

# McGladrey & Pullen

Certified Public Accountants

## **STATE OF ILLINOIS JUDGES' RETIREMENT SYSTEM OF ILLINOIS**

FINANCIAL REPORT  
YEARS ENDED JUNE 30, 2007 AND 2006  
PERFORMED AS SPECIAL ASSISTANT AUDITORS  
FOR THE AUDITOR GENERAL, STATE OF ILLINOIS

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**JUDGES' RETIREMENT SYSTEM OF ILLINOIS**

FINANCIAL STATEMENTS

JUNE 30, 2007 AND 2006

**FINANCIAL STATEMENT REPORT**

**SUMMARY**

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

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

**Summary of Finding**

The auditors identified a matter involving the System's internal control over financial reporting that they considered to be a significant deficiency. The significant deficiency is described on page 22 as *Finding 07-1, Lack of Segregation of Duties*. This finding was not considered to be a material weakness.

**Exit Conference**

The System reviewed the finding and recommendation in this report and waived a formal exit conference. The response to the recommendation was provided by David M. Richter, Accounting Division Supervisor, in an email dated February 11, 2008.

# McGladrey & Pullen

Certified Public Accountants

## INDEPENDENT AUDITORS' REPORT

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

Board of Trustees  
Judges' Retirement System of Illinois  
Springfield, Illinois

As Special Assistant Auditors for the Auditor General, we have audited the accompanying statements of plan net assets of the Judges' Retirement System of Illinois (the System), as of June 30, 2007 and 2006 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 System's management. Our responsibility is to express an opinion on these financial statements based on our audits. We did not audit the financial statements of the Illinois State Board of Investment, an internal investment pool of the State of Illinois, which statements represent 98 percent, 98 percent, and 66 percent, respectively, in 2007, and 97 percent, 97 percent, and 58 percent, respectively, in 2006 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 audits in accordance with auditing standards generally accepted in the United States of America and the standards applicable to the 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, based on our audits and the report of other auditors, the financial statements referred to above present fairly, in all material respects, the plan net assets of the Judges' Retirement System of Illinois as of June 30, 2007 and 2006, and the changes in plan net assets 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 our report dated February 8, 2008 on our consideration of the System's internal control over financial reporting and our tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements and other matters. The purpose of that report is to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing, and not to provide an opinion on the internal control. 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 management's discussion and analysis on pages 3 and 4 and the schedules of funding progress and employer contributions on page 17 are not a required part of the basic financial statements but are supplementary information required by accounting standards generally accepted in the United States of America. We and the other auditors 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 audits were conducted for the purpose of forming an opinion on the basic financial statements of the System for the years ended June 30, 2007 and 2006. The supplementary financial information on pages 18 and 19 is presented for purposes of additional analysis and is not a required part of the basic financial statements. The supplementary financial information on pages 18 and 19 has been subjected to the auditing procedures applied by us and the other auditors in the audit of the basic financial statements and, in our opinion, based on our audit and the report of other auditors, is fairly stated in all material respects in relation to the basic financial statements taken as a whole.

*McGladrey & Pullen, LLP*

Schaumburg, Illinois  
February 8, 2008

# MANAGEMENT'S DISCUSSION AND ANALYSIS

This financial report is designed to provide a general overview of the Judges' 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 Judges' Retirement System of Illinois (System) for the years ended June 30, 2007 and 2006. 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 957 active judges and 946 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, 2007 and 2006, 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, 2007 and 2006. 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 System's net assets increased by \$70.9 million and \$34.2 million during fiscal years 2007 and 2006, respectively. The increase was primarily due to a \$75.6 million and \$32.3 million increase in the System's investments, at fair value during fiscal years 2007 and 2006, respectively.
- The System was actuarially funded at 48.4% as of June 30, 2007 an increase from 46.4% as of June 30, 2006.
- The overall rate of return for the Illinois State Board of Investment (ISBI) Commingled Fund was 17.1% for fiscal year 2007 compared to 11.0% for fiscal year 2006.

## ADDITIONS TO PLAN NET ASSETS

Additions to Plan Net Assets include employer and participant contributions and net income from investment activities. Participant contributions were \$14.2 million and \$13.8 million for the years ended June 30, 2007 and 2006, respectively. Participant contribution rates are set by statute as a percentage of gross salary. Employer contributions increased to \$35.2 million in 2007 from \$29.3 million in 2006. This increase was due to Public Act 94-0004 which was enacted into law on June 1, 2005. This legislation stipulated that state contributions for fiscal year 2006 and 2007 shall be based on specific dollar amounts rather than actuarial calculations.

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.

	As of June 30,			Increase/(Decrease) from	
	2007	2006	2005	2006 to 2007	2005 to 2006
Cash	\$ 11,698.0	\$ 16,363.6	\$ 11,788.7	\$ (4,665.6)	\$ 4,574.9
Receivables	262.3	301.6	2,945.3	(39.3)	(2,643.7)
Investments, at fair value	658,193.7	582,604.4	550,350.1	75,589.3	32,254.3
Equipment, net	3.3	4.3	3.3	(1.0)	1.0
Total assets	670,157.3	599,273.9	565,087.4	70,883.4	34,186.5
Liabilities	66.4	39.8	88.0	26.6	(48.2)
Total plan net assets	<u>\$ 670,090.9</u>	<u>\$ 599,234.1</u>	<u>\$ 564,999.4</u>	<u>\$ 70,856.8</u>	<u>\$ 34,234.7</u>

# MANAGEMENT'S DISCUSSION AND ANALYSIS

## DEDUCTIONS FROM PLAN NET ASSETS

Deductions from Plan Net Assets are primarily benefit payments. During 2007 and 2006, the System paid out \$76.2 million and \$69.8 million, respectively, in benefits and refunds, an increase of approximately 9.2% from 2006. Those higher payments were mainly due to an increase in the number of annuitants as well as a 3% automatic annuity increase paid each year to offset the effects of inflation. The administrative costs of the System represented less than 1% of total deductions in both 2007 and 2006.

## FUNDED RATIO

The funded ratio of the plan measures the ratio of net 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, 2007 increased to 48.4% from 46.4% on June 30, 2006.

The amount by which actuarially determined liabilities exceeded net assets was \$715.2 million on June 30, 2007 compared to \$692.2 million on June 30, 2006.

## INVESTMENTS

Investments of the System are combined in a commingled investment pool with the State Employees' 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 Plan Net Assets of each retirement system.

Net investment income less expenses of the total ISBI Commingled Fund was approximately \$1.9 billion during fiscal year 2007, versus net investment income of \$1.2 billion during fiscal year 2006, resulting in returns of 17.1% and 11.0%, respectively.

For the three, five, and ten year period ended June 30, 2007, the ISBI Commingled Fund earned a compounded rate of return of 12.6%, 10.8%, and 8.0%, respectively.

## LEGISLATION

On June 1, 2005, Public Act 94-0004 was enacted into law. This legislation contained employer contribution funding reductions of approximately \$9.3 million and \$8.8 million for fiscal years 2007 and 2006, respectively. This resulted in increased transfers from the ISBI Commingled Fund in fiscal years 2007 and 2006 in order to meet future funding requirements for benefit obligations.

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

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 thousands)

	For the Year Ended June 30,			Increase/(Decrease) from	
	2007	2006	2005	2006 to 2007	2005 to 2006
<b>Additions</b>					
Participant contributions	\$ 14,153.0	\$ 13,833.1	\$ 13,268.5	\$ 319.9	\$ 564.6
Employer contributions	35,236.8	29,337.9	32,043.0	5,898.9	(2,705.1)
Net investment income	<u>98,157.7</u>	<u>61,329.7</u>	<u>50,849.0</u>	<u>36,828.0</u>	<u>10,480.7</u>
Total additions	<u>147,547.5</u>	<u>104,500.7</u>	<u>96,160.5</u>	<u>43,046.8</u>	<u>8,340.2</u>
<b>Deductions</b>					
Benefits	75,615.9	68,997.1	64,539.6	6,618.8	4,457.5
Refunds	620.6	821.6	740.5	(201.0)	81.1
Administrative expenses	<u>454.2</u>	<u>447.3</u>	<u>460.8</u>	<u>6.9</u>	<u>(13.5)</u>
Total deductions	<u>76,690.7</u>	<u>70,266.0</u>	<u>65,740.9</u>	<u>6,424.7</u>	<u>4,525.1</u>
Net increase	<u>70,856.8</u>	<u>34,234.7</u>	<u>30,419.6</u>	<u>36,622.1</u>	<u>3,815.1</u>
Plan net assets, beginning	<u>599,234.1</u>	<u>564,999.4</u>	<u>534,579.8</u>	<u>34,234.7</u>	<u>30,419.6</u>
Plan net assets, ending	<u>\$ 670,090.9</u>	<u>\$ 599,234.1</u>	<u>\$ 564,999.4</u>	<u>\$ 70,856.8</u>	<u>\$ 34,234.7</u>

# FINANCIAL STATEMENTS

## JUDGES' RETIREMENT SYSTEM OF ILLINOIS

Statements of Plan Net Assets

June 30, 2007 and 2006

	2007	2006
Assets		
Cash	\$ 11,697,990	\$ 16,363,642
Receivables:		
Participants' contributions	145,281	141,031
Refundable annuities	33,785	41,042
Interest on cash balances	38,026	56,513
Due from General Assembly Retirement System	45,243	62,989
Total receivables	<u>262,335</u>	<u>301,575</u>
Investments - held in the Illinois State Board of Investment Commingled Fund at fair value	<u>658,193,724</u>	<u>582,604,390</u>
Equipment, net of accumulated depreciation	<u>3,323</u>	<u>4,289</u>
Total Assets	<u>\$ 670,157,372</u>	<u>\$ 599,273,896</u>
Liabilities		
Benefits payable	21,145	-
Refunds payable	1,538	2,804
Administrative expenses payable	<u>43,739</u>	<u>36,943</u>
Total Liabilities	<u>66,422</u>	<u>39,747</u>
Net assets held in trust for pension benefits	<u>\$ 670,090,950</u>	<u>\$ 599,234,149</u>

(A schedule of funding progress is presented on page 17.)

See accompanying notes to financial statements.

# FINANCIAL STATEMENTS

## JUDGES' RETIREMENT SYSTEM OF ILLINOIS

Statements of Changes in Plan Net Assets

Years Ended June 30, 2007 and 2006

	2007	2006
Additions:		
Contributions:		
Participants	\$ 14,152,973	\$ 13,833,096
Employer	<u>35,236,800</u>	<u>29,337,911</u>
Total contributions	<u>49,389,773</u>	<u>43,171,007</u>
Investments:		
Net investment income	14,742,583	14,434,078
Interest earned on cash balances	568,347	575,354
Net appreciation in fair value of investments	<u>82,846,751</u>	<u>46,320,241</u>
Total net investment income	<u>98,157,681</u>	<u>61,329,673</u>
Total Additions	<u>147,547,454</u>	<u>104,500,680</u>
Deductions:		
Benefits:		
Retirement annuities	60,911,363	54,553,869
Survivors' annuities	<u>14,704,503</u>	<u>14,443,234</u>
Total benefits	75,615,866	68,997,103
Refunds of contributions	620,577	821,637
Administrative expenses	<u>454,210</u>	<u>447,238</u>
Total Deductions	<u>76,690,653</u>	<u>70,265,978</u>
Net Increase	<u>70,856,801</u>	<u>34,234,702</u>
Net assets held in trust for pension benefits:		
Beginning of year	<u>599,234,149</u>	<u>564,999,447</u>
End of year	<u>\$ 670,090,950</u>	<u>\$ 599,234,149</u>

See accompanying notes to financial statements.

# FINANCIAL STATEMENTS

## JUDGES' RETIREMENT SYSTEM OF ILLINOIS

Notes to Financial Statements June 30, 2007 and 2006

### 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 statements to be misleading or incomplete.

The Judges' Retirement System of Illinois (System) is administered by a Board of Trustees consisting of five persons, which include the State Treasurer, the Chief of the Supreme Court, ex officio, and three participating judges appointed by the Supreme Court.

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.

Pursuant to federal tax law and regulations governing the administration of public employee pension plans, the System has established a separate fund for

the sole purpose of paying benefits in accordance with Section 415 of the Internal Revenue Code. The receipts and disbursements from the fund for fiscal years 2007 and 2006 were each less than \$235,000. Due to the immaterial nature of the separate fund, these receipts and disbursements have been included in the System's financial statements.

### 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 participants.

#### a. Eligibility and Membership

The Judges' Retirement System covers Judges, Associate Judges and, under certain conditions, the Administrative Director of the Illinois courts. Participation by Judges, either appointed or elected, is mandatory unless the Judge files an election not to participate within 30 days of receipt of notice of this option.

#### b. Contributions

In accordance with Chapter 40, Section 5/18-133 of the Illinois Compiled Statutes, participants contribute specified percentages of their salaries for retirement annuities, survivors' annuities and automatic annual increases. Contributions are excluded from gross income for Federal and State income tax purposes.

At June 30, 2007 and 2006, the System membership consisted of:

	2007	2006
Retirees and beneficiaries		
currently receiving benefits:		
Retirement annuities	620	581
Survivors' annuities	<u>326</u>	<u>331</u>
	946	912
Inactive participants entitled to benefits		
but not yet receiving them	<u>33</u>	<u>30</u>
Total	<u>979</u>	<u>942</u>
Current participants:		
Vested	656	661
Nonvested	<u>301</u>	<u>256</u>
Total	<u>957</u>	<u>917</u>

The statutes governing the Judges' Retirement System provide for optional contributions by participants, with interest at prescribed rates, to retroactively establish service credits for periods of prior creditable service.

The Board of Trustees has adopted the policy that interest payments by a participant, included in optional contributions to retroactively establish service credits, shall be considered an integral part of the participant's investment in annuity expectancies and, as such, shall be included as a part of any refund payable.

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

# FINANCIAL STATEMENTS

The total contribution rate is 11% if the participants elect to contribute for their spouse and dependents as shown below:

7.5%	Retirement annuity
2.5%	Survivors' annuity
1.0%	Automatic annual increases
<hr style="border: 0.5px solid black;"/>	
<u>11.0%</u>	

The payment of (1) the required State contributions, (2) all benefits granted under the System and (3) all expenses in connection with the administration and operation thereof are the obligations of the State to the extent specified in Chapter 40, Article 5/18 of the Illinois Compiled Statutes.

**c. Benefits**

After 10 years of credited service, participants have vested rights to full retirement benefits beginning at age 60, or reduced retirement benefits beginning at age 55. Participants also have vested rights to full retirement benefits at age 62 upon completing 6 years of credited service or at age 55 upon completing 26 years of credited service.

The Judges' Retirement System also provides annual automatic annuity increases for retirees and survivors, survivors' annuity benefits, temporary and/or total disability benefits and, under specified conditions, lump-sum death benefits.

The retirement annuity provided under the system is 3-1/2% for each of the first 10 years of service, plus 5% for each year of service in excess of 10, based upon the applicable final salary. The maximum retirement annuity is 85% of the applicable final salary. Annual automatic increases of 3% of the current amount of retirement annuity are provided.

Participants who terminate service and are not eligible for an immediate annuity may receive, upon application, a refund of their total contributions. Participants or annuitants who are not married are entitled to refunds of their contributions for survivors.

Participants who are eligible to receive the maximum rate of annuity may irrevocably elect to discontinue contributions and have their benefits "frozen" based upon the applicable salary in effect immediately prior to the effective date of such election.

Participants who have attained age 60 and are eligible to receive the maximum rate of annuity and have not elected to discontinue contributing to the System may irrevocably elect to have their contribu-

tions based only on the salary increases received on or after the effective date of such election rather than on the total salary received.

### 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.

Participant 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**

In June, 2004, GASB issued Statement No. 45, "Accounting and Financial Reporting by Employers for Postemployment Benefits Other than Pensions" (OPEB). The statement establishes standards of accounting and financial reporting for OPEB expense/expenditures and related OPEB liabilities or assets, note disclosures, and required supplementary information (RSI) in the financial reports of state and local government employers. The requirements of this statement are effective for periods beginning after December 15, 2006. The first disclosure, if any is required, will be for the year ending June 30, 2008.

In May, 2007, GASB issued Statement No. 50, "Pension Disclosures - an amendment of GASB Statements No. 25 and No. 27". This statement modifies and enhances note disclosure and required supplementary information (RSI) by pension plans and employers that provide pension benefits. The requirements of this statement are effective for periods beginning after June 15, 2007. The first disclosure will be for the year ending June 30, 2008.

# FINANCIAL STATEMENTS

## d. Investments

The System transfers money to the ISBI for investment in the ISBI Commingled Fund. This money is then allocated among various investment managers to pursue a specific investment strategy. All investment transactions are initiated by the investment managers. The transaction settlement information is then forwarded to the agent bank's trust department under a master custodial agreement.

Custody of a majority of the actual physical securities is maintained at an agent of the agent bank's trust department using a book-entry system. The ISBI's master custodian is The State Street Bank & Trust Company. The agent of the master custodian is the Depository Trust Company.

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, Convertible Preferred Stock, Preferred Stock, Foreign Equity Securities, Forward Foreign Currency Contracts and Options: (a) Listed - closing prices as reported on the composite summary of national securities exchanges; (b) Over-the-counter - bid prices; (3) Money Market Instruments - average cost which approximates fair values; (4) Real Estate Investments - fair values as determined by the ISBI and its investment managers; and (5) Alternative Investments (Private Equity, Hedge Funds, and Infrastructure 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.

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

	June 30, 2007	June 30, 2006
Government and agency obligations	\$ 1,184,275,884	\$ 1,110,919,988
Foreign obligations	72,189,687	104,455,671
Corporate obligations	1,228,970,012	1,382,574,163
Common stock & equity funds	6,059,409,027	5,369,124,032
Preferred stock	1,865,020	1,057,334
Foreign equity securities	1,365,647,941	1,113,268,102
Hedge Funds	496,404,578	416,462,183
Real estate investments	1,189,614,911	1,134,025,154
Private Equity	563,366,021	482,264,036
Money market instruments	535,699,912	320,641,552
Infrastructure funds	108,436,449	-
Forward foreign exchange contracts	(108,696)	26,145
<b>Total investments</b>	<b><u>\$ 12,805,770,746</u></b>	<b><u>\$ 11,434,818,360</u></b>

## 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 an outside party. As of June 30, 2007 and 2006, 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:

	2007	2006
Common stock	\$ 3,423,509	\$ 7,540,275
Government and agency obligations	28,351,415	43,932,397
Corporate obligations	2,152,096	4,649,641
<b>Total</b>	<b><u>\$ 33,927,020</u></b>	<b><u>\$ 56,122,313</u></b>

## 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 \$100,000. During fiscal year 2007, a Credit Risk Policy was

## FINANCIAL STATEMENTS

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 Aa1 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. For financial statement presentation and investment purposes, the ISBI reports its cash equivalents as Money Market Instruments within their investments. The table at the top of the next column discloses the deposits held by the ISBI at June 30, 2007 and 2006, and the portion of those deposits exposed to custodial credit risk.

**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, 2007 and 2006. The table at right presents the quality ratings of debt securities held by the ISBI as of June 30, 2007 and 2006.

### 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

	June 30, 2007	June 30, 2006
Carrying amount of Cash	\$ 42,916,419	\$ 80,644,137
Bank balance total	<u>\$ 43,068,157</u>	<u>\$ 80,724,748</u>
Amount exposed to custodial credit risk	<u>\$ 42,920,664</u>	<u>\$ 80,566,513</u>

	Moody's Quality Rating	2007	2006
<b>Government and agency obligations</b>			
U.S. Government obligations	AAA	\$ 317,358,768	\$ 457,091,471
Federal agency obligations	AAA	866,917,116	651,140,066
Municipal	AAA	-	2,688,451
Total Government and agency obligations		<u>\$ 1,184,275,884</u>	<u>\$ 1,110,919,988</u>
<b>Foreign obligations</b>			
	AAA	\$ 16,064,111	\$ 16,124,526
	AA	4,407,275	4,040,041
	A	5,363,202	16,276,367
	BAA	17,202,270	27,419,722
	BA	15,153,571	12,024,660
	B	3,348,055	19,290,811
	CAA	-	1,274,200
	Not rated	10,651,203	8,005,344
Total foreign obligations		<u>\$ 72,189,687</u>	<u>\$ 104,455,671</u>
<b>Corporate obligations</b>			
	AAA	\$ 254,534,185	\$ 324,130,117
	AA	122,242,182	144,481,958
	A	132,484,746	148,904,618
	BAA	111,327,503	115,363,940
	BA	183,959,419	238,778,065
	B	262,208,497	274,358,266
	CAA	50,779,805	14,129,168
	CA	907,309	682,031
	C	683,890	461,236
	Not rated	109,842,476	121,284,764
Total corporate obligations		<u>\$ 1,228,970,012</u>	<u>\$ 1,382,574,163</u>

of its securities lending program as the collateral held exceeded the fair value of the securities lent. As of June 30, 2007 and 2006, there were outstanding loaned investment securities having fair values of \$2,129,513,426 and \$1,568,683,721, respectively; against which collateral was received with a fair value of \$2,189,767,674 and \$1,597,656,445, respectively. Collateral received at June 30, 2007 and 2006 consisted of \$2,084,820,497 and \$1,530,783,382, respectively, in cash and \$104,947,177 and \$66,873,063, respectively, in securities for which the ISBI does not have the ability to pledge or sell.

## FINANCIAL STATEMENTS

### 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 full price. The effective duration measures the sensitivity of market price to parallel shifts in the yield curve. The ISBI benchmarks its debt security portfolio to Lehman Brothers Aggregate. At June 30, 2007 and 2006, the effective duration of the Lehman Brothers Aggregate was 3.7 years and 3.6 years, respectively. The effective duration of the ISBI debt security portfolio at June 30, 2007 and 2006 was 3.3 years and 3.8 years, respectively.

Investment Type	2007		2006	
	Fair Value	Effective Weighted Duration Years	Fair Value	Effective Weighted Duration Years
Government & agency obligations				
U.S. Treasury	\$ 317,358,768	4.8	\$ 457,091,471	4.4
Federal agency	866,917,116	1.6	651,140,066	3.3
Municipal	-	N/A	2,688,451	4.8
Foreign obligations	72,189,687	4.5	104,455,671	5.1
Corporate obligations				
Finance	256,092,972	3.7	306,124,824	3.4
Mortgage backed securities	170,384,277	2.4	211,686,803	2.1
Industrials	531,051,552	5.1	580,581,651	4.7
Commingled funds	23,679,106	N/A	40,713,286	N/A
Other	247,762,105	3.6	243,467,599	5.5
	<u>\$ 2,485,435,583</u>		<u>\$ 2,597,949,822</u>	

### 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. The table below presents the foreign currency risk by type of investment as of June 30, 2007 and 2006.

	2007		2006	
	Foreign Equity Securities	Foreign Obligations	Foreign Equity Securities	Foreign Obligations
Australian Dollar	\$ 72,095,189	\$ -	\$ 45,031,863	\$ -
Canadian Dollar	25,401,638	671,932	27,309,690	-
Danish Krone	14,131,867	-	11,811,080	-
English Pound Sterling	245,374,152	-	208,671,160	-
Euro Currency	434,344,665	-	298,835,278	2,773,684
Hong Kong Dollar	49,855,829	-	48,639,162	-
Malaysian Ringgit	-	5,818,897	-	-
Japanese Yen	276,514,350	4,526,106	272,057,458	-
Iceland Krona	-	2,274,574	-	-
Mexican Peso	-	4,468,150	-	147,648
New Zealand Dollar	-	1,492,263	767,645	2,205,864
Norwegian Krone	13,319,542	-	9,864,745	-
Singapore Dollar	24,082,058	5,774,393	9,200,224	-
South African Rand	-	2,954,509	-	-
South Korean Won	29,407,763	-	22,537,972	-
Swedish Krona	33,723,011	-	29,340,607	-
Swiss Franc	69,190,076	-	54,417,316	-
Foreign investments denominated				
in U.S. Dollars	78,207,801	44,208,863	74,783,902	99,328,475
Total	<u>\$ 1,365,647,941</u>	<u>\$ 72,189,687</u>	<u>\$ 1,113,268,102</u>	<u>\$ 104,455,671</u>

## FINANCIAL STATEMENTS

### 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, 2007 and 2006, was as follows:

	Cost	Fair Value	Gain/(Loss)
As of June 30, 2007			
Forward currency purchases	\$1,559,632	\$1,550,171	\$ (9,461)
Forward currency sales	7,691,150	7,790,385	(99,235)
Total gain/(loss)			<u>\$ (108,696)</u>
As of June 30, 2006			
Forward currency purchases	\$3,956,106	\$4,008,201	\$ 52,095
Forward currency sales	7,860,622	7,886,572	(25,950)
Total gain/(loss)			<u>\$ 26,145</u>

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. Therefore, they are sensitive to prepayments by mortgagees, which may result from a decline in interest rates. As of June 30, 2007 and 2006, the fair value of the ISBI's CMO holdings totaled \$170,384,277 and \$211,686,803, 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.

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.

# FINANCIAL STATEMENTS

Futures and options positions held by the ISBI as of June 30, 2007 and 2006

	2007		2006	
	Number of Contracts	Contract Principal*	Number of Contracts	Contract Principal*
Equity futures purchased	2,169	\$ 168,891,330	2,667	\$ 190,210,548
Fixed income futures purchased	609	77,268,953	1,605	269,684,894
Fixed income futures sold	1,333	248,776,093	355	37,149,313
Fixed income written put options	78	33,000,000	71	7,100,000
Fixed income written call options	209	74,900,000	320	122,900,000
Eurocurrency purchased call options	-	-	23,550,000	23,550,000
Fixed income purchased put options	-	-	58	58,000,000
Fixed income purchased call options	241	241,000,000	-	-

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

#### 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 \$369 million and \$400 million, as of June 30, 2007 and 2006, respectively. Also, at the end of fiscal years 2007 and 2006, the ISBI had outstanding commitments of \$311 million and \$567 million, respectively, to separate real estate accounts.

#### Other Information

The System owns approximately 5% of the net investment assets of the ISBI Commingled Fund as of June 30, 2007 and 2006. 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, 2007. A copy of the report can be obtained from the ISBI at 180 North LaSalle Street, Suite 2015, Chicago, Illinois 60601.

#### 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, 2005.

#### 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.

For fiscal year 2007, administrative expenses common to the Judges' Retirement System and the General Assembly Retirement System are allocated 70% to the Judges' Retirement System and 30% to the General Assembly Retirement System. For fiscal year 2006, administrative expenses common to the Judges' Retirement System and the General Assembly Retirement System were allocated 60% to the Judges' Retirement System and 40% to the General Assembly Retirement System.

Invoices/vouchers covering common expenses incurred are paid by the Judges' Retirement System, and the appropriate amount is allocated to and reimbursed by the General Assembly Retirement System. Administrative expenses allocated to and reimbursed by the General Assembly Retirement System as of June 30, 2007 and 2006, were \$162,870 and \$262,868, respectively.

#### 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.

# FINANCIAL STATEMENTS

**h. 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.

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.

**i. Reclassifications**

Certain fiscal year 2006 amounts have been reclassified to conform to the fiscal year 2007 presentation. These reclassifications have not changed the fiscal year 2006 results.

The total amount of statutorily required employer contributions for fiscal years 2007 and 2006 was \$35,236,800 and \$29,189,400, respectively. The total amount of employer contributions received from the state during fiscal years 2007 and 2006 was \$35,236,800 and \$29,189,400, respectively.

### Administrative expenses for fiscal years 2007 and 2006

**4. 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 2007 and 2006, the actuary used the projected unit credit actuarial method for determining the proper employer contribution amount.

	2007	2006
Personal services	\$226,155	\$258,869
Employee retirement contributions paid by employer	9,007	9,657
Employer retirement contributions	26,070	20,181
Social security contributions	17,311	17,127
Group insurance	44,568	44,671
Contractual services	99,158	80,852
Travel	6,576	9,628
Printing	3,310	3,463
Commodities	624	606
Telecommunications	2,317	2,165
Electronic data processing	9,700	7,354
Automotive	775	-
Depreciation	1,700	1,292
Change in accrued compensated absences	6,939	(8,627)
<b>Total</b>	<u>\$454,210</u>	<u>\$447,238</u>

For fiscal years 2007 and 2006, state contributions were based on dollar amounts specified by Public Act 94-0004, rather than actuarial calculations. This legislation contained a two-year funding reduction of nearly 22% or \$18.0 million for the System. State contributions will be higher in future years to make up for the two-year funding reduction, as the overall goal of 90% funding in fiscal year 2045 is unchanged.

**5. Administrative Expenses**

A summary of the administrative expenses for the Judges' Retirement System for fiscal years 2007 and 2006 are listed above.

For fiscal year 2008, the required employer contribution will be computed in accordance with Public Act 88-0593, as modified by Public Act 93-0002. 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%.

**6. Accrued Compensated Absences**

Employees of the Judges' Retirement System are entitled to receive compensation for all accrued but unused vacation time and one-half of all unused sick leave earned after December 31, 1983 and prior to January 1, 1998 upon termination of employment. These accrued compensated absences as of June 30, 2007 and 2006 total \$36,492 and \$29,553, respectively and are included in administrative expenses payable.

# FINANCIAL STATEMENTS

## 7. Pension Plan

**Plan Description.** All of the System's full-time employees who are not eligible for participation in another state-sponsored retirement plan participate in the State Employees' Retirement System (SERS), which is a pension trust fund in the State of Illinois reporting entity.

The SERS is a single-employer defined benefit public employee retirement system (PERS) in which state employees participate, except those covered by the State Universities, Teachers', General Assembly, and Judges' Retirement Systems.

The financial position and results of operations of the SERS for fiscal years 2007 and 2006 are included in the State of Illinois' Comprehensive Annual Financial Report (CAFR) for the years ended June 30, 2007 and 2006, respectively. The SERS also issues a separate CAFR that may be obtained by writing to the SERS, 2101 South Veterans Parkway, Springfield, Illinois, 62794-9255 or by calling 217-785-7202.

The State of Illinois' CAFR may be obtained by writing to the State Comptroller's Office, Financial Reporting Department, 325 West Adams St., Springfield, Illinois, 62704-1858 or by calling 217-782-2053.

A summary of SERS' benefit provisions, changes in benefit provisions, employee eligibility requirements including eligibility for vesting, and the authority under which benefit provisions are established, are included as an integral part of the SERS' CAFR. Also included is a discussion of employer and employee obligations to contribute, and the authority under which those obligations are established.

**Funding Policy.** The System pays employer retirement contributions based upon an actuarially determined percentage of its payrolls. For fiscal years 2007, 2006, and 2005 the employer contribution rates were 11.525%, 7.792%, and 16.107%, respectively. The System's contributions to SERS for fiscal years 2007, 2006, and 2005 were \$26,070, \$20,181, and \$39,537, respectively, and were equal to the required contributions for each fiscal year.

**Other Post-Employment Benefits.** In addition to providing pension benefits, the State Employees Group Insurance Act of 1971, as amended, requires that certain health, dental and life insurance benefits shall be provided by the state to annuitants who are former state employees. This includes annuitants of the System.

Substantially all state employees including the System's employees may become eligible for post-employment benefits if they eventually become annuitants. Health and dental benefits include basic benefits for annuitants under the state's self-insurance plan and insurance contracts currently in force. Life insurance benefits are limited to five thousand dollars per annuitant age 60 and older.

Costs incurred for health, dental and life insurance for annuitants and their dependents were not separated from benefits provided to active employees and their dependents for the years ended June 30, 2007 and 2006. However, post-employment costs for the state as a whole for all state agencies/departments for dependent health, dental and life insurance for annuitants and their dependents are disclosed in the State of Illinois' Comprehensive Annual Financial Report.

Cost information for retirees by individual state agency is not available. Payments are made on a "pay-as-you-go" basis. The System is not the administrator of any of the other post-employment benefits described above.

## FINANCIAL STATEMENTS

### 8. 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, and (3) certain electronic data processing equipment - 3 years.

Summary of the changes in equipment for fiscal years 2007 and 2006

	2007			Ending Balance
	Beginning Balance	Additions	Deletions	
Equipment	\$ 38,377	\$ 734	\$ (6,980)	\$ 32,131
Accumulated depreciation	<u>(34,088)</u>	<u>(1,700)</u>	<u>6,980</u>	<u>(28,808)</u>
Equipment, net	<u>\$ 4,289</u>	<u>\$ (966)</u>	<u>\$ -</u>	<u>\$ 3,323</u>
	2006			
	Beginning Balance	Additions	Deletions	Ending Balance
Equipment	\$ 37,293	\$ 2,303	\$ (1,219)	\$ 38,377
Accumulated depreciation	<u>(34,015)</u>	<u>(1,292)</u>	<u>1,219</u>	<u>(34,088)</u>
Equipment, net	<u>\$ 3,278</u>	<u>\$ 1,011</u>	<u>\$ -</u>	<u>\$ 4,289</u>

### 9. Analysis of Changes in Reserve Balances

The funded statutory reserves of the Judges' Retirement System are composed of the following:

#### Statements of Changes in Reserve Balances Years Ended June 30, 2007 and 2006

	Participants' Contributions	Future Operations	Total Reserve Balances
a. Reserve for Participants' Contributions			
This reserve consists of participants' accumulated contributions for retirement annuities, survivors' annuities and automatic annual increases.			
Balance at June 30, 2005	\$ 135,440,555	\$ 429,558,892	\$ 564,999,447
Add (deduct):			
Excess of revenues over expenses	13,159,969	21,074,733	34,234,702
Reserve transfers:			
Accumulated contributions of participants who retired or died with eligible survivor during the year	<u>(5,753,883)</u>	<u>5,753,883</u>	<u>-</u>
Balance at June 30, 2006	142,846,641	456,387,508	599,234,149
Add (deduct):			
Excess of revenues over expenses	13,532,396	57,324,405	70,856,801
Reserve transfers:			
Accumulated contributions of participants who retired or died with eligible survivor during the year	<u>(11,136,539)</u>	<u>11,136,539</u>	<u>-</u>
Balance at June 30, 2007	<u>\$ 145,242,498</u>	<u>\$ 524,848,452</u>	<u>\$ 670,090,950</u>

## REQUIRED SUPPLEMENTARY INFORMATION

### SCHEDULE OF FUNDING PROGRESS

Actuarial Valuation Date	Actuarial Value of Assets (a)	Actuarial Liability (AAL) - Projected Unit Credit (b)	Unfunded AAL (UAAL) (b-a)	Funded Ratio (a/b)	Covered Payroll (c)	UAAL as a Percentage of Covered Payroll ((b-a)/c)
6/30/02	\$343,659,294	\$1,020,846,773	\$677,187,479	33.7%	\$118,700,000	570.5%
6/30/03	330,053,560	1,076,231,965	746,178,405	30.7	123,900,000	602.2
6/30/04	534,579,823	1,156,092,951	621,513,128	46.2	127,200,000	488.6
6/30/05	564,999,447	1,236,512,156	671,512,709	45.7	128,700,000	521.8
6/30/06	599,234,149	1,291,394,861	692,160,712	46.4	135,400,000	511.2
6/30/07	670,090,950	1,385,339,573	715,248,623	48.4	142,900,000	500.5

### SCHEDULE OF EMPLOYER CONTRIBUTIONS

Year Ended June 30	Annual Required Contribution per GASB Statement No. 25	Percentage Contributed	Annual Required Contribution per State Statute	Percentage Contributed
2002	\$ 47,277,311	58.2%	\$ 27,532,000	100.0%
2003	53,470,841	58.7	31,373,000	100.0
2004	63,261,895	57.7	36,526,000	100.0 (1)
2005	57,749,460	55.4	31,991,000	100.0
2006	62,927,993	46.4	29,189,400	100.0
2007	73,371,653	48.0	35,236,800	100.0

(1) This percentage excludes the additional employer contributions received from the sale of General Obligation bonds by the State of Illinois. These proceeds were not part of the current fiscal year required contributions.

### Notes to Required Supplementary Information

Valuation date: June 30, 2007

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: 38 years, closed

Asset valuation method: Fair value

Actuarial assumptions:

- Investment rate of return: 8.0 percent per year, compounded annually
- Projected salary increases: 5.0 percent per year, compounded annually
- Assumed inflation rate: 4.0 percent
- Group size growth rate: 0.0 percent
- Post-retirement increase: 3.0 percent per year, compounded annually

## SUPPLEMENTARY FINANCIAL INFORMATION

### SUMMARY OF REVENUES BY SOURCE Years Ended June 30, 2007 and 2006

	2007	2006
Contributions:		
Participants:		
Participants	\$ 14,031,967	\$ 13,564,359
Interest paid by participants	16,468	112,916
Repayment of refunds	10,714	54,013
Transferred from reciprocating systems	93,824	101,808
Total participant contributions	<u>14,152,973</u>	<u>13,833,096</u>
Employer:		
General Revenue Fund	35,236,800	29,189,400
Paid by participants	-	148,511
Total employer contributions	<u>35,236,800</u>	<u>29,337,911</u>
Total contributions revenue	<u>49,389,773</u>	<u>43,171,007</u>
Investments:		
Net investment income	14,742,583	14,434,078
Interest earned on cash balances	568,347	575,354
Net appreciation in fair value of investments	82,846,751	46,320,241
Total net investment income	<u>98,157,681</u>	<u>61,329,673</u>
Total revenues	<u>\$ 147,547,454</u>	<u>\$ 104,500,680</u>

### SCHEDULE OF PAYMENTS TO CONSULTANTS Years Ended June 30, 2007 and 2006

	2007	2006
Actuary	\$19,000	\$19,500
Audit fees	20,676	16,376
Legal services	3,284	627
Financial planner	259	392
Medical services	140	140
Total	<u>\$43,359</u>	<u>\$37,035</u>

SUPPLEMENTARY FINANCIAL INFORMATION

SUMMARY SCHEDULE OF CASH RECEIPTS AND DISBURSEMENTS  
 Years Ended June 30, 2007 and 2006

	2007	2006
Cash balance, beginning of year	\$ 16,363,642	\$ 11,788,710
Receipts:		
Participant contributions	13,987,367	13,766,749
Employer contributions:		
General Revenue Fund	35,236,800	31,704,400
Paid by participants	-	148,511
Interest income on cash balances	586,834	551,430
Reimbursements from General Assembly Retirement System	180,617	263,081
Post-tax installment payments	12,474	-
Cancellation of refunds	48,665	63,981
Cancellation of annuities, net of overpayments	81,705	99,653
Cancellation of administrative expenses	145	-
Tax-deferred installment payments	38,069	46,788
Repayment of refunds	16,988	42,833
Transfers from reciprocating systems	93,824	101,808
Transfers from Illinois State Board of Investment	22,000,000	28,500,000
Miscellaneous	297	87
Total cash receipts	<u>72,283,785</u>	<u>75,289,321</u>
Disbursements:		
Benefit payments:		
Retirement annuities	60,927,106	54,604,903
Survivors' annuities	14,742,062	14,464,474
Refunds	670,508	920,682
Administrative expenses	609,761	724,330
Total cash disbursements	<u>76,949,437</u>	<u>70,714,389</u>
Cash balance, end of year	<u>\$ 11,697,990</u>	<u>\$ 16,363,642</u>

# McGladrey & Pullen

Certified Public Accountants

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

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

Board of Trustees  
Judges' Retirement System of Illinois  
Springfield, Illinois

As Special Assistant Auditors for the Auditor General, we have audited the statement of plan net assets and statement of changes in plan net assets of the Judges' Retirement System of Illinois (System), as of and for the year ended June 30, 2007, and have issued our report thereon dated February 8, 2008. Our Independent Auditors' Report was modified to include a reference to 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. Other auditors audited the financial statements of the Illinois State Board of Investment, as described in our Independent Auditors' 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.

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

A control deficiency exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent or detect misstatements on a timely basis. A significant deficiency is a control deficiency, or combination of control deficiencies, that adversely affects the entity's ability to initiate, authorize, record, process, or report financial data reliably in accordance with generally accepted accounting principles such that there is more than a remote likelihood that a misstatement of the entity's financial statements that is more than inconsequential will not be prevented or

detected by the entity's internal control. We consider the deficiency described in Finding 07-1 in the accompanying current finding section to be a significant deficiency in internal control over financial reporting.

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

Our consideration of internal control over financial reporting was for the limited purpose described in the first paragraph of this section and would not necessarily identify all deficiencies in internal control that might be significant deficiencies and, accordingly, would not necessarily disclose all significant deficiencies that are also considered to be material weaknesses. However, we believe the significant deficiency described in the current finding is not a material weakness.

### **Compliance and Other Matters**

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

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 separate cover.

The System's response to the finding identified in our audit is presented in the current finding section. We did not audit the System's response and, accordingly, we express no opinion on it.

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

*McGladrey & Pullen, LLP*

Schaumburg, Illinois  
February 8, 2008

**State of Illinois  
Judges' Retirement Systems  
Year Ended June 30, 2007**

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**Current Findings – Government Auditing Standards**

**Finding No. 07-1            Lack of Segregation of Duties**

The Judges' Retirement System (System) did not have an adequate segregation of duties for the approval and payment of contracts.

During our testing of contractual expenditures, we identified 2 out of 4 contracts (50%), totaling \$23,000, where the Administrative Services Manager signed off for both his position and also for the Executive Secretary indicating approval of the contract. The Administrative Services Manager and Executive Secretary's signatures were the only signatures required on the contracts noted as exceptions. The Contract - Obligation Documents required to be filed with the Office of the Comptroller to obligate funds for payment of the contracts were also signed off as being approved by the Administrative Services Manager. In addition, we found the Administrative Services Manager approved the invoice vouchers for payment on both contracts.

The Fiscal Control and Internal Auditing Act (Act) (30 ILCS 10/3001) notes State agencies shall establish and maintain a system of internal fiscal and administrative controls, which shall provide assurance that funds, property, and other assets and resources are safeguarded against waste, loss, unauthorized use, and misappropriation. A lack of segregation of duties does not provide assurance against waste, loss, unauthorized use, and misappropriation.

The previous Executive Secretary and current Acting Executive Secretary granted the Administrative Services Manager authority to sign for them on contracts and invoice vouchers. System management indicated they were not aware of the lack of segregation of duties when the Administrative Services Manager approves / signs for himself and the Executive Secretary on contracts and payments.

Because of the significance of the lack of segregation of duties noted, we are considering this to be a significant deficiency in the design of the System's internal control. A significant deficiency is a control deficiency, or combination of control deficiencies, that adversely affects the System's ability to initiate, authorize, record, process, or report financial data reliably in accordance with generally accepted accounting principles such that there is more than a remote likelihood that a misstatement of the System's financial statements that is more than inconsequential will not be prevented or detected by the System's internal control.

A lack of segregation of duties leaves the System open to risks of error and fraud if left uncorrected. (Finding Code No. 07-1)

**Recommendation:**

We recommend someone other than the Administrative Services Manager review and sign for the Executive Secretary in those instances when the Executive Secretary is unavailable to approve contracts and payments when both the Administrative Services Manager and Executive Secretary signatures are required.

**System Response:**

The System concurs with the Recommendation of the auditors.