

**ILLINOIS STATE EMPLOYEES'
DEFERRED COMPENSATION PLAN**

**FINANCIAL AUDITS
For the Fiscal Years Ended
December 31, 2010 and 2009**

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

ILLINOIS STATE EMPLOYEES' DEFERRED COMPENSATION PLAN
 FINANCIAL AUDITS
 For the Fiscal Years Ended
 December 31, 2010 and 2009

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ILLINOIS STATE EMPLOYEES' DEFERRED COMPENSATION PLAN

AGENCY OFFICIALS

| | | |
|-------------------------|--------------------|---|
| Director | | Mr. James P. Sledge |
| Assistant Director | Chicago Office | Ms. Christine Cegelis (Effective June 23, 2009) |
| | Springfield Office | Mr. Steve McCurdy (Effective June 24, 2009) |
| Chief Operating Officer | | Ms. Tasha Green Cruzat (Effective September 20, 2010) |
| | | Mr. Doug Kucia (Effective April 1, 2010 thru April 24, 2010) |
| | | Ms. Elizabeth Nicholson (Effective August 25, 2008 thru September 21, 2009) |
| Chief Financial Officer | | Mr. Paul Romiti |
| General Counsel | | Ms. Nadine Lacombe (Effective February 10, 2010) |
| | | Ms. Deborah Matlock (Effective February 14, 2006 thru December 31, 2009) |
| Chief Internal Auditor | | Mr. Spenser Staton (Effective September 16, 2010) |
| | | Ms. Deborah Abbott (Effective November 1, 2009 thru June 30, 2010) |
| | | Ms. Carol Kraus (Effective March 9, 2007 thru October 13, 2009) |

ILLINOIS STATE EMPLOYEES' DEFERRED COMPENSATION PLAN

AGENCY OFFICIALS - Continued

Deputy Director – Bureau of Benefits Ms. Janice Bonneville

Acting Division Manager Mr. Jason Musgrave

Division Fiscal Officer Ms. Carol Arterberry

Agency offices are located at: 201 East Madison, Suite 1C
Springfield, IL 62702

ILLINOIS STATE EMPLOYEES' DEFERRED COMPENSATION PLAN
FINANCIAL STATEMENT REPORT

SUMMARY

The audits of the accompanying statements of plan net assets of the State of Illinois, Department of Central Management Services State Employees' Deferred Compensation Plan Fund (755) (Plan) as of December 31, 2010 and 2009, and the related statements of changes in plan net assets for the years then ended, were performed by Sikich LLP as Special Assistant Auditors to the Auditor General, State of Illinois.

Based on their audits, the auditors expressed an unqualified opinion on the Plan's basic financial statements as noted above for the years ended December 31, 2010 and 2009.



3201 West White Oaks Drive, Suite 102 • Springfield, IL 62704

INDEPENDENT AUDITOR'S REPORT

Honorable William G. Holland
Auditor General
State of Illinois

As Special Assistant Auditors for the Auditor General, we have audited the accompanying statements of plan net assets of the State Employees' Deferred Compensation Plan Fund (755) of the State of Illinois, Department of Central Management Services as of December 31, 2010 and 2009, and the related statements of changes in plan net assets for the years then ended, as listed in the table of contents. These financial statements are the responsibility of the State of Illinois, Department of Central Management Services' 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 audits 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.

As discussed in Note 1, the financial statements present only the State Employees' Deferred Compensation Plan Fund (755), a fund of the State of Illinois, Department of Central Management Services, and do not purport to, and do not, present fairly the financial position of the State of Illinois or the Department of Central Management Services as of December 31, 2010 and 2009, and its changes in financial position for the years then ended in conformity with accounting principles generally accepted in the United States of America.

In our opinion, the financial statements referred to above present fairly, in all material respects, the plan net assets of the State Employees' Deferred Compensation Plan Fund (755) of the State of Illinois, Department of Central Management Services, as of December 31, 2010 and 2009, and the changes in plan net assets, thereof for the years 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 a report dated June 17, 2011 on our consideration of the State of Illinois, Department of Central Management Services' internal control over financial reporting of the State Employees' Deferred Compensation Plan Fund (755) and on our tests of the State of Illinois, Department of Central Management Services' 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 audits.

The State of Illinois, Department of Central Management Services has not presented a management's discussion and analysis for the State Employees' Deferred Compensation Plan Fund (755) that accounting principles generally accepted in the United States of America has deemed is necessary to supplement, although not required to be part of, the financial statements.

Our audits were conducted for the purpose of forming opinions on the financial statements of the State Employees' Deferred Compensation Plan Fund (755) of the State of Illinois, Department of Central Management Services. The accompanying supplementary information, as listed in the table of contents, is presented for purposes of additional analysis and is not a required part of the financial statements. The accompanying supplementary information, as listed in the table of contents, has been subjected to the auditing procedures applied in our audits of the financial statements and, in our opinion, is fairly stated in all material respects in relation to the financial statements taken as a whole.

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



Springfield, Illinois
June 17, 2011

ILLINOIS STATE EMPLOYEES' DEFERRED COMPENSATION PLAN
STATEMENTS OF PLAN NET ASSETS
PENSION TRUST FUND
December 31, 2010 and 2009

| | 2010 | 2009 |
|---|------------------|------------------|
| ASSETS | | |
| Cash and cash equivalents | | |
| Cash in custody of State Treasurer | \$ 5,296,993 | \$ 6,355,942 |
| Cash advanced to recordkeeping agent | 2,449,522 | 3,456,745 |
| Total cash and cash equivalents | 7,746,515 | 9,812,687 |
| Accounts receivable | 890,966 | 1,589,528 |
| Investments | | |
| Investment contracts | 695,558,871 | 661,746,788 |
| Money market fund | 50,587,524 | 30,462,677 |
| Bond trust funds | 97,783,698 | - |
| Mutual funds | 2,102,363,544 | 1,977,233,633 |
| Equity trust funds | 246,386,444 | 115,869,494 |
| Annuities | 1,108,354 | 1,327,358 |
| Total investments | 3,193,788,435 | 2,786,639,950 |
| Property and equipment | | |
| Office equipment, net of accumulated depreciation of \$146,326 and \$142,894 | 5,147 | 8,579 |
| Total Assets | 3,202,431,063 | 2,798,050,744 |
| LIABILITIES | | |
| Accounts payable | 728,835 | 857,868 |
| Accrued compensated absences | 107,889 | 98,630 |
| Total Liabilities | 836,724 | 956,498 |
| NET ASSETS | | |
| Held in trust for deferred compensation benefits and other purposes | 3,201,594,339 | 2,797,094,246 |
| TOTAL NET ASSETS | \$ 3,201,594,339 | \$ 2,797,094,246 |

The accompanying notes to financial statements are an integral part of this statement.

ILLINOIS STATE EMPLOYEES' DEFERRED COMPENSATION PLAN
STATEMENTS OF CHANGES IN PLAN NET ASSETS
PENSION TRUST FUND
Years Ended December 31, 2010 and 2009

| | 2010 | 2009 |
|---|------------------|------------------|
| ADDITIONS | | |
| Contributions | | |
| Participant deferrals | \$ 162,202,807 | \$ 162,839,982 |
| Participant accounts transferred in from qualified retirement plans | 3,434,473 | 2,256,322 |
| Total Contributions | 165,637,280 | 165,096,304 |
| Investment Income | | |
| Interest, dividends and other investment income | 77,314,244 | 50,171,060 |
| Net appreciation (depreciation) in fair value of investments | 323,892,073 | 462,612,283 |
| Total Investment Income | 401,206,317 | 512,783,343 |
| Less investment expense | (553,384) | (527,018) |
| Net Investment Income | 400,652,933 | 512,256,325 |
| Other Income (Expense) | | |
| Recordkeeping reimbursement income | 2,291,843 | 2,093,239 |
| Recordkeeping and marketing expense | (2,017,559) | (2,296,437) |
| Other operating income (expense) | 962 | 1,745 |
| Transfer from (to) another State agency for accrued compensated absences | | 1,423 |
| Total Other Income (Expense) | 275,246 | (200,030) |
| Total Additions | 566,565,459 | 677,152,599 |
| DEDUCTIONS | | |
| Distributions: | | |
| Terminations | 57,952,855 | 45,129,963 |
| Deaths | 6,611,557 | 6,971,426 |
| Hardship | 6,039,259 | 3,711,597 |
| Participant accounts transferred out to other qualified plans | 90,433,124 | 64,181,094 |
| Administrative costs | 1,028,571 | 974,271 |
| Total Deductions | 162,065,366 | 120,968,351 |
| NET INCREASE | 404,500,093 | 556,184,248 |
| NET ASSETS, BEGINNING OF YEAR | 2,797,094,246 | 2,240,909,998 |
| NET ASSETS, END OF YEAR | \$ 3,201,594,339 | \$ 2,797,094,246 |

The accompanying notes to financial statements are an integral part of this statement.

ILLINOIS STATE EMPLOYEES' DEFERRED COMPENSATION PLAN
NOTES TO FINANCIAL STATEMENTS
December 31, 2010 and 2009

1. ORGANIZATION

The Illinois State Employees' Deferred Compensation Plan (the Plan) is administered by the State of Illinois, Department of Central Management Services (the Department) at 201 East Madison, Suite 1C, Springfield, Illinois. The Plan consists of the State Employees' Deferred Compensation Fund (Fund 755), a pension trust fund which records all the assets and liabilities and additions and deductions of the plan. A portion of the Fund is held in the State Treasury and certain administrative costs are appropriated. The current Director is James P. Sledge. The current Deputy Director for the Bureau of Benefits is Janice Bonneville and the current acting division manager for the Plan is Jason Musgrave. The Plan employed 10 full-time employees during 2010. The Illinois State Board of Investment has oversight responsibilities for the Plan.

The Department is part of the executive branch of the State of Illinois and operates under the authority of and review by the Illinois General Assembly. Activities of the Plan are subject to the authority of the Office of the Governor, the State's chief executive office, and other departments of the executive and legislative branches of the government (such as the State Comptroller's Office) as defined by the General Assembly.

As described in the Illinois Comprehensive Annual Financial Report, the State of Illinois (the State) is the oversight unit which includes all funds, elected offices, departments and agencies of the State, as well as boards, commissions, authorities, universities, and colleges over which the State's executive or legislative branches exercise oversight responsibility. The Department is part of the primary government of the State of Illinois' executive branch. These financial statements present the statement of plan net assets and statement of changes in plan net assets for the years ended December 31, 2010 and 2009. The statements are not intended to, and do not present the financial position or changes in financial position of the Department or the State.

2. GENERAL DESCRIPTION OF THE PLAN

The following description of the Plan provides only general information. Participants should refer to the Plan agreement for a complete description of the Plan's provisions.

General

The Plan was created in accordance with Illinois Compiled Statutes (40 ILCS 5/24-101) and Section 457 of the Internal Revenue Code. The first contributions to the Plan were made in May 1979. Under Plan provisions, all employees of the State are eligible to voluntarily elect to contribute a portion of their compensation into the Plan through payroll deductions.

ILLINOIS STATE EMPLOYEES' DEFERRED COMPENSATION PLAN
NOTES TO FINANCIAL STATEMENTS – Continued

2. GENERAL DESCRIPTION OF THE PLAN – Continued

General – Continued

All amounts of compensation deferred pursuant to the Plan, all property and rights purchased with such amounts, and all income attributable to such amounts, property, or rights shall be held in one or more custodial accounts for the exclusive benefit of participants and beneficiaries under the Plan. Participants' rights under the Plan are limited to an amount equal to the fair market value of the deferred account for each participant.

Effective January 1, 1999, the State of Illinois amended the Plan in accordance with the provisions of Internal Revenue Code (IRC) Section 457(g). IRC Section 457(g) requires that assets and income thereon be held in trust for the exclusive benefit of participants and their beneficiaries. Accordingly, the net assets are no longer assets of the State of Illinois. However, due to the administrative involvement of the State of Illinois, this Plan is reported as a pension trust fund as required by the Governmental Accounting Standards Board (GASB).

Contributions

In compliance with IRC Section 457, the Plan limits the amount of an individual's annual contribution to 100 percent of their annual taxable compensation, not to exceed \$16,500 for 2010 and 2009, or \$22,000 for participants age 50 or older for 2010 and 2009. The State does not make any contributions to the Plan.

In the Plan, the annual compensation on which the maximum is calculated is reduced by the following:

- Employee retirement system contributions, which are tax deferred under Section 414 (h) of the IRC.
- Payroll deductions for the payment of group health insurance premiums and member life insurance premiums for coverage up to \$50,000, elected by the employee through state sponsored plans.
- Employee contributions made to the Dependent or Medical Care Assistance Plan which are authorized under Section 125 of the IRC.

In accordance with IRC Section 457, the Plan allows participants a limited make-up on deferrals in the three years prior to the year a participant reaches normal retirement age. For each of these three years, a participant can defer the regular limit plus an additional amount based on actual underutilized deferrals which were made in prior years, up to a maximum of \$33,000 in 2010 and 2009 or twice the regular limits.

ILLINOIS STATE EMPLOYEES' DEFERRED COMPENSATION PLAN
NOTES TO FINANCIAL STATEMENTS – Continued

2. GENERAL DESCRIPTION OF THE PLAN – Continued

Payment of Benefits

Participants may withdraw the current value of funds contributed upon termination of employment with the State of Illinois. Withdrawal can also be made due to financial hardship if approved by a committee established by the Plan.

Upon retirement, participants may select various payment options, including lump sum, partial lump sum, periodic payments or rollover to another qualified tax deferred retirement plan. The participants may wait to start the distribution of their account up to the tax year they turn age 70 ½. They can also stop or change their elected distribution method. Participants with accounts less than or equal to \$5,000 who terminate their employment with the State of Illinois are required to take a lump sum distribution or transfer to another qualified retirement plan. Death beneficiaries may select similar payment options as retired employees. All investments of the Plan are held in custodial accounts for the exclusive benefit of the participants until such time as payments are made.

3. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Use of Estimates in Preparing Financial Statements

The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of additions and deductions during the reporting period. Actual results could differ from those estimates.

Measurement Focus and Basis of Accounting

Pension Trust Fund financial statements are reported using the economic resources measurement focus and the accrual basis of accounting. Additions are recognized when earned and deductions are recorded when a liability is incurred, regardless of when the related cash flow takes place.

ILLINOIS STATE EMPLOYEES' DEFERRED COMPENSATION PLAN
NOTES TO FINANCIAL STATEMENTS – Continued

3. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES – Continued

Cash and Cash Equivalents

Cash equivalents consist of money market mutual funds, funds maintained by the Office of the State Treasurer, and cash advanced to recordkeeping agency representatives. The cash advanced to the recordkeeping agent represents amounts withheld from employees but not remitted to the investment carriers at December 31, and other amounts, such as reinvested income and other fees.

Investment Valuation and Income Recognition

Investments in the guaranteed investment contracts are stated at contract value as reported by the contract administrator, INVESCO (PRIMCO Capital Management). Investments in mutual funds are stated at fair value as determined by using the closing price listed on national exchanges as of December 31. Investments in equity trust funds are also stated at fair value as reported by the respective trustees and investment managers. Annuities are stated at their present value of future payments calculated by the Plan using information as reported by the various insurance companies.

Interest income from the investments in the guaranteed investment contracts and interest earned on temporary cash deposits in both the State Treasury and with the recordkeeping agent at the current money market rates are recorded as earned.

Capital Assets

Capital assets are carried at cost, net of accumulated depreciation. The Illinois State Employees' Deferred Compensation Plan capitalizes purchases over \$5,000 and use the straight-line method to depreciate appropriate assets over their estimated useful lives approximating five years.

Compensated Absences

Vested or accumulated vacation leave is recorded as a deduction and liability of the fund as the benefits accrue to employees. Until January 1, 1984, sick leave, which generally is earned one day per month with unlimited accumulation, was paid only where an employee was absent due to illness or other acceptable circumstances as outlined by personnel regulations. Effective January 1, 1984, upon death, retirement by resignation, or termination from State employment, employees are able to receive payment for one-half of accumulated sick leave earned subsequent to January 1, 1984, or full service credit for such accumulated sick leave under the State Employees' Article of the State Pension Code.

ILLINOIS STATE EMPLOYEES' DEFERRED COMPENSATION PLAN
 NOTES TO FINANCIAL STATEMENTS – Continued

3. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES – Continued

Compensated Absences – Continued

Effective January 1, 1998, upon death, retirement by resignation, or termination from State employment, employees are no longer able to receive payment for accumulated sick leave earned subsequent to January 1, 1998.

Changes in compensated absences are as follows:

| | <u>2010</u> | <u>2009</u> |
|-----------------------------|-------------------|------------------|
| Balance January 1 | \$ 98,630 | \$ 91,751 |
| Additions | 13,254 | 9,643 |
| Deletions | <u>(3,995)</u> | <u>(2,764)</u> |
| Balance December 31 | <u>\$ 107,889</u> | <u>\$ 98,630</u> |
| Amounts due within one year | <u>\$ 350</u> | <u>\$ 350</u> |

4. RETIREMENT BENEFITS

Retirement benefits for Plan employees are provided under a separate State plan and are funded by State appropriations which are invested and accounted for by other State agencies.

5. DEPOSITS AND INVESTMENTS

Deposits

Deposits in the custody of the State Treasurer are pooled and invested with other State funds in accordance with the Deposit of State Moneys Act of the Compiled Statutes (15 ILCS 520/11). Funds held by the State Treasurer have not been categorized as to credit risk because the Plan does not own individual securities. Detail on the nature of these deposits and investments are available within the State of Illinois' Comprehensive Annual Financial Report.

ILLINOIS STATE EMPLOYEES' DEFERRED COMPENSATION PLAN
 NOTES TO FINANCIAL STATEMENTS – Continued

5. DEPOSITS AND INVESTMENTS - Continued

Investments

The Plan's investment policy allows investment options selected by the Illinois State Board of Investments (Board) after satisfactory review of such factors as the investment experience of the underlying manager, the suitability of the investment approach used, and the investment record.

The Plan assets shall be invested with care, skill and diligence that would be applied by a prudent professional investor, acting in a like capacity and knowledgeable in the investment of retirement funds and all transactions undertaken on behalf of the Plan shall be for the sole interest of Plan participants and beneficiaries.

The objective of the Board is to offer a sufficient range of investment options to allow participants to diversify their account balances and construct portfolios that reasonably span the risk/return spectrum.

In accordance with governmental accounting standards, the net assets held in trust for deferred compensation benefits includes \$1,108,354 at December 31, 2010 of annuities due to retired participants who are receiving monthly benefits. The accounts of those participants electing annuity payments have been liquidated and closed by the Plan recordkeeper on the scheduled accounting date and the proceeds were used by the Plan to purchase an annuity on behalf of the participant.

The carrying and fair market value of investments and annuities are summarized as follows:

| | <u>2010</u> | <u>2009</u> |
|--|--------------------|--------------------|
| Stable Return Fund: | | |
| Investment contracts – synthetic investment funds: | | |
| ING Life Insurance & Annuity Co. | \$ 128,837,266 | \$ 117,504,660 |
| JP Morgan Chase Co. | 176,811,528* | 170,387,291* |
| Monumental Life Insurance Co. | 160,497,848* | 154,821,796* |
| Rabobank Nederland | 100,563,805 | 95,692,957 |
| State Street Bank & Trust | 96,638,824 | 123,340,084 |
| Prudential Insurance Co. | <u>32,209,600</u> | <u>-</u> |
| Total Investment Contracts | <u>695,558,871</u> | <u>661,746,788</u> |
| Money Market Fund: | | |
| # State Street Bank & Trust Fund | <u>50,587,524</u> | <u>30,462,677</u> |
| Total Stable Return Fund | <u>746,146,395</u> | <u>692,209,465</u> |

* Investment amount is greater than five percent of total investments.

Debt mutual funds

ILLINOIS STATE EMPLOYEES' DEFERRED COMPENSATION PLAN
NOTES TO FINANCIAL STATEMENTS – Continued

5. DEPOSITS AND INVESTMENTS - Continued

| | <u>2010</u> | <u>2009</u> |
|--|----------------------|----------------------|
| Mutual Funds: | | |
| Columbia Acorn Fund | \$ 985,538,552* | \$ 819,837,553* |
| Ariel Fund | 112,467,311 | 89,676,923 |
| Fidelity Puritan Fund | 252,789,842* | 224,334,075* |
| Legg Mason Value Trust | - | 108,748,423 |
| LSV Value Equity | 35,152,049 | 31,432,915 |
| # T. Rowe Price New Income Fund | - | 92,745,858 |
| T. Rowe Price Retirement Income Fund | 15,023,450 | 12,916,159 |
| T. Rowe Price Retirement 2005 Fund | 6,412,894 | 5,533,720 |
| T. Rowe Price Retirement 2010 Fund | 41,781,391 | 38,690,214 |
| T. Rowe Price Retirement 2015 Fund | 46,859,567 | 35,093,999 |
| T. Rowe Price Retirement 2020 Fund | 52,092,127 | 38,610,411 |
| T. Rowe Price Retirement 2025 Fund | 23,573,494 | 16,629,656 |
| T. Rowe Price Retirement 2030 Fund | 20,136,200 | 15,175,639 |
| T. Rowe Price Retirement 2035 Fund | 10,045,257 | 6,986,754 |
| T. Rowe Price Retirement 2040 Fund | 8,162,826 | 5,960,990 |
| T. Rowe Price Retirement 2045 Fund | 3,575,835 | 2,786,480 |
| T. Rowe Price Retirement 2050 Fund | 641,817 | 395,981 |
| T. Rowe Price Retirement 2055 Fund | 1,241,760 | 956,697 |
| # Vanguard Total Bond Market Index Fund - Institutional Shares | 106,551,433 | 90,154,339 |
| Vanguard Institutional Index Fund | 231,835,132* | 208,152,785* |
| # Vanguard Money Market Reserves Prime Portfolio - Institutional Shares | 83,708,836 | 88,569,353 |
| William Blair Int'l SmCap Growth Fund | 3,364,553 | - |
| Janus Adviser International Growth Fund | 38,952,604 | 28,816,138 |
| Northern Small Capital Value Fund | 22,456,614 | 15,028,571 |
| Total Mutual Funds | <u>2,102,363,544</u> | <u>1,977,233,633</u> |
| Bond Trust Funds: | | |
| T. Rowe Price Bond Trust I | 97,783,698 | - |

* Investment amount is greater than five percent of total investments.

Debt mutual funds

ILLINOIS STATE EMPLOYEES' DEFERRED COMPENSATION PLAN
 NOTES TO FINANCIAL STATEMENTS – Continued

5. DEPOSITS AND INVESTMENTS – Continued

| Equity Trust Funds: | <u>2010</u> | <u>2009</u> |
|---|-------------------------|-------------------------|
| Wellington Trust Diversified Growth | \$ 33,284,774 | \$ 26,928,704 |
| Lord Abbett Lgcp Core StrategySep Account | 115,797,073 | - |
| Invesco International Growth Equity Trust | <u>97,304,597</u> | <u>88,940,790</u> |
| Total Equity Trust Funds | <u>246,386,444</u> | <u>115,869,494</u> |
| Annuities: | | |
| Equitable Life Assurance Society | 37,368 | 41,946 |
| First Colony Life Insurance Co. | 49,246 | 55,255 |
| Hartford Life Insurance Co. | 36,759 | 42,790 |
| IDS Financial Services, Inc. | 4,672 | 8,297 |
| Jackson National Life Insurance Co. | 29,123 | 36,764 |
| Keyport Life Insurance Co. | 4,464 | 6,229 |
| Lincoln National Life | 50,202 | 53,509 |
| Massachusetts Mutual Life Insurance Co. | 10,267 | 14,142 |
| Metropolitan Life Insurance Co. | 255,381 | 277,157 |
| New York Life Insurance Co. | 28,703 | 31,874 |
| Northwestern Mutual Life Insurance Co. | 20,533 | 47,416 |
| Prudential Insurance Co. | 36,092 | 44,752 |
| State Farm Life Insurance Co. | 102,765 | 124,610 |
| Transamerica | 3,558 | 60,944 |
| The Travelers Insurance Co. | <u>439,221</u> | <u>481,703</u> |
| Total annuities | <u>1,108,354</u> | <u>1,327,358</u> |
| Total investments | <u>\$ 3,193,788,435</u> | <u>\$ 2,786,639,950</u> |

Custodial Credit Risk

Custodial credit risk for investments is the risk that, in the event of the failure of the counterparty to the investment, the Plan will not be able to recover the value of its investments that are in possession of an outside party. None of the Plan's investments are subject to custodial credit risk.

Interest Rate Risk

The Plan does not have a formal investment policy that limits investment maturities as a means of managing its exposure to fair value losses arising from increasing interest rates.

ILLINOIS STATE EMPLOYEES' DEFERRED COMPENSATION PLAN
NOTES TO FINANCIAL STATEMENTS – Continued

5. DEPOSITS AND INVESTMENTS – Continued

Credit Risk

The Plan does not have a formal investment plan that limits investment choices. At December 31, 2010, the following debt mutual funds were rated as follows:

| | | <u>Average Maturity</u> |
|---|----------------------|-------------------------|
| State Street Bank & Trust Money Market Fund | A1(S&P)/P1 (Moody's) | 51 days |
| Vanguard Total Bond Market Index Fund | AA (S&P) | 7 years |
| Vanguard Money Market Reserves Fund | Aa (Moody's) | 56 days |

6. PLAN ADMINISTRATION

By statute, the Department administers the Plan. The Department has entered into a contract for recordkeeping services to be performed by T. Rowe Price Retirement Plan Services, Inc.

- A. Asset charges intended to cover the costs of administration, including recordkeeping, are computed monthly, withdrawn from participants' accounts and recorded as revenue. Effective November 1, 1997, the annual fee was .15 percent on the total account value. Effective January 1, 1999, the annual fee charged to participants was limited to a maximum of \$75. Effective January 1, 2001, the annual fee charged to participants was limited to a maximum of \$45 per participant. Effective January 1, 2003, the Department declared a fee holiday and there were no annual fees charged to the participants during 2003 or 2004. The fee holiday is reviewed annually. Consequently, these fees were reinstated for 2005 limited to a maximum \$45 per participant. In 2006 the maximum was \$35 and in 2007, the maximum was lowered to \$30. Again in 2008, 2009 and 2010, the Department declared a fee holiday and there were no annual asset fees charged to the participants. Exchange fees for certain reallocations as provided by the Plan were still incurred by participants during 2009 but were waived for 2010. Redemption fees were still charged to participants as usual for funds redeemed in 2009 and 2010.
- B. For the Stable Return Fund, the investment management fees assessed by Invesco are calculated daily, based on values during the quarter, in accordance with an annual fee rate applied to billable assets value. The fees are paid on a quarterly basis.

The billable assets value is determined at the end of each preceding calendar month based on 100 percent of total guaranteed investment contract assets. The annual fee rate schedule is as follows:

- .15 Percent of the first \$50 million of billable assets,
- .10 Percent of the next \$250 million of billable assets, and
- .05 Percent of billable assets in excess of \$300 million.

ILLINOIS STATE EMPLOYEES' DEFERRED COMPENSATION PLAN
NOTES TO FINANCIAL STATEMENTS – Continued

6. PLAN ADMINISTRATION – Continued

- C. The funds take their fund expenses, including investment management fees, before any dividends and/or capital gains are declared. Their fees and expenses are amortized and charged to the funds on an ongoing basis and shared equally by all other shareholders of the mutual funds.
- D. Effective January 1, 2008, the Illinois State Board of Investment (ISBI) entered into a new agreement with T. Rowe Price Retirement Plan Services, Inc. for expanded recordkeeping services. The original annual fees charged were to be \$45 per participant per year (or \$11.25 per quarter). However, since not all of the recordkeeping services were immediately taken over by T. Rowe Price, the fees were reduced to \$42 per participant per year (\$10.50 per quarter). This agreement was renegotiated and, as of April 1, 2010, the fees were reduced to \$35 per participant per year (\$8.75 per quarter).

Prior to 2008, T. Rowe Price Retirement Plan Services, Inc. received a set monthly fee for maintaining the detail records of the participants. This fee was based upon a contract, as amended, awarded by the Department. Marketing fees for quarterly newsletters were also paid to T. Rowe Price.

The previous contract fees were as follows:

\$129,167 per month from July 2000 through June 2001
\$134,333 per month from July 2001 through June 2002
\$140,000 per month from June 2002 through December 2002
\$140,000 per month from January 2003 through December 2003
\$145,600 per month from January 2004 through December 2004
\$151,424 per month from January 2005 through December 2005
\$151,424 per month from January 2006 through December 2006
\$151,424 per month from January 2007 through December 2007

This fee was reduced by reimbursements of recordkeeping expenses from the participating investment funds.

Reimbursements of \$2,291,843 exceeded fees of \$2,017,559 by \$274,284 for 2010. Fees of \$2,296,437 for the year ended December 31, 2009 exceeded reimbursements of \$2,093,239 by \$203,198. The reimbursement cash account held at T. Rowe Price Retirement Plan Services, Inc. earned interest of \$347 for 2010 and \$9,143 for 2009.

ILLINOIS STATE EMPLOYEES' DEFERRED COMPENSATION PLAN
NOTES TO FINANCIAL STATEMENTS – Continued

7. TAX STATUS

The Plan constitutes an eligible deferred compensation plan under Section 457 of the Internal Revenue Code and, therefore, the amounts of compensation (and earnings thereon) deferred by employees participating in the Plan are not subject to federal income tax withholding nor are they includable in taxable income until actually paid or otherwise made available to the participant, a beneficiary, or an estate. In addition, early distributions are not subject to the 10% federal tax penalty.

For Illinois Income Tax Act purposes, per private letter ruling issued by the Illinois Department of Revenue on February 18, 1977, compensation deferred under the Plan will be treated the same as for federal income tax. On December 19, 1988, the Illinois Department of Revenue ruled that distributions from Internal Revenue Code Section 457 plans are not taxable under the Illinois Income Tax Act. Distributions qualify as Illinois income tax subtraction modifications and are not subject to withholding.

Amounts deferred are subject to social security taxes in the year deferred. Benefit payments under the Plan do not constitute earnings and thus are not subject to social security taxes in the year received as clarified by Social Security Act Amendments of 1983, P.L. 98-21.

The Plan obtained its latest determination letters on October 7, 1976 and February 18, 1977 for federal and state rulings, respectively. The Plan has been amended since receiving the determination letters. However, the Plan Administration (the Department) believes that the Plan is currently designed and being operated in compliance with applicable requirements of the Internal Revenue Code.

SUPPLEMENTARY INFORMATION

ILLINOIS STATE EMPLOYEES' DEFERRED COMPENSATION PLAN
 COMBINED SCHEDULES OF RECEIPTS, DISBURSEMENTS, AND
 CHANGES IN CASH BALANCES
 Years Ended December 31, 2010 and 2009

| | 2010 | 2009 |
|--|---------------------|---------------------|
| RECEIPTS | | |
| Participant deferrals | \$ 162,263,187 | \$ 162,901,115 |
| Participant accounts transferred in from other qualified retirement plans | 1,192,350 | 2,235,887 |
| Transfer from Prime Reimbursement account | 3,376,367 | 1,096,900 |
| Interest received: | | |
| Prime Reserve Fund - purchase and exchange | 1 | - |
| State Treasury | 25,839 | 63,243 |
| Other | 20,052 | 100 |
| Total receipts | 166,877,796 | 166,297,245 |
| DISBURSEMENTS | | |
| Transfers to service agent for investment | 166,929,485 | 164,430,014 |
| Administrative costs | 946,880 | 991,660 |
| Refunds | 60,380 | 61,133 |
| Total disbursements | 167,936,745 | 165,482,807 |
| EXCESS (DEFICIENCY) OF RECEIPTS OVER DISBURSEMENTS | (1,058,949) | 814,438 |
| CASH BALANCE, BEGINNING OF YEAR | 6,355,942 | 5,541,504 |
| CASH BALANCE, END OF YEAR | \$ 5,296,993 | \$ 6,355,942 |

Note: The above schedule presents the combined cash transactions, and summarizes cash receipts and cash disbursements in the State Employees' Deferred Compensation Plan Fund in the State Treasury. The ending cash balance has been reconciled to the balance reported by the State Comptroller.

ILLINOIS STATE EMPLOYEES' DEFERRED COMPENSATION PLAN
SUMMARY SCHEDULES OF INVESTMENT INCREASES,
DEDUCTIONS, AND BALANCES
Years Ended December 31, 2010 and 2009

| | 2010 | 2009 |
|---|------------------|------------------|
| INVESTMENT INCREASES | | |
| Deferral contributions | \$ 163,539,390 | \$ 162,455,975 |
| Participant accounts transferred in from other qualified retirement plans | 3,424,171 | 2,265,665 |
| Reinvested income | 77,329,646 | 49,762,900 |
| Net appreciation (depreciation) in value | 323,910,691 | 461,897,183 |
| Total increase | 568,203,898 | 676,381,723 |
| INVESTMENT DEDUCTIONS | | |
| Distributions: | | |
| Terminations | 57,952,855 | 45,129,963 |
| Deaths | 6,611,557 | 6,971,426 |
| Hardship | 6,039,259 | 3,711,597 |
| Total distributions | 70,603,671 | 55,812,986 |
| PARTICIPANT ACCOUNTS TRANSFERRED OUT TO OTHER QUALIFIED RETIREMENT PLANS | 90,433,124 | 64,181,094 |
| Total deductions in response to distribution qualifying events | 161,036,795 | 119,994,080 |
| REDEMPTION CHARGES AND EXCHANGE FEES | 18,618 | 24,441 |
| Total deductions | 161,055,413 | 120,018,521 |
| NET INCREASE IN INVESTMENTS DURING THE YEAR | 407,148,485 | 556,363,202 |
| INVESTMENT BALANCE, BEGINNING OF YEAR | 2,786,639,950 | 2,230,276,748 |
| INVESTMENT BALANCE, END OF YEAR | \$ 3,193,788,435 | \$ 2,786,639,950 |
| NUMBER OF PARTICIPANTS | 52,335 | 52,418 |
| AVERAGE ACCOUNT VALUE | \$ 61,026 | \$ 53,162 |
| LARGEST ACCOUNT VALUE | \$ 1,858,622 | \$ 1,472,841 |
| SMALLEST ACCOUNT VALUE | \$ 10 | \$ 10 |

Note: This schedule summarizes amounts withheld from State employees under the deferred compensation program and which were invested in the various investment vehicles of the Plan. Due to timing differences relating to the deposit of funds into the various investment vehicles, certain amounts may be included in the cash balance at year-end and balances reflected on this schedule will not agree with balances reported on the Statement of Plan Net Assets.

ILLINOIS STATE EMPLOYEES' DEFERRED COMPENSATION PLAN
 SCHEDULES OF ADMINISTRATIVE COSTS
 Years Ended December 31, 2010 and 2009

| | <u>2010</u> | <u>2009</u> |
|----------------------------|---------------------|-------------------|
| Salaries | \$ 522,892 | \$ 520,173 |
| Fringe benefits | 330,664 | 300,821 |
| Telecommunication services | 6,849 | 7,520 |
| Statistical services | 70,572 | 19,491 |
| Travel | 1,408 | 149 |
| Contractual services | 90,495 | 111,539 |
| Printing | 81 | 512 |
| Depreciation | 3,432 | 12,919 |
| Equipment | - | - |
| Other | 188 | - |
| Office supplies | <u>1,990</u> | <u>1,147</u> |
| | | |
| TOTAL ADMINISTRATIVE COSTS | <u>\$ 1,028,571</u> | <u>\$ 974,271</u> |

Note: The above schedule summarizes the administrative costs incurred by the Department of Central Management Services in connection with the Deferred Compensation Plan. These costs are stated on an accrual basis and have been paid from the State Employees' Deferred Compensation Plan Fund. Annual appropriations are made to the Department from the Plan for these administrative expenses. Purchases of investments in the various funds and payments of benefits to participants are made under continuing appropriations provided under Public Act 80-1181, effective January 30, 1978.



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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

As Special Assistant Auditors for the Auditor General, we have audited the statements of plan net assets of the State Employees' Deferred Compensation Plan Fund (755) of the State of Illinois, Department of Central Management Services (Department) as of December 31, 2010 and 2009, and the related statements of changes in plan net assets for the years ended, and have issued our report thereon dated June 17, 2011. 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.

Internal Control Over Financial Reporting

In planning and performing our audits, we considered the Department's internal control over financial reporting of the State Employees' Deferred Compensation Plan Fund (755) 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 Department's internal control over financial reporting. Accordingly, we do not express an opinion on the effectiveness of the Department's internal control over financial reporting.

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

A material weakness is a deficiency, or combination of deficiencies, in internal control, such that there is a reasonable possibility that a material misstatement of the entity'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 first paragraph of this section and was not designed to identify all deficiencies in internal control that might be deficiencies, significant deficiencies or material weaknesses. We did not identify any deficiencies in internal control over financial reporting of the State Employees' Deferred Compensation Plan Fund (755) that we consider to be material weaknesses, as defined above.

Compliance and Other Matters

As part of obtaining reasonable assurance about whether the State Employees' Deferred Compensation Plan Fund's (755) 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 audits 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*.

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



Springfield, Illinois
June 17, 2011