

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

Compliance Examination

Year ended June 30, 2011

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

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

Table of Contents

	Page
Agency Officials	1
Management Assertion Letter	2
Compliance Report:	
Summary	3
Accountants' Report:	
Independent Accountants' Report on State Compliance, on Internal Control over Compliance, and on Supplementary Information for State Compliance Purposes	4
Schedule of Findings:	
Current Findings	7
Prior Finding Not Repeated	8
Supplementary Information for State Compliance Purposes:	
Summary	9
Fiscal Schedules and Analysis:	
Comparative Schedules of Operations	10
Schedules of Investment Portfolio	11
Schedules of Investment Manager Fees	12
Schedules of Soft Dollar Credits (Unaudited)	14
Schedules of Investment Commissions (Unaudited)	15
Schedules of Property and Equipment	18
Reconciliation of the State Treasurer's Cash Balance with that of ISBI	18
Analysis of Accounts Receivable	18
Analysis of Operations:	
Board Functions and Planning Program	19
Number of Employees	20
Proceeds from General Obligation Bonds (Unaudited)	20
Third-Party Marketing Fees Paid (Unaudited)	21
Service Efforts and Accomplishments (Unaudited)	21
Overall Rates of Return (Unaudited)	22
Investment Returns – Benchmark and Actual (Unaudited)	22
Net Asset Allocation as of June 30, 2011 (Unaudited)	24

The annual financial statements of the Illinois State Board of Investment for the year ended June 30, 2011 were issued under a separate cover.

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

Agency Officials

Executive Director	Mr. William R. Atwood
Deputy Executive Director	Ms. Katherine A. Spinato
Chief Fiscal Officer	Vacant (July 1, 2010 – February 25, 2011) Ms. Adanna Nwodu (February 26, 2011- Current)
Chief Financial Officer/Investment Portfolio Accounting Officer	Ms. Alise White (July 1, 2010 – Current)
General Counsel/Chief Compliance Officer	Ms. Emily A. Reid (July 1, 2010 – September 2010) Ms. Linsey J. Schoemehl (October 2010 – Current)

Illinois State Board of Investment Office is located at:

180 N. LaSalle Street
Suite 2015
Chicago, Illinois 60601



ILLINOIS STATE BOARD OF INVESTMENT

180 North LaSalle Street, Suite 2015

Chicago, Illinois 60601

(312) 793-5718

January 18, 2012

McGladrey & Pullen, LLP
20 N. Martingale Road, Suite 500
Schaumburg, IL 60173

Ladies and Gentlemen:

We are responsible for the identification of, and compliance with, all aspects of laws, regulations, contracts, or grant agreements that could have a material effect on the operations of the Illinois State Board of Investment (ISBI). We are responsible for and we have established and maintained an effective system of internal controls over compliance requirements. We have performed an evaluation of ISBI's compliance with the following assertions during the year ended June 30, 2011. Based on this evaluation, we assert that during the year ended June 30, 2011, ISBI has materially complied with the assertions below.

- A. ISBI has obligated, expended, received, and used public funds of the State in accordance with the purpose for which such funds have been appropriated or otherwise authorized by law.
- B. ISBI has obligated, expended, received, and used public funds of the State in accordance with any limitations, restrictions, conditions, or mandatory directions imposed by law upon such obligation, expenditure, receipt or use.
- C. ISBI has complied, in all material respects, with applicable laws and regulations, including the State uniform accounting system, in its financial and fiscal operations.
- D. The State revenues and receipts collected by ISBI are in accordance with applicable laws and regulations and the accounting and recordkeeping of such revenues and receipts is fair, accurate, and in accordance with law.
- E. The money or negotiable securities or similar assets handled by ISBI on behalf of the State or held in trust by ISBI have been properly and legally administered, and the accounting and recordkeeping relating thereto is proper, accurate, and in accordance with law.

Very truly yours,

ILLINOIS STATE BOARD OF INVESTMENT

William Atwood
Executive Director

Katherine Spinato
Deputy Executive Director

Alise White
Chief Financial Officer/
Investment Portfolio
Accounting Officer

Linsey J. Schoemehl
General Counsel/ Chief
Compliance Officer

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

Compliance Report

Summary

Year ended June 30, 2011

The compliance testing performed during this examination was conducted in accordance with *Government Auditing Standards* and in accordance with the Illinois State Auditing Act.

Accountants' Reports

The Independent Accountants' Report on State Compliance, on Internal Control over Compliance, and on Supplementary Information for State Compliance Purposes does not contain scope limitations, disclaimers, or other significant nonstandard language.

Summary of Findings

	<u>Current Report</u>	<u>Prior Report</u>
Number of:		
Findings	-	1
Repeated findings	-	-
Prior recommendations implemented or not repeated	1	2

Details of findings are presented in a separate section of the report.

<u>Item No.</u>	<u>Page</u>	<u>Description</u>	<u>Finding Type</u>
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FINDINGS (GOVERNMENT AUDITING STANDARDS)

None

FINDINGS (STATE COMPLIANCE)

The following findings which are reported as current findings relating to *Government Auditing Standards* also meet the reporting requirements for State Compliance.

None

PRIOR FINDING NOT REPEATED

A	Noncompliance with Statutory Mandates
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Exit Conference

In correspondence received from the Illinois State Board of Investment on December 2, 2011, ISBI elected to waive a formal exit conference.



**Independent Accountants' Report on State Compliance,
on Internal Control over Compliance, and on
Supplementary Information for State Compliance Purposes**

Honorable William G. Holland
Auditor General
State of Illinois

Board of Trustees
Illinois State Board of Investment

Compliance

As Special Assistant Auditors for the Auditor General, we have examined the Illinois State Board of Investment's (ISBI) compliance with the requirements listed below, as more fully described in the Audit Guide for Financial Audits and Compliance Attestation Engagements of Illinois State Agencies (Audit Guide) as adopted by the Auditor General, during the year ended June 30, 2011. The management of ISBI is responsible for compliance with these requirements. Our responsibility is to express an opinion on ISBI's compliance based on our examination.

- A. ISBI has obligated, expended, received, and used public funds of the State in accordance with the purpose for which such funds have been appropriated or otherwise authorized by law.
- B. ISBI has obligated, expended, received, and used public funds of the State in accordance with any limitations, restrictions, conditions, or mandatory directions imposed by law upon such obligation, expenditure, receipt, or use.
- C. ISBI has complied, in all material respects, with applicable laws and regulations, including the State uniform accounting system, in its financial and fiscal operations.
- D. The State revenues and receipts collected by ISBI are in accordance with applicable laws and regulations and the accounting and recordkeeping of such revenues and receipts is fair, accurate, and in accordance with law.
- E. Money or negotiable securities or similar assets handled by ISBI on behalf of the State or held in trust by ISBI have been properly and legally administered and the accounting and recordkeeping relating thereto is proper, accurate, and in accordance with law.

We conducted our examination in accordance with attestation standards established by the American Institute of Certified Public Accountants; the standards applicable to attestation engagements contained in *Government Auditing Standards*, issued by the Comptroller General of the United States; the Illinois State Auditing Act (Act); and the Audit Guide as adopted by the Auditor General pursuant to the Act; and, accordingly, included examining, on a test basis, evidence about ISBI's compliance with those requirements listed in the first paragraph of this report and performing such other procedures as we considered necessary in the circumstances. We believe that our examination provides a reasonable basis for our opinion. Our examination does not provide a legal determination on ISBI's compliance with specified requirements.

In our opinion, ISBI complied, in all material respects, with the requirements listed in the first paragraph of this report during the year ended June 30, 2011.

Internal Control

The management of ISBI is responsible for establishing and maintaining effective internal control over compliance with the requirements listed in the first paragraph of this report. In planning and performing our examination, we considered ISBI's internal control over compliance with the requirements listed in the first paragraph of this report as a basis for designing our examination procedures for the purpose of expressing our opinion on compliance and to test and report on internal control over compliance in accordance with the Audit Guide issued by the Illinois Office of the Auditor General, but not for the purpose of expressing an opinion on the effectiveness of internal control over compliance. Accordingly, we do not express an opinion on the effectiveness of ISBI's internal control over compliance.

A deficiency in an entity's internal control over compliance exists when the design or operation of a control over compliance does not allow management or employees, in the normal course of performing their assigned functions, to prevent, or detect and correct, noncompliance with the requirements listed in the first paragraph of this report on a timely basis. A *material weakness in an entity's internal control over compliance* is a deficiency, or combination of deficiencies, in internal control over compliance such that there is a reasonable possibility that material noncompliance with a requirement listed in the first paragraph of this report will not be prevented, or detected and corrected, on a timely basis.

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

As required by the Audit Guide, immaterial findings excluded from this report have been reported in a separate letter to your office.

Supplementary Information for State Compliance Purposes

As Special Assistant Auditors for the Auditor General, we have audited the basic financial statements of ISBI as of and for the year ended June 30, 2011, and have issued our report thereon dated December 14, 2011. The accompanying supplementary information, as listed in the table of contents as Supplementary Information for State Compliance Purposes, is presented for purposes of additional analysis and is not a required part of the basic financial statements of ISBI. The 2011 Supplementary Information for State Compliance Purposes, except for that portion marked "unaudited" on which we express no opinion, 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 for the year ended June 30, 2011, taken as a whole.

We have also previously audited, in accordance with auditing standards generally accepted in the United States, ISBI's basic financial statements for the year ended June 30, 2010. In our report dated January 12, 2011, we expressed an unqualified opinion on those financial statements. In our opinion, the 2010 Supplementary Information for State Compliance Purposes, except for the portion marked "unaudited" is fairly stated in all material respects in relation to the basic financial statements for the year ended June 30, 2010, 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 Board of Trustees, and ISBI's management and is not intended to be and should not be used by anyone other than these specified parties.

McGladrey & Pullen, LLP

Schaumburg, Illinois
January 18, 2012

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

Schedule of Findings

Current Findings

Year ended June 30, 2011

None.

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

Schedule of Findings

Prior Finding Not Repeated

Year ended June 30, 2011

A. Noncompliance with Statutory Mandates

During the previous audit, the Illinois State Board of Investment (ISBI) did not comply with mandate requirements related to the management of the Power Agency Trust Fund, quarterly and annual financial reporting, and publishing information on their website. During the current audit, ISBI complied with all mandates tested with the exception of publishing information to its website in a timely manner. This has been reported in a separate immaterial findings letter. (Finding Code No. 10-1)

ILLINOIS STATE BOARD OF INVESTMENT

(An Internal Investment Pool of the State of Illinois)

Supplementary Information for State Compliance Purposes

Year ended June 30, 2011

Summary

Supplementary Information for State Compliance Purposes presented in this section of the report includes the following:

Fiscal Schedules and Analysis:

- Comparative Schedule of Operations
- Schedules of Investment Portfolio
- Schedules of Investment Manager Fees
- Schedules of Soft Dollar Credits (Unaudited)
- Schedules of Investment Commissions (Unaudited)
- Schedules of Property and Equipment
- Reconciliation of the State Treasurer's Cash Balance with that of ISBI
- Analysis of Accounts Receivable

Analysis of Operations:

- Board Functions and Planning Program
- Number of Employees
- Proceeds from General Obligation Bonds (Unaudited)
- Third-Party Marketing Fees Paid (Unaudited)
- Service Efforts and Accomplishments (Unaudited)
- Overall Rates of Return (Unaudited)
- Investment Returns – Benchmark and Actual (Unaudited)
- Net Asset Allocations as of June 30, 2011 (Unaudited)

The accountants' report that covers the Supplementary Information for State Compliance Purposes presented in the Compliance Report Section states that it has been subjected to the auditing procedures applied in the audit of the basic financial statements and, in the accountants' opinion, except for that portion marked "unaudited," on which they express no opinion, it is fairly stated in all material respects in relation to the basic financial statements taken as a whole.

ILLINOIS STATE BOARD OF INVESTMENT

(An Internal Investment Pool of the State of Illinois)

Fiscal Schedules and Analysis

Comparative Schedules of Operations

Years ended June 30, 2011 and 2010

	2011	2010	Increase (decrease)
Investment income (loss):			
Interest	\$ 136,079,683	\$ 128,588,561	\$ 7,491,122
Dividends	132,335,702	114,725,819	17,609,883
Securities lending	3,494,441	6,605,329	(3,110,888)
Realized gain on investments	328,255,478	178,915,029	149,340,449
Unrealized gain on investments	<u>1,482,232,941</u>	<u>455,098,197</u>	<u>1,027,134,744</u>
Total investment income	<u>2,082,398,245</u>	<u>883,932,935</u>	<u>1,198,465,310</u>
Administrative expenses:			
Salaries and benefits	1,777,998	1,946,875	(168,877)
Operating	515,534	527,166	(11,632)
External support	<u>34,929,987</u>	<u>35,210,736</u>	<u>(280,749)</u>
Total expenses	<u>37,223,519</u>	<u>37,684,777</u>	<u>(461,258)</u>
Excess of investment income over administrative over expenses	<u>\$ 2,045,174,726</u>	<u>\$ 846,248,158</u>	<u>\$ 1,198,926,568</u>

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

Fiscal Schedules and Analysis
Schedules of Investment Portfolio
June 30, 2011 and 2010

Fair value	2011		2010	
	Amount	Percentage of portfolio	Amount	Percentage of portfolio
Fixed income securities:				
Government and agency obligations:				
U.S. Treasury	\$ 479,422,631	4.17%	\$ 155,303,411	1.61%
Federal agencies and other governments	887,676,120	7.72	655,435,901	6.78%
Foreign government obligations	37,951,769	0.33	44,409,906	0.46%
Corporate obligations:				
Finance	204,608,577	1.78	246,087,134	2.54%
Industrials	425,847,041	3.70	496,856,383	5.14%
Collateralized mortgage obligations	13,492,526	0.12	39,240,826	0.41%
Asset backed	-	0.00	1,835,282	0.02%
Miscellaneous	118,885,238	1.03	136,515,033	1.41%
Private placement	-	0.00	5,133,730	0.05%
Total fixed income securities	<u>2,167,883,902</u>	<u>18.85</u>	<u>1,780,817,606</u>	<u>18.42%</u>
Equities:				
Common stocks:				
U.S. equities:				
Consumer discretionary	399,406,954	3.47	343,626,241	3.56
Consumer staples	292,352,546	2.54	258,447,603	2.67
Energy	340,835,612	2.96	256,984,831	2.66
Financials	541,615,534	4.71	513,834,902	5.32
Healthcare	388,948,328	3.38	362,369,958	3.75
Industrials	454,644,071	3.97	351,096,444	3.63
Information Technology	575,451,158	5.00	443,096,046	4.58
Materials	162,314,769	1.41	111,765,377	1.16
Telecommunication Services	77,405,727	0.67	79,229,563	0.82
Utilities	103,955,890	0.91	113,802,554	1.18
Other	43,268,269	0.38	22,891,040	0.24
Commingled funds	256,817,374	2.23	270,510,642	2.80
Preferred stock	-	0.00	517,676	0.01
Non-U.S. equities	2,195,241,217	19.09	1,733,357,594	17.93
Total equities	<u>5,832,257,449</u>	<u>50.72</u>	<u>4,861,530,471</u>	<u>50.30</u>
Hedge funds	1,075,584,754	9.36	917,854,201	9.50
Real estate funds	819,053,366	7.12	750,210,957	7.76
Private equity	629,256,286	5.47	542,441,291	5.61
Money market instruments	303,501,465	2.64	270,231,935	2.80
Infrastructure funds	417,267,415	3.63	320,293,041	3.31
Bank loans	253,447,070	2.20	222,623,999	2.30
Foreign currency forward contracts	(353)	0.01	(266,410)	0.00
Total investments	<u>\$ 11,498,251,354</u>	<u>100.00%</u>	<u>\$ 9,665,737,091</u>	<u>100.00%</u>

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

Fiscal Schedules and Analysis
 Schedules of Investment Manager Fees
 Years ended June 30, 2011 and 2010

	2011	2010
Alinda	\$ -	\$ 2,744,372
Amalgamated Bank NY	752,037	987,814
Buford, Dixon	77,241	100,924
Channing	256,018	223,301
Chicago Equity Partners	1,044,487	877,030
Credo	197,337	55,028
Crescent Capital	655,782	672,204
Decatur	76,328	67,543
Entrust	2,041,554	1,663,552
Fiduciary Management Associates	330,767	300,102
Fort Washington	790,437	695,611
Garcia Hamilton	48,007	-
Globeflex Capital	482,053	442,446
Grosvenor Capital Management	1,758,416	1,655,792
Herndon Capital	364,070	300,960
IronBridge Capital Management	1,169,319	1,057,326
LM Capital	434,679	354,350
LSV Asset Management	3,473,063	2,796,100
Lynmar	-	129,575
Macquarie	3,669,149	3,749,940
McDonnell Investment Management	592,949	681,434
Mesirow	1,939,851	1,781,227

(Continued)

ILLINOIS STATE BOARD OF INVESTMENT

(An Internal Investment Pool of the State of Illinois)

Fiscal Schedules and Analysis

Schedules of Investment Manager Fees (Continued)

Years ended June 30, 2011 and 2010

	2011	2010
Opus Capital Management	\$ 424,333	\$ 379,617
Profit	716,437	645,010
Rhumblin	191,503	182,889
Rockcreek	2,064,475	1,897,327
Segall Bryant and Hamill	982,410	929,913
State Street Bank	140,000	-
SSgA (Cash Overlay)	125,000	125,000
SSgA MSCI ACWI Index	338,454	210,180
SSgA MSCI EAFE Index	-	41,821
SSgA Small Cap Global	1,317,286	1,224,675
Templeton	1,747,843	1,622,204
Union Labor Life Investment Co. (ULLICO)	889,152	1,095,090
Various (allocated equally to all Investment Managers)	36,900	39,500
Vontobel Asset Management	2,180,479	1,895,693
William Blair	2,011,546	1,914,850
	<u>\$ 33,319,362</u>	<u>\$ 33,540,400</u>

Investment manager fees are related to fees paid to various investment managers. Fees are negotiated primarily on market values. A graduated rate is used for most managers based upon various increments per million dollars of market value.

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

Fiscal Schedules and Analysis
 Schedules of Soft Dollar Credits (Unaudited)
 Years ended June 30, 2011 and 2010

	2011	2010
Soft dollar credits outstanding, at beginning of fiscal year	\$ 325,187	\$ 318,210
Soft dollar credits earned	26,429	6,977
Bank of New York payout amount	(357,361)	-
Adjustment***	<u>20,598</u>	<u>-</u>
Soft dollar credits outstanding, at end of fiscal year	<u>\$ 14,853</u>	<u>\$ 325,187</u>

*** This adjustment reflects an adjustment to record prior year soft dollar credits earned but not recorded for soft dollars held at Bank of New York and a balance outstanding in soft dollars held at Citibank.

Soft dollar credits are issued to ISBI by certain brokers based on the level of activity of investment managers using that particular broker. ISBI can use these credits to pay for various investment expenses.

ILLINOIS STATE BOARD OF INVESTMENT

(An Internal Investment Pool of the State of Illinois)

Fiscal Schedules and Analysis

Schedules of Investment Commissions (Unaudited)

Years ended June 30, 2011 and 2010

	2011	2010
Investment brokerage firms:		
Banc of America Securities Inc.	\$ 39,997	\$ 69,070
Barclays Capital	-	33,997
Bloomberg Tradebook	-	18,034
BNY Brokerage	25,676	34,432
BOE Securities	-	19,199
Brockhouse & Cooper Inc.	-	6,840
Cabrera Asset Management	277,702	271,731
Cantor Fitzgerald & Co.	64,896	98,617
Carnegie Inc. New York	-	12,054
CF Global Trading LLC	44,751	8,117
Cheevers & Company	183,168	147,882
Cheurex de Virieu Paris	19,932	37,662
Chicago Analytic Trading Co.	82,428	37,508
Citigroup Smith Barney Inc.	85,966	174,644
Collins Stewart LLC	-	12,102
Credit Agricole Indosuez	-	6,654
Credit Suisse First Boston Corp.	117,539	261,287
CS First Boston	10,610	-
Daiwa Securities	5,340	-
Deutsche Banc Securities Inc.	37,396	46,296
Direct Access Partners	-	12,608
Enskilda Securities	5,861	-
First Analysis Securities	-	5,123
Friedman Billings and Ramsey & Co. Inc.	8,721	12,132
Gardner Rich & Co.	96,993	237,164
Goldman Sachs & Company	14,930	30,833

(Continued)

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

Fiscal Schedules and Analysis
Schedules of Investment Commissions (Unaudited) (Continued)
Years ended June 30, 2011 and 2010

	2011	2010
Investment brokerage firms (Continued):		
Greentree Brokerage	\$ -	\$ 11,856
Instinet	29,301	60,905
International Strategy & Investment	-	83,401
Investment Technology Group	47,489	-
Itau Securities	5,321	-
J.P. Morgan Securities, Inc.	46,766	82,061
Jefferies & Company	49,112	66,045
Johnson Rice	-	9,635
Jones Trading	-	10,541
Keefe Bruynette and Woods Inc.	-	10,264
Kepler Securities	6,068	-
Knight Securities	7,064	-
Ladenburg Thalmann	-	5,103
Leerink Swan	-	13,259
Liquidnet Inc.	100,772	165,928
Loop Capital Markets	328,847	223,420
Loopus	-	27,702
Lynch Jones & Ryan	-	11,520
M. Ramsey King Securities	59,186	98,270
Macquarie Equities Ltd	25,190	23,484
Magna Securities	-	43,997
Melvin Securities Corp	48,476	42,774
Merrill Lynch Pierce Fenner & Smith	10,768	93,832
Morgan Stanley & Co.	54,817	108,348
MR Beal	77,276	88,055
Muriel Siebert	-	9,748
Natixis Group	-	8,729
Needham & Company	-	5,596
Nomura Securities	59,373	53,023

(Continued)

ILLINOIS STATE BOARD OF INVESTMENT

(An Internal Investment Pool of the State of Illinois)

Fiscal Schedules and Analysis

Schedules of Investment Commissions (Unaudited) (Continued)

Years ended June 30, 2011 and 2010

	2011	2010
Investment brokerage firms (Continued):		
Nutmeg Securities	\$ -	\$ 6,721
Oppenheimer	-	7,848
Pacific American	-	13,627
Pershing	-	17,681
Piper, Jaffrey & Hopwood Inc.	9,592	11,064
Pulse Trading	61,243	66,235
Ramsey King	6,909	-
RBC Capital Markets	8,324	-
Robert W. Baird & Co.	40,912	65,255
Samdler & O'Neil	-	7,613
Sanford C. Bernstein	6,398	30,289
Scotia Capital Markets Toronto	-	6,213
SG Americas Securities	13,715	-
Sidoti	-	6,981
Signal Hill	-	5,314
Societe Generale	-	9,872
Sogen Securities	-	46,039
Stephen Inc.	-	9,040
Stiffel, Nicolaus & Company Inc.	16,510	18,692
Svenska Handelsbank	-	9,371
UBS Securities	124,749	86,714
Viewpoint Securities	-	9,369
Weeden & Co.	-	10,949
William Blair & Co.	12,730	-
Williams Capital Group	48,140	331,790
Various (Under \$5,000)	356,136	195,958
	<u>\$ 2,783,090</u>	<u>\$ 3,924,117</u>

Commissions relate to fees paid to investment brokerage firms for the purchase and sale of investments.

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

Fiscal Schedules and Analysis

Year ended June 30, 2011

Schedules of Property and Equipment

Schedules of changes in property and equipment are as follows:

	Balance at June 30, 2009	Additions	Deletions	Balance at June 30, 2010	Additions	Deletions	Balance at June 30, 2011
Cost	\$ 116,900	\$ -	\$ -	\$ 116,900	\$ 9,394	\$ (18,943)	\$ 107,351
Less accumulated depreciation	<u>(59,265)</u>	<u>(7,244)</u>	<u>-</u>	<u>(66,509)</u>	<u>(4,494)</u>	<u>-</u>	<u>(71,003)</u>
Net property and equipment	<u>\$ 57,635</u>	<u>\$ (7,244)</u>	<u>\$ -</u>	<u>\$ 50,391</u>	<u>\$ 4,900</u>	<u>\$ (18,943)</u>	<u>\$ 36,348</u>

Note: Amounts reported in the Schedule of Property and Equipment have been reconciled to property reports submitted to the Office of the Comptroller.

Reconciliation of the State Treasurer's Cash Balance with that of ISBI

	<u>2011</u>	<u>2010</u>
Balance per State Treasurer at June 30	\$ 119,804	\$ 34,557
Vouchers in transit	<u>(9,354)</u>	<u>(70,540)</u>
Balance per ISBI at June 30	<u>\$ 110,450</u>	<u>\$ (35,983)</u>

Analysis of Accounts Receivable

ISBI's receivable balance at June 30, 2011 and 2010 amounted to \$66,419,100 and \$68,431,963, respectively. The balance consisted of \$41,266,917 and \$33,086,416 of dividends, interest, foreign taxes, and accounts receivable on investments held as of June 30, 2011 and 2010, respectively, and included receivables of \$25,152,183 and \$35,345,547 for investments sold prior to June 30, 2011 and 2010, respectively, but settled after year-end. Because the collection of this interest is relatively assured and the sale of investments is merely an issue of timing, ISBI does not maintain a reserve for uncollectible receivables or age the receivable detail.

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

Analysis of Operations

Year ended June 30, 2011

Board Functions and Planning Program

The Illinois State Board of Investment (ISBI) was created on October 10, 1969, by Article 22A of the Illinois Pension Code to manage and invest the assets and reserves of any pension fund or retirement system that transfers this responsibility to ISBI. In accordance with Article 22A, the Trustees of the State Employees' Retirement System, the General Assembly Retirement System, and the Judges' Retirement System transferred all of their investment assets to ISBI as of June 30, 1970. Since that date, all additional funds available for investment for those three systems have been transferred to ISBI.

In 1978, in accordance with Article 24, ISBI shall be responsible for developing and establishing the State Employees' Deferred Compensation Plan (the Plan). Initial enrollment began in 1979, at which time the Department of Personnel (now Department of Central Management Services) was named as the Administrator of the Plan. With respect to developing and establishing the plan, ISBI reviews investment offering options for the Plan and supervises the Department of Central Management Services' administration of the Plan.

Beginning July 1, 1978, ISBI merged the Illinois Board Fund, Illinois Equity Fund, and Illinois Segregated Fund into the Illinois State Board of Investment Commingled Fund (the Commingled Fund). The purpose of this consolidation was to enhance control over investment policy through increased flexibility in the allocation of cash reserves between fixed income and equity investments. ISBI's investment policy and strategy can be more uniformly applied to each member system irrespective of cash flow. In addition, it simplified ISBI's accounting and reporting systems. The result is that the Commingled Fund now represents all of the assets under ISBI's supervision.

Beginning in 1982, ISBI expanded the asset base of the Commingled Fund to include both real estate and venture capital.

In 1992, ISBI completed its investment strategy to have all equity security investments managed externally.

During fiscal year 2004, ISBI engaged Marquette Associates as its investment consultant. ISBI conducted an asset allocation study and, in December 2003, adopted a written Asset Allocation Study. The Asset Allocation Study summarizes ISBI's investment policies and measures of performance, formally documents objectives of ISBI, and details a strategic plan for ISBI. Criteria for the review and evaluation of investment managers are included in the Asset Allocation Study. Additionally, a methodology and format is outlined to highlight the results of the objectives and goals established within the Asset Allocation Study. The Asset Allocation Study reaffirms the broadly diversified investment strategy that has been pursued by ISBI with the belief that, over a period of time, this approach will maximize investment return within a prudent level of risk. In March 2008, the Asset Allocation Study was updated to incorporate asset classes and revise asset allocation percentages.

Members of the Board of Trustees as of June 30, 2011 include:

Roderick Bashir	Justice Thomas Hoffman
Devon Bruce	Fred Montgomery
Michelle Bush	Treasurer Dan Rutherford
John Casey	Comptroller Judy Barr Topinka
Senator John Clayborne	

ISBI has established both long-term and short-term goals with the intention of maximizing earnings for Member Retirement Systems' investments. These goals are reviewed in accordance with the Strategic Investment Policy.

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

Analysis of Operations

Year ended June 30, 2011

Number of Employees

ISBI had 10 full-time employees at June 30, 2011 and June 30, 2010.

Proceeds from General Obligation Bonds (Unaudited)

Public Act 93-0002 (the Act) became effective on April 7, 2003 and authorized the State of Illinois to issue \$10 billion of General Obligation Bonds for the purpose of making contributions to designated retirement systems. The State Employees' Retirement System, General Assembly Retirement System, and Judges' Retirement System are "designated retirement systems" for the purpose of this law.

On June 12, 2003, the State of Illinois issued \$10 billion of General Obligation Bonds, Pension Funding Series June 2003. The net bond proceeds were allocated among the five state-funded retirement systems to reduce their actuarial reserve deficiencies as provided in the Act.

The State Employees' Retirement System, General Assembly Retirement System, and Judges' Retirement System (member systems) received an allocation of bond proceeds equal to \$1,544,924,744 on July 1, 2003. The monies were deposited into the Master Trust Account with the Illinois State Board of Investment on July 2, 2003. ISBI initially approved investing the pension bond proceeds in separate index funds. These index funds were subsequently liquidated and combined with ISBI's other investments and invested in accordance with the asset allocation policy of ISBI during the year ended June 30, 2004.

Public Act 96-0043 (the Act) became effective on July 15, 2009 and authorized the State of Illinois to issue \$3.466 billion of General Obligation Bonds for the purpose of making contributions to designated retirement systems. The State Employees' Retirement System, General Assembly Retirement System, and Judges' Retirement System are "designated retirement systems" for the purpose of this law.

On January 7, 2010, the State of Illinois issued \$3.466 billion of General Obligation Bonds, Taxable Bond Series January 2010. The net bond proceeds were allocated among the five state-funded retirement systems to reduce their actuarial reserve deficiencies as provided in the Act.

The State Employees' Retirement System, General Assembly Retirement System, and Judges' Retirement System received an allocation of bond proceeds equal to \$809,401,372 on January 20, 2010. The monies were deposited into the Master Trust Account with the Illinois State Board of Investment the same day. The monies were combined with ISBI's other investments and invested in accordance with the asset allocation policy of ISBI during the year ended June 30, 2010.

Public Act 96-1497 (the Act) became effective on January 14, 2011 and authorized the State of Illinois to issue up to \$4.1 billion of General Obligation Bonds for the purpose of making contributions to designated retirement systems. On March 10, 2011, the State of Illinois issued \$3.7 billion of General Obligation Bonds, Taxable Bond Series February 2011. The net bond proceeds were allocated among the five state-funded retirement systems to reduce their actuarial reserve deficiencies as provided in the Act.

The State Employees' Retirement System, General Assembly Retirement System, and Judges' Retirement System received an allocation of bond proceeds equal to \$745,546,496 on March 14, 2011. The monies were deposited into the Master Trust Account with the Illinois State Board of Investment the same day. The monies were combined with ISBI's other investments and invested in accordance with the asset allocation policy of ISBI during the year ended June 30, 2011.

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

Analysis of Operations

Year ended June 30, 2011

ISBI estimates the annualized return of each pension bond series as follows:

Series	Return
General Obligation Bonds, Pension Fund Series June 2003	6.40%
General Obligation Bonds, Taxable Bond Series January 2010	10.74%
General Obligation Bonds, Taxable Bond Series February 2011	4.56%

Third-Party Marketing Fees Paid (Unaudited)

ISBI disclosed that investment managers hired marketing groups to assist with promoting their investment product to ISBI. Marketing fees paid by investment managers were as follows:

Investment Manager	Third Party Marketer	Type of Fund	Year Ended June 30,	
			2011	2010
Alinda Infrastructure Fund	C.P. Eaton & Associates	Infrastructure	\$ 154,267	\$ 324,357
Alinda Infrastructure Fund II	Pinnacle and Chors	Infrastructure	-	21,771
Blackstone Capital Ptrs. V	Park Hill Group	Private Equity	-	350,000
Ironbridge Capital	Frontier Partners-Fronterage Asset Mgmt.	Equity	-	148,502
Resolute II	Credit Suisse LLC	Private Equity	-	2,284,488
			\$ 154,267	\$ 3,129,118

Service Efforts and Accomplishments (Unaudited)

For purposes of evaluating service efforts and accomplishments, three different measures have been included. One measure presents a historical perspective of overall annual and compound rates of return; another compares benchmark rates of return with actual rates of return by fund; and the last presents asset allocations by fund type.

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

Analysis of Operations
 Year ended June 30, 2011

Overall Rates of Return (Unaudited)

	<u>2011</u>	<u>2010</u>	<u>2009</u>	<u>2008</u>	<u>2007</u>
Annual total return	21.7%	9.1%	(20.1)%	(6.2)%	17.1%
Compound annual rate of return since July 1, 1982	9.4	9.0	8.9	10.3	11.0

Investment Returns – Benchmark and Actual (Unaudited)

ISBI operates under a long-range investment plan with the objective to maximize the total rate of return. The objectives set forth are as follows:

- At least equal to 7.75%, the actuarially assumed interest rate of return for one of ISBI's member systems, the State Employees' Retirement System (SERS). Historically, SERS had adopted 8.5% as the actuarially assumed rate of return, while the other two member systems - General Assembly Retirement System (GARS) and the Judges' Retirement System (JRS) have assumed 8.0%. In September 2010, SERS reduced its return assumption from 8.5% to 7.75%. Similarly, the GARS and JRS reduced their return assumptions from 8.0% to 7.0%. ISBI has assumed the same rate of return as SERS (7.75% as of June 30, 2011), as SERS' net assets represents approximately 94% of ISBI's net assets as of June 30, 2011.
- At least equal to the return of a composite benchmark of market indices in the same proportions as ISBI's asset allocation policy targets.

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

Analysis of Operations

Year ended June 30, 2011

ISBI earned a total rate of return of 21.7% for the year ended June 30, 2011.

	(Annualized)							
	2011	2010	2009	2008	2007	3 Yrs.	5 Yrs.	10 Yrs.
	%	%	%	%	%	%	%	%
Total Fund	21.7	9.1	(20.1)	(6.2)	17.1	2.0	3.1	4.5
Composite Benchmark*	19.6	10.2	(17.0)	(4.6)	16.4	3.0	3.9	5.3
Consumer Price Index	3.6	1.1	(1.4)	5.0	2.7	1.0	2.2	2.4
U.S. Equities	33.9	17.3	(25.1)	(12.7)	19.9	5.6	4.3	4.4
Russell 3000 Index	32.4	15.7	(26.6)	(12.5)	20.1	4.0	3.4	3.4
Hedge Funds **	12.7	4.4	(11.6)	(2.6)	19.3	1.3	3.9	N/A
HFRX Equity Hedge	3.4	3.1	(20.0)	(4.9)	14.7	(5.2)	(1.4)	2.0
International Equities	32.7	13.1	(29.1)	(10.3)	28.8	2.1	4.2	7.4
MSCI-EAFE Index	30.9	6.4	(31.0)	(10.2)	27.5	(1.3)	2.0	6.1
Fixed Income	5.7	5.5	(2.4)	5.3	6.9	2.9	4.2	4.3
Barclays Capital Universal Index	4.8	10.6	4.9	6.2	6.6	6.7	6.6	6.0
Real Estate	17.0	(8.2)	(31.7)	2.6	15.3	(9.8)	(2.8)	4.0
NCREIF Real Estate Index	16.7	(1.5)	(19.6)	9.2	17.2	(2.6)	3.4	7.6
Private Equity	24.0	14.0	(18.8)	(4.9)	31.7	4.7	7.5	7.0

* Composite Benchmark:

Effective 07/09:

30% Russell 3000; 20% MSCI-EAFE; 25% Barclays Capital Universal; 10% NCREIF;
5% Venture Economics Pooled Average Periodic IRR; 10% HFRX Equity Hedged Index.

Effective 11/08:

30% Russell 3000; 20% MSCI-EAFE; 25% Barclays Capital Universal; 10% NCREIF;
5% Venture Economic All Private Equity Index; 10% HFRX Equity Hedged Index.

Effective 04/08:

30% Russell 3000; 20% MSCI-EAFE; 25% Lehman Universal; 10% NCREIF;
5% Venture Economic All Private Equity Index; 10% HFRX Equity Hedged Index.

Effective 12/03:

45% Wilshire 5000; 10% MSCI-EAFE; 25% Lehman Universal; 10% NCREIF;
5% Venture Economic All Private Equity Index; 5% HFRX Equity Hedged Index.

Effective 4/02:

46% Russell 3000; 15% MS-AC Free ex US; 23% Lehman Universal;
8% NCREIF; 8% Russell 2000 + 3.0%.

Prior to 4/02:

43% Russell 3000; 20% MS-AC Free ex US; 22% Lehman Aggregate;
7% NCREIF; 8% absolute return of 12%.

**Hedge Funds:

ISBI began investing in Hedge Funds in Fiscal 2007, therefore actual return information is not available prior to that period.

Note: Effective 11/08, the Lehman Universal benchmark ceased to exist. Barclays Capital Universal is the benchmark currently used by ISBI.

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

Analysis of Operations

Year ended June 30, 2011

Net Asset Allocation as of June 30, 2011 (Unaudited)

The investment policy of ISBI establishes asset allocation targets and ranges for each asset class, selected to accomplish the long-range investment plan. The actual asset mix is roughly in line with the policy target, with modest over-allocations to U.S. equity and unallocated cash with offsetting under-allocations to international equity, alternative investments, and real estate.

	<u>Fair Value</u>	<u>Actual Asset Mix</u>	<u>Policy Target</u>
U.S. equity	\$ 3,380,198,858	30%	30%
U.S. equity hedge funds	1,075,584,754	9	10
International equity	2,195,241,217	18	20
Commingled funds ⁴	256,817,374	3	—
Fixed income ¹	2,167,883,902	18	18
Bank Loans	253,447,070	2	2
Real estate	819,053,366	8	10
Private Equity ²	629,256,286	6	5
Infrastructure ²	417,267,415	3	5
Cash ³	332,874,782	3	—
Total	<u>\$ 11,527,625,024</u>	<u>100%</u>	<u>100%</u>

¹ Maturities of one year or longer, including convertible bonds.

² Interests in limited partnerships and other entities which have limited liquidity.

³ Includes money market instruments and other assets, less liabilities.

⁴ Holdings include fixed income and equity instruments.