible Assets, establishes accounting and financial reporting requirements for intangible assets (including certain internally developed software). All intangible assets not specifically excluded by the scope of this Statement should be classified as capital assets. All existing authoritative guidance for capital assets should be applied to those intangible assets, as applicable. The System is required to implement this Statement for the year ending June 30, 2010.

GASB Statement No. 53, Accounting and Financial Reporting for the Derivative Instruments, issued June 2008, is effective for the ISBI beginning with its year ending June 30, 2010. This Statement addresses the recognition, measurement, and disclosure of information regarding derivative instruments entered into by the state and local governments. Derivative instruments are often complex financial arrangements used by governments to manage specific risks or to make investments.

d. Methods Used to Value Investments
Investments are managed by the ISBI pursuant to Chapter 40, Article 5/22A of the Illinois Compiled Statutes (ILCS) and are maintained in the ISBI Commingled Fund.

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, 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 the ISBI and its investment managers; (5) Alternative Investments (Private Equity, Hedge Funds, and Infrastructure Funds) fair values as determined by the ISBI and its investment managers; and (6) Commingled Funds- fair values as determined by the ISBI and its investment managers.

Units of the ISBI Commingled Fund are issued to the member systems on the last day of the month based on the unit net asset value calculated as of that date. Net investment income of the ISBI Commingled Fund is allocated to each of the member systems on the last day of the month on the basis of percentage of accumulated units owned by the respective systems. Management expenses are deducted monthly from income before distribution.

The investment authority of the ISBI is provided in Chapter 40, Section 5/22A-112 of the ILCS. Such investment authority requires that all opportunities be undertaken with care, skill, prudence and diligence given prevailing circumstances that a prudent person acting in like capacity and experience would undertake.

e. Actuarial Experience Review
In accordance with Illinois Compiled Statutes, an actuarial experience review is to be performed at least once every five years to determine the adequacy of actuarial assumptions regarding the mortality, retirement, disability, employment, turnover, interest and earnable compensation of the members and beneficiaries of the System. An experience review was last performed as of June 30, 2006.

f. Administrative Expenses
Expenses related to the administration of the System are financed through investment earnings and employer retirement contributions. These expenses are budgeted and approved by the System's Board of Trustees.

g. Risk Management
The System, as part of the primary government of the State, provides for risks of loss associated with workers' compensation and general liability through

the State's self-insurance program. The System obtains commercial insurance for fidelity, surety, and property. There have been no commercial insurance claims in the past three fiscal years.

h. General Litigation

The System is subject to claims and lawsuits that arise primarily in the ordinary course of business. It is the opinion of management that the disposition or ultimate resolution of such claims and lawsuits will not have a material adverse effect on the plan net assets or the changes in plan net assets of the System.

i. Use of Estimates

In preparing financial statements in conformity with U.S. generally accepted accounting principles, the System 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 revenue and expenses during the reporting period. Actual results could differ from those estimates and assumptions.

j. Reclassifications

Certain fiscal year 2008 amounts have been reclassified to conform to the fiscal year 2009 presentation. These reclassifications have not changed the fiscal year 2008 results.

4. Investments

Summary of the ISBI Fund's investments at fair value by type

	June 30, 2009	June 30, 2008
Government and agency obligations	$ 665,018,889	$ 852,045,701
Foreign obligations	33,237,090	113,005,430
Corporate obligations	668,047,761	1,058,164,332
Common stock & equity funds	2,610,218,733	3,823,791,711
Preferred stock	286,429	4,491,500
Foreign equity securities	1,482,594,431	1,984,314,463
Foreign preferred stock	47,856	603,032
Commingled Funds	335,484,184	417,894,222
Hedge Funds	880,939,190	598,985,402
Real estate investments	875,929,700	1,332,081,349
Private Equity	450,491,810	524,628,589
Money market instruments	235,126,490	307,481,504
Infrastructure funds	305,969,947	209,975,518
Bank loans	197,259,098	202,137,983
Forward foreign exchange contracts	(5,594,545)	(72,622)
Total investments	$ 8,735,057,063	$ 11,429,528,114

Deposits

Custodial credit risk for deposits is the risk that, in the event of a financial institution failure, the System's and 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 by ISBI is neither insured nor collateralized for amounts in excess of $250,000.

During fiscal year 2007, a Credit Risk Policy was implemented by the ISBI staff and formally adopted by the ISBI Board in July, 2007. The policy outlines the control procedures used to monitor custodial credit 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 Standard & Poor's and an Aa2 rating by Moody. Certain investments of the 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, which are not subject to the custodial risk. For financial statement presentation and investment purposes, the ISBI reports these types of cash equivalents as Money Market Instruments within their investments. The table below discloses the deposits held by the ISBI at June 30, 2009 and 2008, and the portion of those deposits exposed to custodial credit risk:

	June 30, 2009	June 30, 2008
Carrying amounts of Cash and Bank Balances	$ 12,440,740	$ 43,558,219
Amount exposed to custodial credit risk	$ -	$ 43,458,219

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, the ISBI will not be able to recover the value of investments or collateral securities that are in the possession of a counterparty. As of June 30, 2009 and 2008, the investments listed in the table below were uninsured and unregistered, with securities held by the counterparty or by its trust department or agent but not in the ISBI's name:

	2009	2008
Common stock	$ 2,529,488	$ 2,024,444
Government and agency obligations	7,847,410	9,695,067
Total	$ 10,376,898	$ 11,719,511

	Moody's Quality Rating	2009	2008
Government and agency obligations			
U.S. Government obligations	AAA	$ 653,019,129	$ 661,038,878
Federal agency obligations	AA	11,999,760	5,057,314
	A	-	12,617,585
	BAA	-	4,847,471
	B	-	976,931
	Not Rated	-	167,507,521
Total Government and agency obligations		$ 665,018,889	$ 852,045,700
Foreign obligations	AAA	$ 7,009,777	$ 8,105,833
	AA	3,433,768	3,578,088
	A	-	12,247,911
	BAA	1,899,728	27,477,167
	BA	10,915,077	30,930,973
	B	7,765,165	10,807,260
	CAA	1,609,335	-
	C	604,240	-
	Not rated	-	19,858,198
Total foreign obligations		$ 33,237,090	$ 113,005,430
Corporate obligations	AAA	$ 39,162,888	$ 129,745,414
	AA	56,839,344	125,292,897
	A	209,758,077	132,759,541
	BAA	99,409,888	148,019,604
	BA	79,410,130	111,315,582
	B	132,204,912	280,234,046
	CAA	39,940,421	64,919,149
	CA	977,375	530,341
	C	-	556,527
	Not rated	10,344,726	64,791,231
Total corporate obligations		$ 668,047,761	$ 1,058,164,332

Concentration of Credit Risk and Credit Risk for Investments

The ISBI's 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 ISBI did not have any single issuer investment that exceeded 5% of the total net assets of the fund as of June 30, 2009 and 2008. The table above presents the quality ratings of debt securities held by the ISBI as of June 30, 2009 and 2008.

Securities Lending

The 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 ISBI 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 the ISBI with counterparty default indemnification. The ISBI had no credit risk as a result of its securities lending program as the collateral received exceeded the fair value of the securities loaned. As of June 30, 2009 and 2008, there were outstanding loaned investment securities having fair values of $1,476,903,266 and $1,851,952,625, respectively; against which collateral was received with a fair value of $1,528,744,414 and $1,912,742,552, respectively. Collateral received at June 30, 2009 and 2008 consisted of $1,467,250,961 and $1,703,959,890, respectively, in cash and $61,493,453 and $208,782,662, respectively, in securities for which the ISBI does not have the ability to pledge or sell.

Investment Commitments

The ISBI's real estate and private equity investment portfolios consist of passive interests in limited partnerships. The ISBI had outstanding commitments to these limited partnerships of approximately $486 million and $515 million, as of June 30, 2009 and 2008, respectively. Also, at the end of fiscal year 2009 and 2008, the ISBI had outstanding commitments of $159 million and $165 million, respectively, to separate real estate accounts. Also at the end of Fiscal Year 2009 and 2008, the ISBI had outstanding amounts of $155 million and $302 million, respectively, to infrastructure funds.

Foreign Currency Risk

The ISBI's 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. Certain investments held in infrastructure funds trade in a reported currency of Euro based dollars valued at $38,643,067, and $0, as of June 30, 2009 and 2008. The table below presents the foreign currency risk by type of investment as of June 30, 2009 and 2008.

	2009		2008	
	Foreign Equity and Foreign Preferred Securities	Foreign Obligations	Foreign Equity and Foreign Preferred Securities	Foreign Obligations
Australian Dollar	$ 64,845,908	$ -	$ 122,273,518	$ -
Brazilian Real	33,224,878	-	9,912,719	822,627
Canadian Dollar	47,104,026	-	67,312,081	640,243
Danish Krone	22,597,007	-	20,127,457	-
Egyptian Pound	631,787	-	315,568	-
English Pound Sterling	291,255,325	-	360,797,972	355,913
Euro Currency	407,541,247	-	579,718,291	3,464,132
Hong Kong Dollar	39,652,995	-	54,097,173	-
Iceland Krona	-	-	-	4,149,151
Japanese Yen	221,156,513	-	278,817,201	-
Malaysian Ringgit	-	-	-	6,031,886
Mexican Peso	2,121,876	-	2,383,899	9,829,450
New Zealand Dollar	1,076,827	-	1,093,179	-
Norwegian Krone	9,277,231	-	33,771,404	-
Singapore Dollar	30,234,461	-	33,616,147	6,136,820
South African Rand	3,495,645	-	3,038,970	-
South Korean Won	21,353,474	-	22,322,531	-
Swedish Krona	15,868,385	-	38,232,833	-
Swiss Franc	124,169,874	-	129,364,946	-
Foreign investments denominated in U.S. Dollars	147,034,828	33,237,090	227,721,606	81,575,208
Total	$1,482,642,287	$ 33,237,090	$ 1,984,917,495	$ 113,005,430

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. The 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 ISBI Board of Directors 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 the 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 ISBI 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, 2009 and 2008, is shown in the table below.

and changes in interest rates. As of June 30, 2009 and 2008, the fair value of the ISBI's CMO holdings totaled $23,611,438 and $165,456,226, respectively.

The 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.

	Cost	Fair Value	Gain/(Loss)
As of June 30, 2009			
Forward currency purchases	$173,126,960	$181,554,864	$ 8,427,904
Forward currency sales	183,451,357	197,473,806	(14,022,449)
Total gain/(loss)			$ (5,594,545)

	Cost	Fair Value	Gain/(Loss)
As of June 30, 2008			
Forward currency purchases	$6,018,928	$6,025,470	$ 6,542
Forward currency sales	5,890,350	5,969,514	(79,164)
Total gain/(loss)			$ (72,622)

The 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. The value, liquidity and related income of these securities are sensitive to prepayments by mortgagees, changes in economic conditions, including real estate values, delinquencies or defaults, or both, and may be adversely affected by shifts in the market's perception of the issuers and insurers

Futures and options positions held by the ISBI as of June 30, 2009 and 2008

	2009		2008	
	Number of Contracts	Contract Principal*	Number of Contracts	Contract Principal*
Equity futures purchased	1,626	$ 74,430,150	1,892	$ 122,985,600
Fixed income futures purchased	-	-	3	599,694
Fixed income futures sold	-	-	790	167,444,230
Fixed income written put options	-	-	347	34,700,000
Fixed income written call options	-	-	283	28,300,000

* Contract principal amounts shown represent the market 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.

The ISBI'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, the 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, the 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.

Investment Liquidity

The ISBI holds investments in hedge funds, real estate funds, private equity funds and infrastructure funds that are considered illiquid by the very nature of the investment. Market risk exists with respect to these investments as the ISBI may not be able to exit from the investments during periods of significant market value declines.

Interest Rate Risk

The 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 fair value. The effective duration measures the sensitivity of market price to parallel shifts in the yield curve. As of June 30, 2009, the ISBI benchmarks its debt security portfolio to Barclay's Capital Intermediate U.S. Government/Credit Bond Index. As of June 30, 2008, the ISBI benchmarked its debt security portfolio to Lehman Brothers Aggregate. At June 30, 2009, the effective duration of the Barclay's Capital Intermediate U.S. Government/ Credit Bond Index was 3.9 years. At June 30, 2008, the effective duration of the Lehman Brothers Aggregate was 3.8 years. At the same point in time, the effective duration of the ISBI debt security portfolio at June 30, 2009 and 2008 was 3.8 and 4.2 years, respectively.

Other Information

The System owns approximately 94% of the net investment assets of the ISBI Commingled Fund as of June 30, 2009 and 2008. A schedule of investment expenses is included in the ISBI's annual report.

For additional information on ISBI's investments, please refer to their Annual Report as of June 30, 2009. A copy of the report can be obtained from the ISBI at 180 North LaSalle Street, Suite 2015, Chicago, Illinois 60601.

	2009		2008	
		Effective Weighted		Effective Weighted
Investment Type	Fair Value	Duration Years	Fair Value	Duration Years
Government & agency obligations				
U.S. Government	$ 75,529,694	5.3	$ 235,753,279	5.3
Federal agency	589,489,195	2.9	616,292,422	3.4
Foreign obligations	33,237,090	4.7	113,005,430	5.1
Corporate obligations				
Bank and Finance	159,283,917	4.0	159,397,789	3.8
Collateralized Mortgage Obligations	19,360,918	2.8	136,048,371	1.4
Industrials	425,239,911	4.4	593,294,641	4.9
Other	64,163,015	4.7	169,423,531	5.1
	$ 1,366,303,740		$ 2,023,215,463	

5. Funding - Statutory Contributions Required & Contributions Made

On an annual basis, a valuation of the liabilities and reserves of the System is performed by the System's actuarial consultants in order to determine the amount of contributions statutorily required from the State of Illinois. For fiscal years 2009 and 2008 the actuary used the projected unit credit actuarial method for determining the proper employer contribution rate and amount.

For fiscal year 2009 and 2008 the required employer contributions was computed in accordance with the State's funding plan. This funding legislation provides for a systematic 50 year funding plan with an ultimate goal to fund the cost of maintaining and administering the System at an actuarial funded ratio of 90%.

In addition, the funding plan provides for a 15 year phase-in period to allow the state to adapt to the increased financial commitment. Once the 15 year phase-in period is complete, the state's contribution will then remain at a level percentage of payroll for the next 35 years until the 90% funded level is achieved.

The funded status of the System as of June 30, 2009, the most recent actuarial valuation date, is in the table below:

The schedule of funding progress, presented as required supplementary information (RSI) following the notes to the financial statements, present multiyear trend information about whether the actuarial values of plan assets are increasing or decreasing over time relative to the AALs for benefits.

Additional information as of the latest actuarial valuation follows:

Valuation date: June 30, 2009

Actuarial cost method: Projected Unit Credit

Amortization method:

a. For GASB Statement No. 25 reporting purposes: Level percent of payroll
b. Per state statute: 15-year phase-in to a level percent of payroll until a 90% funding level is achieved

Remaining amortization period:

a. For GASB Statement No. 25 reporting purposes: 30 years, open
b. Per state statute: 36 years, closed

Asset valuation method: Fair value, adjusted for any actuarial gains or losses from investment return incurred in the fiscal year recognized in equal amounts over the five year period following that fiscal year.

Actuarial assumptions:

Investment rate of return:	8.5 percent
Projected salary increases:	1.0 to 5.35 percent, based upon member's age
Assumed inflation rate:	3.0 percent
Group size growth rate:	0.0 percent
Post-retirement increase:	3.0 percent, compounded
Mortality table:	1994 Group Annuity Mortality Table for males and females. Five percent of deaths amongst active employees are assumed to be in the performance of their duty.

Actuarial Value of Assets (a)	Actuarial Accrued Liability (AAL) -Projected Unit Credit (b)	Unfunded AAL (UAAL) (b-a)	Funded Ratio (a/b)	Covered Payroll (c)	UAAL as a Percentage Covered Payroll ([b-a]/c)
$10,999,953,527	$25,298,346,092	$14,298,392,565	43.5%	$4,027,263,000	355.0%

6. Accrued Compensated Absences

Employees of the System are entitled to receive compensation for all accrued but unused vacation time and one-half of all unused sick leave earned on and after January 1, 1984 and before January 1, 1998 upon termination of employment. These accrued compensated absences as of June 30, 2009 and 2008 totaled $830,237 and $757,073, respectively are included in Administrative Expenses Payable.

7. Property & Equipment

Capital assets are capitalized at their cost at the time of acquisition. Depreciation is computed using the straight-line method over the estimated useful life of the asset. The estimated useful lives are as follows: (1) office furniture - 10 years, (2) equipment - 6 years, (3) automobiles and certain electronic data processing equipment - 3 years, and (4) building - 30 years. Land is carried at its original cost, including applicable legal fees, surveying costs, etc.

This is a summary of changes in property and equipment assets for 2009 and 2008:

	2009			
	Beginning Balance	Additions	Deletions	Ending Balance
Assets				
Land	$ 655,241	$ -	$ -	$ 655,241
Land improvements	250,316	-	-	250,316
Building	3,352,428	-	-	3,352,428
Equipment	2,289,613	98,881	(443,363)	1,945,131
TOTAL	6,547,598	98,881	(443,363)	6,203,116
Accumulated depreciation				
Land Improvements	(506)	(71)	-	(577)
Building	(1,952,130)	(113,382)	-	(2,065,512)
Equipment	(1,874,286)	(131,317)	443,335	(1,562,268)
TOTAL	(3,826,922)	(244,770)	443,335	(3,628,357)
Net property and equipment	$2,720,676	$ (145,889)	$ (28)	$ 2,574,759

	2008			
	Beginning Balance	Additions	Deletions	Ending Balance
Assets				
Land	$ 655,241	$ -	$ -	$ 655,241
Land improvements	250,316	-	-	250,316
Building	3,352,428	-	-	3,352,428
Equipment	2,115,547	279,706	(105,640)	2,289,613
TOTAL	6,373,532	279,706	(105,640)	6,547,598
Accumulated depreciation				
Land Improvements	(434)	(72)	-	(506)
Building	(1,838,748)	(113,382)	-	(1,952,130)
Equipment	(1,863,934)	(98,054)	87,702	(1,874,286)
TOTAL	(3,703,116)	(211,508)	87,702	(3,826,922)
Net property and equipment	$2,670,416	$ 68,198	$ (17,938)	$2,720,676

8. Collection and Remittance of Bond and Interest Payments

On April 7, 2003 House Bill 2660 was signed into law as Public Act 93-0002. This legislation authorized the State to issue $10 billion in general obligation bonds for the purpose of making required contributions to the five state-funded retirement systems, including the State Employees' Retirement System. On July 1, 2003, the net bond proceeds were allocated and distributed to each of the five state-funded retirement systems based on each system's relative percentage of the total unfunded liability at June 30, 2002. The State Employees' Retirement System received an allocation of bond proceeds totaling $1,385,895,278 and deposited all of the proceeds into the Illinois State Board of Investment Commingled Fund on July 2, 2003.

As of June 30, 2009 and 2008 the following amounts are included in the System's Statement of Plan Net Assets regarding the collection of bond principal and interest payments:

	2009	2008
Cash - payments collected but not yet remitted to the State of Illinois	$ 6,777,811	$ 7,156,944
Accounts receivable - for June payrolls received in July and August	$ 3,250,031	$ 3,219,427
Due to the State of Illinois	$ (10,027,842)	$ (10,376,371)

Public Act 93-0839, effective July 30, 2004, requires that employer contributions to the System shall include an additional amount to be paid over to the General Obligation Bond Retirement and Interest Fund to pay principal of and interest on those general obligation bonds due that fiscal year. This debt service payment is to be made on the first day of each month, or as soon thereafter as practical.

The total debt service payments received for all fiscal year 2009 and 2008 payrolls, amounted to $78.0 million and $80.6 million, respectively. The total amount remitted to the State of Illinois as of June 30, 2009 and 2008 was $68.0 million and $70.3 million, respectively.

9. Administrative Expenses & Other Post-Employment Benefits

Expenses related to the administration of the System are financed through investment earnings and employer retirement contributions. These expenses are budgeted and approved by the System's Board of Trustees.

The System pays employer retirement contributions based upon an actuarially determined percentage of its payrolls. For fiscal years 2009, 2008, and 2007 the employer contribution rates were 21.049%, 16.561%, and 11.525%, respectively. The System's contributions to SERS for fiscal years 2009, 2008, and 2007 were $852,808, $620,113, and $397,983 respectively, for the general staff. The System's contributions for the electronic data processing staff for fiscal years 2009, 2008, and 2007 were $179,993, $194,913, and $114,204, respectively. These amounts were equal to the required contributions for each fiscal year.

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 towards 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 Employee's Retirement System do not contribute towards 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 allowing those annuitants with twenty or more years of credited service to not contribute towards 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 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.

A summary of the administrative expenses of the System for fiscal years 2009 and 2008 are as follows:

	2009	2008
Personal Services	$ 4,044,917	$ 3,740,484
Employee Retirement Pickup	51,206	26,145
Retirement Contributions	852,808	620,113
Social Security Contributions	301,708	278,258
Group Insurance	950,343	903,197
Contractual Services	1,746,425	1,438,261
Travel	30,581	32,450
Commodities	29,298	27,261
Printing	52,521	77,075
Electronic data processing	2,210,406	2,119,167
Telecommunications	67,063	62,341
Automotive	19,305	18,535
Depreciation	244,771	211,508
Other (net)	80,024	(17,490)
Total	$10,681,376	$ 9,537,305

10. Social Security Division - Administrative Expenses

The Social Security Division of the State Employees' Retirement System was created by 40 ILCS 5/21, to administer the state's responsibilities under Title II Section 218 of the Federal Social Security Act and the master federal-state agreement.

The state's responsibilities include extending Social Security coverage by agreement to any of the state's retirement systems or units of local government requesting social security or medicare only coverage for their members or employees.

In addition, the Social Security Division was responsible for collecting wage information and contribution payments from covered retirement systems and units of local government on wages paid prior to January 1, 1987. Administrative expenses for the Social Security Division are appropriated annually by the State Legislature.

Administrative expenses for the Social Security Division are appropriated annually by the State Legislature

	2009	2008
Personal services	$ 37,805	$ 52,794
Retirement contributions	7,961	8,746
Social Security contributions	2,804	3,912
Contractual services	24,995	17,500
Travel	441	1,200
Commodities	175	188
Electronic Data Processing	421	452
Telecommunications	-	400
Total	$ 74,602	$ 85,192

11. Analysis of Changes in Reserve Balances

The System maintains three reserve accounts. The reserves are defined as follows:

a. Participants' contributions: Accounts for assets contributed by each participant,

b. Interest accumulations: Accounts for interest credited to each participant's account,

c. Other future benefits: Accounts for all assets not otherwise specifically provided for in items (a) and (b) above.

State Employees' Retirement System
Statements of Changes in Reserve Balances Years Ended June 30, 2009 and 2008

	Participants' Contributions	Interest Accumulations	Other Future Benefits	Total Reserve Balances
Balance at June 30, 2007	$ 1,951,976,176	$ 1,327,434,550	$ 8,799,498,228	$12,078,908,954
Add (deduct):				
Excess revenue over/(under) expenses	215,763,541	-	(1,299,306,010)	(1,083,542,469)
Reserve transfers:				
Accumulated contributions of members who retired during the year, less contributions of annuitants returning to active status	(97,187,084)	-	97,187,084	-
Interest credited to members' accounts	-	98,123,807	(98,123,807)	-
Balance at June 30, 2008	$ 2,070,552,633	$ 1,425,558,357	$ 7,499,255,495	$10,995,366,485
Add (deduct):				
Excess revenue over/(under) expenses	215,177,901	-	(2,732,692,298)	(2,517,514,397)
Reserve transfers:				
Accumulated contributions of members who retired during the year, less contributions of annuitants returning to active status	(97,127,550)	-	97,127,550	-
Interest credited to members' accounts	-	111,570,393	(111,570,393)	-
Balance at June 30, 2009	$ 2,188,602,984	$ 1,537,128,750	$ 4,752,120,354	$8,477,852,088

SCHEDULE OF FUNDING PROGRESS

Actuarial Valuation Date	Actuarial Value of Assets (a)	Actuarial Accrued Liability (AAL) -Projected Unit Credit (b)	Unfunded AAL (UAAL) (b-a)	Funded Ratio (a/b)	Covered Payroll (c)	UAAL as a Percentage Covered Payroll ([b-a]/c)
6/30/04	$ 9,990,186,874	$ 18,442,664,834	$ 8,452,477,960	54.2	3,439,251,000	245.8%
6/30/05	10,494,147,953	19,304,646,648	8,810,498,695	54.4	3,475,528,000	253.5
6/30/06	10,899,853,065	20,874,541,910	9,974,688,845	52.2	3,572,541,000	279.2
6/30/07	12,078,908,954	22,280,916,665	10,202,007,711	54.2	3,762,777,000	271.1
6/30/08	10,995,366,485	23,841,280,102	12,845,913,617	46.1	3,967,704,000	323.8
6/30/09	10,999,953,527	25,298,346,092	14,298,392,565	43.5	4,027,263,000	355.0

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

SCHEDULE OF EMPLOYER CONTRIBUTIONS

Year Ended June 30	Annual Required Contribution per GASB Statement No. 25 (1)	Percentage Contributed	(A) Annual Required Payroll Contribution per State Statute(3)	(B) State Pension Fund (4) Contribution	(A) + (B) Total Required State Contribution	Percentage Contributed
2004	$ 576,219,951	83.1% (2)	$ 462,200,942	$ 15,150,000	$ 477,350,942	100% (2)
2005	727,428,010	58.8	425,682,669	-	425,682,669	100
2006	672,555,569	31.3	207,814,710	-	207,814,710	100
2007	823,802,760	43.6	361,113,709	-	361,113,709	99
2008	986,410,891	59.6	576,626,422	-	576,626,422	102
2009	1,003,432,849	77.2	769,851,595	-	769,851,595	101

(1) This amount includes both payroll and non-payroll employer required contributions.
(2) This percentage excludes the additional employer contributions received from the State of General Obligation bonds by the State of Illinois. These proceeds were not part of the current fiscal year required contributions.
(3) Employer required contribution determined in accordance with P.A. 88-0593, and P.A. 94-0004 (for Fiscal Years 2006 and 2007 only). These amounts reflect only payroll required contributions.
(4) The actual distribution from the State Pension Fund was $5,970,645, the additional amount of $9,179,355 was received in accordance with HB585 (P.A.93-0665), as a distribution from the Pension Contribution Fund.

Notes to Required Supplementary Information

Valuation date: June 30, 2009
Actuarial cost method: Projected Unit Credit
Amortization method:
a. For GASB Statement No. 25 reporting purposes - Level percent of payroll
b. Per state statute - 15-year phase-in to a level percent of payroll until a 90% funding level is achieved

Remaining amortization period:
a. For GASB Statement No. 25 reporting purposes - 30 years, open
b. Per state statute - 36 years, closed

Asset valuation method - Fair value, adjusted for any actuarial gains or losses from investment return incurred in the fiscal year recognized in equal amounts over the five year period following that fiscal year.

Actuarial assumptions:
- Investment rate of return - 8.5 percent
- Projected salary increases - 1.0 to 5.35 percent, based upon member's age
- Assumed inflation rate - 3.0 percent
- Group size growth rate - 0.0 percent
- Post-retirement increase - 3.0 percent, compounded
- Mortality table - 1994 Group Annuity Mortality Table for males and females. Five percent of deaths amongst active employees are assumed to be in the performance of their duty.

SUMMARY OF REVENUES BY SOURCE

	2009	2008
Contributions:		
Participants	$ 235,028,054	$ 235,489,713
Repayments of contributions refunded	994,044	1,250,800
Interest received from participants	6,205,334	13,214,695
Total participants contributions	242,227,432	249,955,208
Employing state agencies	774,910,344	587,732,407
Investments:		
Net investments income	224,823,314	274,524,210
Interest earned on cash balances	7,319,968	13,404,255
Net depreciation in fair value of investments	(2,441,040,917)	(968,688,184)
Total investment loss	(2,208,897,635)	(680,759,719)
TOTAL REVENUE (LOSS)	$ (1,191,759,859)	$ 156,927,896

SUMMARY SCHEDULE OF CASH RECEIPTS & DISBURSEMENTS

	2009	2008
Cash balance, beginning of year	$ 306,528,043	$ 249,858,696
Receipts:		
Participant contributions	230,732,180	235,381,660
Employer contributions		
(net of bond principal and interest transfers)	764,832,593	574,487,622
Transfers from Illinois State Board of Investment	237,000,000	462,000,000
Interest income on cash balance	7,782,920	13,825,554
Claims receivable payments	6,283,274	6,435,920
Installment payments	5,173,247	5,776,758
Other	94,658	283,509
Total cash receipts	1,251,898,872	1,298,191,023
Disbursements:		
Annuity payments:		
Retirement annuities	1,164,972,311	1,090,075,427
Widow's and Survivor's annuities	73,853,072	68,941,055
Disability benefits	44,556,315	42,468,835
Lump Sum benefits	15,979,556	13,118,221
Refunds (including transfers to reciprocal systems)	15,798,728	17,772,808
Administrative expenses	10,587,864	9,145,330
Total cash disbursements	1,325,747,846	1,241,521,676
Cash balance, end of year	$ 232,679,069	$ 306,528,043

SCHEDULE OF PAYMENTS TO CONSULTANTS & ADVISORS

	2009	2008
Legal Services	$ 32,117	$ 38,935
Actuarial Costs	173,846	88,358
Audit Expense	113,014	94,163
Physicians and Disability Inspections	274,409	243,483
Financial Planning	64,164	52,040
Management Consultants	252,782	93,910
TOTAL	$ 910,332	$ 610,889

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

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

As Special Assistant Auditors for the Auditor General, we have audited the financial statements of the State Employees' Retirement System of the State of Illinois (System), as of and for the year ended June 30, 2009 and have issued our report thereon dated February 2, 2010. 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. Other auditors audited the financial statements of the Illinois State Board of Investment, as described in our Independent Auditor's Report on the System's financial statements. This report does not include the results of the other auditors' testing of internal control over financial reporting or compliance and other matters that are reported on separately by those auditors.

Internal Control Over Financial Reporting

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

A deficiency in control exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent, detect and correct misstatement on a timely basis.

A material weakness is a deficiency, or a combination of deficiencies, in internal control, such that there is a reasonable possibility that a material misstatement of the System's financial statements will not be prevented, or detected and corrected on a timely basis.

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 over financial reporting that might be deficiencies, significant deficiencies or material weaknesses. We did not identify any deficiencies in internal control over financial reporting of the System that we consider to be material weaknesses, as defined above.

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*.

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

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

BKD, LLP

February 2, 2010

State Employees' Retirement System
of the State of Illinois
Current Finding – *Government Auditing Standards*
June 30, 2009

No matters are reportable

State Employees' Retirement System of the State of Illinois

Schedule of Prior Finding Not Repeated

June 30, 2009

A. Finding – Journal Entry Review

During the prior audit, we noted the System did not have a process for review of financial journal entries by a person independent of the person that initiates them. (Finding Code No. 08-1)

During the current audit, we noted the System implemented a process to have all financial journal entries reviewed by an independent person.