State Employees' Retirement System of the State of Illinois

Auditors' Report and Financial Audit

For the Year Ended June 30, 2010

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

BKD LLP

CPAs & Advisors

State Employees' Retirement System of the State of Illinois

Financial Audit

For the Year Ended June 30, 2010

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State Employees' Retirement System
of the State of Illinois
Financial Statement Report Summary
June 30, 2010

Summary

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

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

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Independent Auditors' Report

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

As Special Assistant Auditors for the Auditor General, we have audited the accompanying statement of plan net assets of the State Employees' Retirement System of the State of Illinois (System), as of June 30, 2010 and 2009, and the related statement of changes in plan net assets for the year then ended, as listed in the table of contents. These financial statements are the responsibility of the System's management. Our responsibility is to express an opinion on these financial statements based on our audit. We did not audit the 2010 and 2009 financial statements of the Illinois State Board of Investment, an internal investment pool of the State of Illinois, which statements represent 99 percent, 99 percent, and 37 percent, respectively in 2010, and 97 percent, 97 percent, and 186 percent, respectively, in 2009 of total assets, net assets held in trust for pension benefits, and total additions of the System. Those financial statements were audited by other auditors whose report thereon has been furnished to us, and our opinion, insofar as it relates to the amounts included for the Illinois State Board of Investment is based on the report of the other auditors.

We conducted our audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the plan net assets of the System as of June 30, 2010 and 2009, and the changes in its plan net assets for the year then ended in conformity with accounting principles generally accepted in the United States of America.

In accordance with *Government Auditing Standards*, we have also issued our report dated February 17, 2011 on our consideration of the System's internal control over financial reporting and on our tests of its compliance with certain provisions of laws, regulations, contracts, grant agreements and other matters. The purpose of that report is to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing, and not to provide an opinion on the internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* and should be considered in assessing the results of our audit.

The accompanying management's discussion and analysis and schedules of funding progress and employer contributions and accompanying notes as listed in the table of contents are not a required part of the basic financial statements but are supplementary information required by accounting principles generally accepted in the United States of America. We have applied certain limited procedures, which consisted principally of inquiries of management regarding the methods of measurement and presentation of the required supplementary information. However, we did not audit the information and express no opinion on it.

Our audit was conducted for the purpose of forming an opinion on the financial statements that comprise the System's basic financial statements. The supplementary financial information as noted in the table of contents is presented for purposes of additional analysis and is not a required part of the basic financial statements. The supplementary financial information has been subjected to the auditing procedures applied in the audit of the basic financial statements and, in our opinion, is fairly stated, in all material respects, in relation to the basic financial statements as of and for the years ended June 30, 2010 and 2009, taken as a whole.

BKD, LLP

February 17, 2011

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

This section presents management's discussion and analysis of the financial position and performance of the State Employees' Retirement Systems of Illinois (System) for the years ended June 30, 2010 and 2009. 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 over 64,000 active state employees and over 58,000 benefit recipients. Throughout this discussion and analysis units of measure (i.e. billions, millions, thousands) are approximate, being rounded up or down to the nearest tenth of the respective unit value.

OVERVIEW OF THE FINANCIAL STATEMENTS

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

1. Basic Financial Statements. For the fiscal years ended June 30, 2010 and 2009, 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, 2010 and 2009. This financial information also summarizes the changes in net assets held in trust for pension benefits for the years then ended.

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

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

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

FINANCIAL HIGHLIGHTS

- The Systems' net assets increased by $723.9 million and decreased by $2,517.5 million during fiscal years 2010 and 2009, respectively. The changes were primarily due to an increase of $919.8 million (excluding securities lending collateral), and a decrease of $2,453.2 million in the System's investments, at fair value, for fiscal years 2010 and 2009, respectively.
- The System was actuarially funded at 37.4% as of June 30, 2010, compared to 43.5% as of June 30, 2009. For fiscal years 2010 and 2009, the actuarial value of assets equals the fair value of assets adjusted for any actuarial gains or losses from investment return incurred in the fiscal year recognized in equal amounts over the five year period following that fiscal year.
- The overall rate of return for the Illinois State Board of Investment (ISBI) Commingled Fund was 9.1% for fiscal year 2010 compared to (20.1)% for fiscal year 2009.

PLAN NET ASSETS

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

Condensed Statements of Plan Net Assets
(in millions)

	As of June 30			Increase/(Decrease) from	
	2010	2009	2008	2009 to 2010	2008 to 2009
Cash	$ 49.9	$ 232.7	$ 306.5	$ (182.8)	$ (73.8)
Receivables	39.3	57.4	48.5	(18.1)	8.9
Investments, at fair value *	9,143.2	8,200.8	10,654.0	942.4	(2,453.2)
Property & equipment, net	2.8	2.6	2.7	0.2	(0.1)
Total assets	9,235.2	8,493.5	11,011.7	741.7	(2,518.2)
Liabilities *	33.4	15.6	16.3	17.8	0.7
Total plan net assets	$ 9,201.8	$ 8,477.9	$ 10,995.4	$ 723.9	$ (2,517.5)

* Including securities lending collateral

ADDITIONS TO PLAN NET ASSETS

Additions to Plan Net Assets include employer and participant contributions and net income from investment activities. Participant contributions were approximately $246.2 million and $242.2 million for the years ended June 30, 2010 and 2009, respectively. Participant contribution rates are set by statute as a percentage of gross salary. Employer contributions increased to approximately $1,095.5 million in 2010 from approximately $774.9 million in 2009. This increase was the result of the State's funding plan.

DEDUCTIONS FROM PLAN NET ASSETS

Deductions from Plan Net Assets are primarily benefit payments. During 2010 and 2009, the System paid out approximately $1,405.9 million and $1,315.1 million, respectively, in benefits and refunds, an increase of approximately 6.9%. These higher payments were mainly due to a scheduled 3% increase in retirement and other benefit payments. The administrative costs of the System represented approximately 1% of total deductions in both 2010 and 2009.

FUNDED RATIO

The funded ratio of the plan measures the ratio of the actuarial value of assets against actuarially determined liabilities and is one indicator of the fiscal strength of a pension fund's ability to meet obligations to its members. An annual actuarial valuation is required by statute. The most recent available valuation showed the funded status of the System on June 30, 2010 decreased to 37.4% from 43.5% at June 30, 2009. The major reason for the decline was the lingering effect of prior investment performance on the smoothed-market value of assets. The amount by which actuarially determined liabilities exceeded the actuarial value of assets was $18.3 billion at June 30, 2010 compared to $14.3 billion at June 30, 2009.

INVESTMENTS

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

The net investment gain for the System totaled approximately $799.9 million during fiscal year 2010, versus a net investment loss of $2,208.9 million during fiscal year 2009, resulting in a positive return of 9.1% and a negative return of 20.1%, respectively. For the three, five, and ten year period ended June 30, 2010, the ISBI Commingled Fund earned a compounded rate of return of (6.5)%, 1.2%, and 1.7%, respectively.

The ISBI is exposed to general market risk. This general market risk is reflected in asset valuations fluctuating with market volatility. Any impact from market volatility on the ISBI's investment portfolio depends in large measure on how deep the market downturn is, how long it lasts, and how it fits within fiscal year reporting periods. The resulting market risk and associated realized and unrealized gains and losses could significantly impact the ISBI's financial condition.

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

CHANGES IN PLAN NET ASSETS

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

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

	For the Year Ended June 30,			Increase/(Decrease) from	
	2010	2009	2008	2009 to 2010	2008 to 2009
Additions					
Participant contributions	$ 246.2	$ 242.2	$ 250.0	$ 4.0	$ (7.8)
Employer contributions	1,095.5	774.9	587.7	320.6	187.2
Investment income/(loss)	799.9	(2,208.9)	(680.8)	3,008.8	(1,528.1)
Total additions/(deductions)	2,141.6	(1,191.8)	156.9	3,333.4	(1,348.7)
Deductions					
Benefits	1,390.7	1,300.2	1,214.1	90.5	86.1
Refunds	15.3	14.8	16.8	0.5	(2.0)
Administrative expenses	11.7	10.7	9.5	1.0	1.2
Total deductions	1,417.7	1,325.7	1,240.4	92.0	85.3
Net increase/(decrease) in plan net assets	$ 723.9	$ (2,517.5)	$(1,083.5)	$ 3,241.4	$ (1,434.0)

STATE EMPLOYEES' RETIREMENT SYSTEM OF ILLINOIS

Statements of Plan Net Assets
June 30, 2010 and 2009

	2010	2009
Assets		
Cash	$ 49,912,665	$ 232,679,069
Receivables:		
Contributions:		
Participants	15,308,885	16,280,628
Employing state agencies	17,119,073	35,390,539
Other accounts	6,905,516	5,764,303
Total Receivables	39,333,474	57,435,470
Investments - held in the Illinois State Board of Investment Commingled Fund at fair value	9,120,601,694	8,200,755,918
Securities lending collateral with State Treasurer	22,587,000	-
Property and equipment, net of accumulated depreciation	2,808,489	2,574,759
Total Assets	9,235,243,322	8,493,445,216
Liabilities		
Benefits payable	5,260,823	3,852,764
Refunds payable	640,022	109,360
Administrative expenses payable	1,326,567	1,429,929
Participants' deferred service credit accounts	215,859	173,233
Due to the State of Illinois	3,382,396	10,027,842
Securities lending collateral	22,587,000	-
Total Liabilities	33,412,667	15,593,128
Net assets held in trust for pension benefits	$ 9,201,830,655	$ 8,477,852,088

See accompanying notes to financial statements.

STATE EMPLOYEES' RETIREMENT SYSTEM OF ILLINOIS

Statements of Changes in Plan Net Assets
Years Ended June 30, 2010 and 2009

	2010	2009
Additions:		
Contributions:		
Participants	$ 246,172,971	$ 242,227,432
Employing State agencies and appropriations	1,095,545,856	774,910,344
Total Contributions	1,341,718,827	1,017,137,776
Investment income:		
Net investment income	200,200,994	224,823,314
Interest earned on cash balances	795,373	7,319,968
Net appreciation(depreciation) in fair value of investments	598,899,494	(2,441,040,917)
Total investment income(loss)	799,895,861	(2,208,897,635)
Total Additions (Deductions)	2,141,614,688	(1,191,759,859)
Deductions:		
Benefits:		
Retirement annuities	1,237,118,008	1,164,454,557
Survivors' annuities	89,516,980	73,697,450
Disability benefits	48,312,629	46,513,406
Lump-sum benefits	15,693,575	15,548,262
Total Benefits	1,390,641,192	1,300,213,675
Refunds (including transfers to reciprocating systems)	15,274,174	14,859,487
Administrative	11,720,755	10,681,376
Total Deductions	1,417,636,121	1,325,754,538
Net Increase(Decrease)	723,978,567	(2,517,514,397)
Net assets held in trust for pension benefits:		
Beginning of year	8,477,852,088	10,995,366,485
End of year	$ 9,201,830,655	$ 8,477,852,088

See accompanying notes to financial statements.

STATE EMPLOYEES' RETIREMENT SYSTEM OF ILLINOIS

Notes to Financial Statements June 30, 2010 and 2009

1. Reporting Entity

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

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

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

At June 30, 2010 and 2009, the number of participating state agencies, boards and commissions totaled:

	2010	2009
State agencies	39	39
State boards and commissions	43	43
TOTAL	82	82

At June 30, 2010 and 2009, SERS membership consisted of:

Retirees and beneficiaries currently receiving benefits:		
Retirement annuities	45,659	44,566
Survivors' annuities	10,325	10,236
Disability benefits	2,408	2,297
TOTAL	58,392	57,099
Inactive employees entitled to benefits, but not yet receiving them	4,646	4,672
TOTAL	63,038	61,771
Current Employees:		
Vested: Coordinated with Social Security	46,717	46,159
Noncoordinated	2,020	2,052
Nonvested: Coordinated with Social Security	14,723	16,606
Noncoordinated	683	782
TOTAL	64,143	65,599

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

Pursuant to federal tax laws and regulations governing the administration of public employee pension plans, the System has established a separate fund for the sole purpose of disbursing benefits in accordance with Section 415 of the Internal Revenue Code. For fiscal years 2010 and 2009, receipts were approximately $60,500 and $63,400, respectively. For fiscal years 2010 and 2009 disbursements were approximately $41,200 and $45,400, respectively.

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

2. Plan Description

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

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

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

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

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

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

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

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

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

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

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

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

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

3. Summary of Significant Accounting Policies & Plan Asset Matters

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

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

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

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

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

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

d. New Accounting Pronouncement
GASB Statement No.59, Financial Instruments Omnibus, was established to update and improve existing standards regarding financial reporting and disclosure requirements of certain financial instruments and external investment pools for which significant issues have been identified in practice. The ISBI is required to implement this Statement for the year ending June 30, 2011. The ISBI management has not yet completed their assessment of this Statement; however, it is not expected to have a material effect on the overall financial statement presentation.

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

Investments owned are reported at fair value as follows: (1) U.S. Government and Agency, Foreign and Corporate Obligations, Convertible Bonds - prices quoted by a major dealer in such securities; (2) Common Stock and Equity Funds, Preferred Stock, Foreign Equity Securities, Forward Foreign Currency Contracts and Options: (a) Listed - closing prices as reported on the composite summary of national securities exchanges; (b) Over-the-counter - bid prices; (3) Money Market Instruments - average cost which approximates fair values; (4) Real Estate Investments - fair values as determined by the ISBI and its investment managers; (5) Alternative Investments (Private Equity, Hedge Funds, and Infrastructure Funds) fair values as determined by the ISBI and its investment managers; and (6) Commingled Funds- fair values as determined by the ISBI and its investment managers.

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

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

f. 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 resulting in the adoption of new assumptions as of June 30, 2006.

g. 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.

h. 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 four fiscal years.

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

j. 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.

k. Reclassifications
Certain fiscal year 2009 amounts have been reclassified to conform to the fiscal year 2010 presentation. These reclassifications have not changed the fiscal year 2009 results.

4. Investments

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

	June 30, 2010	June 30, 2009
Government and agency obligations	$ 810,739,312	$ 665,018,889
Foreign obligations	44,409,906	33,237,090
Corporate obligations	925,668,388	668,047,761
Common stock & equity funds	2,857,144,559	2,610,218,733
Preferred stock	517,676	286,429
Foreign equity securities	1,733,177,670	1,482,594,431
Foreign preferred stock	179,924	47,856
Commingled funds	270,510,642	335,484,184
Hedge funds	917,854,201	880,939,190
Real estate funds	750,210,957	875,929,700
Private equity	542,441,291	450,491,810
Money market instruments	270,231,935	235,126,490
Infrastructure funds	320,293,041	305,969,947
Bank loans	222,623,999	197,259,098
Forward foreign currency contracts	(266,410)	(5,594,545)
Total investments	$ 9,665,737,091	$ 8,735,057,063

Custodial Credit Risk for Investments
The custodial credit risk for investments is the risk that, in the event of the failure of the counterparty to a transaction, the ISBI will not be able to recover the value of investments or collateral securities that are in the possession of a counterparty. As of June 30, 2010 and 2009, common stock investments that were uninsured and unregistered, with securities held by the counterpart or by its trust department or agent but not in the ISBI's name totaled $0 and $2,529,488, respectively.

Deposits
Custodial credit risk for deposits is the risk that, in the event of a financial institution failure, the System's and ISBI's deposits may not be returned. All non-investment related bank balances at year end are insured or collateralized with securities held by the Illinois State Treasurer or agents in the name of the State Treasurer. Cash held in the investment related bank account by ISBI is neither insured nor collateralized for amounts in excess of $250,000. During fiscal year 2007, a Credit Risk Policy was implemented by the ISBI staff and formally adopted by the ISBI Board in July, 2007. The policy outlines the control procedures used to monitor custodial credit risk. These assets are under the custody of State Street Bank and Trust. State Street Bank and Trust has a AA Long-term Deposit/Debt rating by Standard & Poor's and an Aa2 rating by Moody. Certain investments of the ISBI with maturities of 90 days or less would be considered cash equivalents; these consist of short-term investment funds and U.S. Treasury bills with maturities of 90 days or less, which are not subject to the custodial credit risk. For financial statement presentation and investment purposes, the ISBI reports these types of cash equivalents as Money Market Instruments within their investments. As of June 30, 2010 and 2009, the ISBI had investment related bank balances of $3,630,043 and $12,440,740, respectively. These balances had no exposure to custodial credit risk due to participation in the FDIC's Transaction Account Guarantee Program.

Securities Lending
The ISBI participates in a securities lending program with State Street who acts as securities lending agent. Securities are loaned to brokers and, in return, the ISBI has rights to a portion of a collateral pool. All of the securities are eligible for the securities lending program. Collateral consists solely of cash, letters of credit, commercial paper and government securities having a fair value equal to or exceeding 102% of the value of the loaned securities (105% for non-U.S. securities). In the event of borrower default,

State Street provides the ISBI with counterparty default indemnification. The ISBI had no credit risk as a result of its securities lending program as the collateral received exceeded the fair value of the securities loaned. As of June 30, 2010 and 2009, there were outstanding loaned investment securities having fair values of $1,055,476,733 and $1,476,903,266, respectively; against which collateral was received with a fair value of $1,091,589,381 and $1,528,744,414, respectively. Collateral received at June 30, 2010 and 2009 consisted of $1,010,115,059 and $1,467,250,961, respectively, in cash and $81,474,322 and $61,493,453, respectively, in securities for which the ISBI does not have the ability to pledge or sell.

The cash collateral received is invested in a short term investment pool having a fair value of $997,638,887 and $1,395,768,803 as of June 30, 2010 and 2009, respectively. This investment pool had an average duration of 12.45 days and 42.64 days as of June 30, 2010 and 2009, respectively. Any decrease in the fair value of invested cash collateral is recorded by the ISBI as unrealized losses and reported as a component of the investment income/loss on the ISBI's Statement of Changes in Net Assets. Regarding the investment pool, at the time of purchase, all securities with maturities of 13 months or less must qualify as first-tier securities and all securities with maturities in excess of 13 months will be rated A or better by at least one nationally recognized statistical rating organization (NRSROs) or if unrated, be determined by State Street to be of comparable quality.

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, 2010 and 2009. The table at right presents the quality ratings of debt securities held by the ISBI as of June 30, 2010 and 2009.

	Moody's Quality Rating	2010	2009
Government and agency obligations			
U.S. Government obligations and Federal agency obligations	AAA	$ 785,753,044	$ 653,019,129
	AA	-	11,999,760
	A	11,999,760	-
	Not Rated	12,986,508	-
Total Government and agency obligations		$ 810,739,312	$ 665,018,889
Foreign obligations	AAA	$ -	$ 7,009,777
	AA	1,601,595	3,433,768
	A	13,951,076	-
	BAA	10,708,205	1,899,728
	BA	11,475,920	10,915,077
	B	5,659,170	7,765,165
	CAA	-	1,609,335
	C	-	604,240
	Not rated	1,013,940	-
Total foreign obligations		$ 44,409,906	$ 33,237,090
Corporate obligations	AAA	$ 43,798,021	$ 39,162,888
	AA	78,359,254	56,839,344
	A	272,476,793	209,758,077
	BAA	201,122,004	99,409,888
	BA	85,333,142	79,410,130
	B	188,825,884	132,204,912
	CAA	38,250,212	39,940,421
	CA	-	977,375
	Not rated	17,503,078	10,344,726
Total corporate obligations		$ 925,668,388	$ 668,047,761

Derivative Securities

During the year ended June 30, 2010, the ISBI implemented GASB Statement No. 53 Accounting and Financial Reporting for Derivative Instruments with respect to investments held in derivative securities. A derivative security is an investment whose payoff depends upon the value of other assets such as commodity prices, bond and stock prices, or a market index. The ISBI invests in derivative instruments including forward foreign currency contracts, futures, rights and warrants. The ISBI's derivatives are considered investment derivatives. The fair value of all derivative financial instruments is reported in the ISBI's Statement of Net Assets as either assets or liabilities, and the change in the fair value is recorded in the ISBI's Statement of Changes in Net Assets as a net increase/decrease in the fair value of investments.

Foreign currency forward contracts are used to protect against the currency risk in the ISBI's foreign equity portfolio. A foreign currency forward contract is an agreement to buy or sell a specific amount of a foreign currency at a specified delivery or maturity date for an agreed-upon price. Fluctuations in the market value of foreign currency forward contracts are marked to market on a daily basis. These investments are reported at fair value in the investment section of the ISBI's Statement of Net Assets. The gain or loss arising from the difference between the original contracts and the closing of such contracts is recognized in the net increase/decrease in the fair value of investments in the ISBI's Statement of Changes in Net Assets.

The ISBI's investment managers use financial futures to replicate an underlying security they wish to hold (sell) in the portfolio. In certain instances, it may be beneficial to own a futures contract rather than the underlying security (arbitrage). A financial futures contract is an agreement to buy or sell a specific amount at a specified delivery or maturity date for an agreed-upon price. As the fair values of the futures contract vary from the original contract price, a gain or loss is recognized and paid to or received from the clearinghouse. The gain or loss is recognized in the net increase/decrease in the fair value of investments in the ISBI's Statement of Changes in Net Assets. 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 ISBI's investment portfolio.

Rights and warrants allow the ISBI investment managers to replicate an underlying security they wish to hold (sell) in the portfolio. Rights and warrants provide the holder with the right, but not the obligation, to buy or sell a company's stock at a predetermined price. Rights usually expire after a few weeks and warrants can expire from one to several years. Under certain circumstances, a type of warrant called Participatory Notes or P-Notes are used in the portfolio by the ISBI's investment managers that are not registered to trade in domestic Indian Capital Markets. Participatory Notes are issued by Indian based brokerage firms against an underlying Indian security permitting holders to get a share in the income from the security. These investments are reported at fair value in the investment section of the ISBI's Statement of Net Assets within the common stock and foreign equity classifications. The gain or loss associated with rights and warrants is recognized in the net increase/decrease in the fair value of investments in the ISBI's Statement of Changes in Net Assets.

The fair values of the forward contracts are estimated based on the present value of their estimated future cash flows.

Futures contracts are exchange traded instruments where the fair value is determined by the equilibrium between the forces of supply and demand. The fair value of a right or warrant closely tracks the intrinsic value of the underlying stock and can be determined either by formulaic methodology (most commonly Black-Scholes) or intrinsic value methodology.

Futures positions held by the ISBI
as of June 30, 2010 and 2009

2010	Number of Contracts	Contract Principal*	Fair Value
Equity futures purchased	1,026	$ 52,664,580	$ (2,586,651)

2009	Number of Contracts	Contract Principal*	Fair Value
Equity futures purchased	1,626	$ 74,430,150	$ (1,415,899)

* Contract principal amounts shown represent the market value of the underlying assets the contracts control. These are shown to present the volume of the transactions but do not reflect the extent to which positions may offset one another. These amounts do not represent the much smaller amounts potentially subject to risk. Contract principal values also do not represent actual recorded values reported in the ISBI's Statement of Net Assets.

The table below presents the investment derivative instruments aggregated by type that were held by the ISBI as of June 30, 2010:

	Changes in Fair Value 2010	Changes in Fair Value 2009	Fair Value at Year End 2010	Fair Value at Year End 2009	Notional Amount 2010	Notional Amount 2009
FX Forwards	$ 4,751,552	$ 3,509,993	$ (266,410)	$ (5,594,545)	$ N/A	$ N/A
Futures	11,874,002	(31,537,188)	(2,586,651)	(1,415,899)	51,300	81,300
Rights	1,184,339	544,848	227,807	465,233	905,044	581,222
Warrants	12,100,555	(6,839,300)	65,373,110	41,247,000	3,391,468	4,259,850
	$ 29,910,448	$ (34,321,647)	$ 62,747,856	$ 34,701,789	$ 4,347,812	$ 4,922,372

The ISBI's derivative investments in foreign currency forward contracts are held with counterparties. The credits ratings and net exposure as of June 30, 2010 for the counterparties are as follows:

Moody's Rating *	Fair Value	Net Exposure	Percentage of Net Exposure
A	$ 2,478,451	$ 2,478,451	97%
AA	69,204	69,204	3
	$ 2,547,655	$ 2,547,655	100%

* Ratings as of June 30, 2009 are not available

Derivative 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. Derivatives which are exchange traded are not subject to credit risk. No derivatives held are subject to custodial credit risk. Market risk is the possibility that a change in interest (interest rate risk) or currency rates (foreign currency risk) 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. These limits are approved by the Board of Trustees and management of the ISBI and the risk positions of the investment managers are reviewed on a periodic basis to monitor compliance with the limits. As of June 30, 2010 and June 30, 2009, the ISBI held no derivatives subject to interest rate risk. The ISBI has not adopted a formal policy specific to master netting arrangements.

The table below presents the fair value of derivative investments exposed to foreign currency risk as of June 30, 2010 and 2009:

	2010 FX Forwards	2010 Rights	2010 Warrants	2009 FX Forwards	2009 Rights	2009 Warrants
Australian Dollar	$ 367,196	$ -	$ -	$ -	$ 111,868	$ -
Brazilian Real	(510,309)	-	-	(166,466)	-	-
Canadian Dollar	(81,756)	-	-	-	-	-
Euro Currency	293,614	191,452	722	(133,149)	19,242	2,251
English Pound Sterling	(603,992)	-	-	(4,268,060)	297,813	-
Hong Kong Dollar	-	31,000	18,357	-	1,363	-
Indian Ruppe	625,478	-	-	(190,655)	-	-
Japanese Yen	(2,226)	-	-	11,990	-	-
Norwegian Krone	-	5,355	-	-	7,157	-
Singapore Dollar	(991)	-	-	106	7,076	-
South Korean Won	841	-	-	(257,427)	-	-
Swedish Krona	(768)	-	-	-	-	-
Swiss Franc	(353,497)	-	-	(590,884)	362	-
Investments denominated in U.S. dollars	-	-	65,354,031	-	20,352	41,244,749
	$ (266,410)	$ 227,807	$ 65,373,110	$ (5,594,545)	$ 465,233	$ 41,247,000

Foreign Currency Risk

The ISBI's international portfolio is constructed on the principles of diversification, quality growth and value. Risk of loss arises from changes in currency exchange rates. International managers may also engage in transactions to hedge currency at their discretion. Certain investments held in infrastructure funds trade in a reported currency of Euro based dollars valued at $34,896,279 and $38,643,067 as of June 30, 2010 and 2009, respectively. The following table presents the foreign currency risk by type of investment as of June 30, 2010 and 2009.

	2010		2009	
	Foreign Equity and Foreign Preferred Securities	Foreign Obligations	Foreign Equity and Foreign Preferred Securities	Foreign Obligations
Australian Dollar	$ 80,124,165	$ -	$ 64,845,908	$ -
Brazilian Real	52,217,836	-	33,224,878	-
Canadian Dollar	97,585,461	-	47,104,026	-
Danish Krone	29,767,544	-	22,597,007	-
Egyptian Pound	2,121,276	-	631,787	-
English Pound Sterling	333,465,799	-	291,255,325	-
Euro Currency	401,821,017	-	407,541,247	-
Hong Kong Dollar	60,278,477	-	39,652,995	-
Hungarian Forint	266,743	-	-	-
Indonesian Rupian	992,274	-	-	-
Japanese Yen	222,916,572	-	221,156,513	-
Mexican Peso	5,584,047	-	2,121,876	-
New Zealand Dollar	3,181,046	-	1,076,827	-
Norwegian Krone	15,111,055	-	9,277,231	-
Singapore Dollar	35,452,297	-	30,234,461	-
South African Rand	8,691,759	-	3,495,645	-
South Korean Won	39,303,338	-	21,353,474	-
Swedish Krona	21,927,042	-	15,868,385	-
Swiss Franc	121,970,148	-	124,169,874	-
Thailand Baht	1,081,519	-	-	-
Foreign investments denominated in U.S. Dollars	199,498,179	44,409,906	147,034,828	33,237,090
Total	$ 1,733,357,594	$ 44,409,906	$ 1,482,642,287	$ 33,237,090

Investment Liquidity

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

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 $463 million and $486 million, as of June 30, 2010 and 2009, respectively. Also, at the end of fiscal year 2010 and 2009, the ISBI had outstanding commitments of $154 million and $159 million, respectively, to separate real estate accounts. Also, at the end of fiscal year 2010 and 2009, the ISBI had outstanding amounts of $147 million and $155 million, respectively, to infrastructure funds. The ISBI would fund outstanding commitments by utilizing available cash and then selling liquid securities in the portfolio as necessary.

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 duration between 80 and 120 percent of the benchmark index.

Duration is a measure of a debt investment's exposure to fair value changes arising from changing interest rates. It uses the present value of cash flows, weighted for those cash flows as a percentage of the investment's fair value. The effective duration measures the sensitivity of market price to parallel shifts in the yield curve. As of June 30, 2010 and 2009, the ISBI benchmarked its debt security portfolio to Barclays Capital Intermediate U.S. Government/ Credit Bond Index. At June 30, 2010 and 2009, the effective duration of the Barclays Capital Intermediate U.S. Government/Credit Bond Index was 3.9 years. At the same point in time, the effective duration of the ISBI debt security portfolio at June 30, 2010 and 2009 was 3.8 years.

Other Information

The System owns approximately 94% of the net investment assets of the ISBI Commingled Fund as of June 30, 2010 and 2009. 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, 2010. A copy of the report can be obtained from the ISBI at 180 North LaSalle Street, Suite 2015, Chicago, Illinois 60601.

	2010		2009	
Investment Type	Fair Value	Effective Weighted Duration Years	Fair Value	Effective Weighted Duration Years
Government & agency obligations				
U.S. Government	$ 155,303,411	4.8	$ 75,529,694	5.3
Federal agency	655,435,901	2.3	589,489,195	2.9
Foreign obligations	44,409,906	4.9	33,237,090	4.7
Corporate obligations				
Bank and Finance	246,087,134	4.8	159,283,917	4.0
Collateralized Mortgage Obligations	39,240,826	3.0	19,360,918	2.8
Industrials	496,856,383	4.8	425,239,911	4.4
Other	143,484,045	5.0	64,163,015	4.7
	$ 1,780,817,606		$ 1,366,303,740	

5. Funding - Statutory Contributions Required & Contributions Made

On an annual basis, a valuation of the liabilities and reserves of the System is performed by the System's actuarial consultants in order to determine the amount of contributions statutorily required from the State of Illinois. For fiscal years 2010 and 2009 the actuary used the projected unit credit actuarial method for determining the proper employer contribution rate and amount.

For fiscal year 2010 and 2009 the required employer contributions was computed in accordance with the State's funding plan. This funding legislation provides for a systematic 50 year funding plan with an ultimate goal to fund the cost of maintaining and administering the System at an actuarial funded ratio of 90%.

In addition, the funding plan provided for a 15 year phase-in period to allow the state to adapt to the increased financial commitment. Since the 15 year phase-in period ended June 30, 2010, the state's contribution will remain at a level percentage of payroll for the next 35 years until the 90% funded level is achieved.

The funded status of the System as of June 30, 2010, the most recent actuarial valuation date, is in the table below:

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

Additional information as of the latest actuarial valuation follows:

Valuation date: June 30, 2010

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: 35 years, closed

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

Actuarial assumptions:

Investment rate of return:	7.75 percent
Projected salary increases:	1.0 to 5.35 percent, based upon member's age
Assumed inflation rate:	3.0 percent
Group size growth rate:	0.0 percent
Post-retirement increase:	3.0 percent, compounded
Mortality table:	1994 Group Annuity Mortality Table for males and females. Five percent of deaths amongst active employees are assumed to be in the performance of their duty.

Actuarial Value of Assets (a)	Actuarial Accrued Liability (AAL) -Projected Unit Credit (b)	Unfunded AAL (UAAL) (b-a)	Funded Ratio (a/b)	Covered Payroll (c)	UAAL as a Percentage Covered Payroll ([b-a]/c)
$10,961,540,164	$29,309,464,296	$18,347,924,132	37.4%	$4,119,360,892	445.4%

6. Accrued Compensated Absences

Employees of the System are entitled to receive compensation for all accrued but unused vacation time and one-half of all unused sick leave earned on and after January 1, 1984 and before January 1, 1998 upon termination of employment. These accrued compensated absences as of June 30, 2010 and 2009 totaled $880,127 and $830,237, respectively are included in Administrative Expenses Payable.

7. Property & Equipment

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

This is a summary of changes in property and equipment assets for 2010 and 2009:

		2010		
Assets	Beginning Balance	Additions	Deletions	Ending Balance
Land	$ 655,241	$ -	$ -	$ 655,241
Land improvements	250,316	48,663	-	298,979
Building	3,352,428	27,665	-	3,380,093
Equipment	1,945,131	429,910	(63,291)	2,311,750
TOTAL	6,203,116	506,238	(63,291)	6,646,063
Accumulated depreciation				
Land Improvements	(577)	(72)	-	(649)
Building	(2,065,512)	(113,381)	-	(2,178,893)
Equipment	(1,562,268)	(158,876)	63,112	(1,658,032)
TOTAL	(3,628,357)	(272,329)	63,112	(3,837,574)
Net property and equipment	$ 2,574,759	$ 233,909	$ (179)	$2,808,489

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

8. Collection and Remittance of Bond and Interest Payments

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

As of June 30, 2010 and 2009 the following amounts are included in the System's Statement of Plan Net Assets regarding the collection of bond principal and interest payments:

	2010	2009
Cash - payments collected but not yet remitted to the State of Illinois	$ 2,426,434	$ 6,777,811
Accounts receivable - for June payrolls received in July and August	$ 955,962	$ 3,250,031
Due to the State of Illinois	$ (3,382,396)	$(10,027,842)

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

The total debt service payments received for all fiscal year 2010 and 2009 payrolls, amounted to $25.7 million and $78.0 million, respectively. The total amount remitted to the State of Illinois as of June 30, 2010 and 2009 was $22.3 million and $68.0 million, respectively.

9. Administrative Expenses & Other Post-Employment Benefits

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

The System pays employer retirement contributions based upon an actuarially determined percentage of its payrolls. For fiscal years 2010, 2009, and 2008 the employer contribution rates were 28.377%, 21.049%, and 16.561%, respectively. The System's contributions to SERS for fiscal years 2010, 2009, and 2008 were $1,206,740, $852,808, and $620,113 respectively, for the general staff. The System's contributions for the electronic data processing staff for fiscal years 2010, 2009, and 2008 were $270,504, $179,993, and $194,913, respectively. These amounts were equal to the required contributions for each fiscal year.

The State provides health, dental, vision, and life insurance benefits for retirees and their dependents in a program administered by the Department of Healthcare and Family Services along with the Department of Central Management Services. Substantially all State employees become eligible for post-employment benefits if they eventually become annuitants of one of the State sponsored pension plans. Health, dental, and vision benefits include basic benefits for annuitants and dependents under the State's self-insurance plan and insurance contracts currently in force. Annuitants may be required to contribute towards health, dental, and vision benefits with the amount based on factors such as date of retirement, years of credited service with the State, whether the annuitant is covered by Medicare, and whether the annuitant has chosen a managed health care plan. Annuitants who retired prior to January 1, 1998, and who are vested in the State Employee's Retirement System do not contribute towards health, dental, and vision benefits. For annuitants who retired on or after January 1, 1998, the annuitant's contribution amount is reduced five percent for each year of credited service with the State allowing those annuitants with twenty or more years of credited service to not contribute towards health, dental, and vision benefits. Annuitants also receive life insurance coverage equal to the annual salary of the last day of employment until age 60, at which time the benefit becomes $5,000.

The State pays the System's portion of employer costs for the benefits provided. The total cost of the State's portion of health, dental, vision, and life insurance benefits of all members, including post-employment health, dental, vision, and life insurance benefits, is recognized as an expenditure by the State in the Illinois Comprehensive Annual Financial Report. The State finances the costs on a pay-as-you-go basis. The total costs incurred for health, dental, vision, and life insurance benefits are not separated by department or component unit for annuitants and their dependents nor active employees and their dependents.

A summary of post-employment benefit provisions, changes in benefit provisions, employee eligibility requirements including eligibility for vesting, and the authority under which benefit provisions are established are included as an integral part of the financial statements of the Department of Healthcare and Family Services. A copy of the financial statements of the Department of Healthcare and Family Services may be obtained by writing to the Department of Healthcare and Family Services, 201 South Grand Ave., Springfield, Illinois, 62763-3838.

A summary of the administrative expenses of the System for fiscal years 2010 and 2009 are as follows:

	2010	2009
Personal Services	$ 4,248,014	$ 4,044,917
Employee Retirement Pickup	42,062	51,206
Retirement Contributions	1,206,740	852,808
Social Security Contributions	314,861	301,708
Group Insurance	947,163	950,343
Contractual Services	1,777,453	1,746,425
Travel	39,497	30,581
Commodities	27,108	29,298
Printing	42,225	52,521
Electronic data processing	2,665,507	2,210,406
Telecommunications	67,333	67,063
Automotive	13,801	19,305
Depreciation	272,329	244,771
Other (net)	56,662	80,024
Total	$11,720,755	$ 10,681,376

10. Social Security Division - Administrative Expenses

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

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

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

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

	2010	2009
Personal services	$ 41,465	$ 37,805
Retirement contributions	3,329	7,961
Social Security contributions	3,122	2,804
Contractual services	25,000	24,995
Travel	1,161	441
Commodities	243	175
Electronic Data Processing	-	421
Telecommunications	403	-
Total	$ 74,723	$ 74,602

11. Analysis of Changes in Reserve Balances

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

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

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

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

State Employees' Retirement System
Statements of Changes in Reserve Balances Years Ended June 30, 2010 and 2009

	Participants' Contributions	Interest Accumulations	Other Future Benefits	Total Reserve Balances
Balance at June 30, 2008	$ 2,070,552,633	$ 1,425,558,357	$ 7,499,255,495	$10,995,366,485
Add (deduct):				
Excess revenue over/(under) expenses	215,177,901	-	(2,732,692,298)	(2,517,514,397)
Reserve transfers:				
Accumulated contributions of members who retired during the year, less contributions of annuitants returning to active status	(97,127,550)	-	97,127,550	-
Interest credited to members' accounts	-	111,570,393	(111,570,393)	-
Balance at June 30, 2009	$ 2,188,602,984	$ 1,537,128,750	$ 4,752,120,354	$8,477,852,088
Add (deduct):				
Excess revenue over/(under) expenses	218,288,124	-	505,690,443	723,978,567
Reserve transfers:				
Accumulated contributions of members who retired during the year, less contributions of annuitants returning to active status	(19,811,506)	-	19,811,506	-
Interest credited to members' accounts	-	109,187,475	(109,187,475)	-
Balance at June 30, 2010	$ 2,387,079,602	$ 1,646,316,225	$ 5,168,434,828	$9,201,830,655

SCHEDULE OF FUNDING PROGRESS

Actuarial Valuation Date	Actuarial Value of Assets (a)	Actuarial Accrued Liability (AAL) -Projected Unit Credit (b)	Unfunded AAL (UAAL) (b-a)	Funded Ratio (a/b)	Covered Payroll (c)	UAAL as a Percentage Covered Payroll ([b-a]/c)
6/30/05	$ 10,494,147,953	$ 19,304,646,648	$ 8,810,498,695	54.4%	$ 3,475,528,000	253.5%
6/30/06	10,899,853,065	20,874,541,910	9,974,688,845	52.2	3,572,541,000	279.2
6/30/07	12,078,908,954	22,280,916,665	10,202,007,711	54.2	3,762,777,000	271.1
6/30/08	10,995,366,485	23,841,280,102	12,845,913,617	46.1	3,967,704,000	323.8
6/30/09	10,999,953,527	25,298,346,092	14,298,392,565	43.5	4,027,263,000	355.0
6/30/10	10,961,540,164	29,309,464,296	18,347,924,132	37.4	4,119,360,842	445.4

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

SCHEDULE OF EMPLOYER CONTRIBUTIONS

Year Ended June 30	Annual Required Contribution per GASB Statement No. 25 (1)	Percentage Contributed	Annual Required Payroll Contribution per State Statute(2)	Percentage Contributed
2005	$ 727,428,010	58.8%	$ 425,682,669	100%
2006	672,555,569	31.3	207,814,710	100
2007	823,802,760	43.6	361,113,709	99
2008	986,410,891	59.6	576,626,422	102
2009	1,003,432,849	77.2	769,851,595	101
2010	1,177,313,343	93.1	1,093,072,413	100

(1) This amount includes both payroll and non-payroll employer required contributions.
(2) Employer required contribution determined in accordance with P.A. 88-0593, and P.A. 94-0004 (for Fiscal Years 2006 and 2007 only). These amounts reflect only payroll required contributions.

Notes to Required Supplementary Information

Valuation date: June 30, 2010
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 - 35 years, closed

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

Actuarial assumptions:
- Investment rate of return - 7.75 percent
- Projected salary increases - 1.0 to 5.35 percent, based upon member's age
- Assumed inflation rate - 3.0 percent
- Group size growth rate - 0.0 percent
- Post-retirement increase - 3.0 percent, compounded
- Mortality table - 1994 Group Annuity Mortality Table for males and females. Five percent of deaths amongst active employees are assumed to be in the performance of their duty.

SUMMARY OF REVENUES BY SOURCE

	2010	2009
Contributions:		
Participants	$ 238,860,138	$ 235,028,054
Repayments of contributions refunded	911,169	994,044
Interest received from participants	6,401,664	6,205,334
Total participants contributions	246,172,971	242,227,432
Employing state agencies and appropriations	372,408,603	774,910,344
Pension Contribution Fund	723,137,253	-
Total employer contributions	1,095,545,856	774,910,344
Investments:		
Net investments income	200,200,994	224,823,314
Interest earned on cash balances	795,373	7,319,968
Net depreciation in fair value of investments	598,899,494	(2,441,040,917)
Total investment loss	799,895,861	(2,208,897,635)
TOTAL REVENUE (LOSS)	$ 2,141,614,688	$ (1,191,759,859)

SUMMARY SCHEDULE OF CASH RECEIPTS & DISBURSEMENTS

	2010	2009
Cash balance, beginning of year	$ 232,679,069	$ 306,528,043
Receipts:		
Participant contributions	235,574,760	230,732,180
Employer contributions		
(net of bond principal and interest transfers)	386,572,210	764,832,593
Pension Contribution Fund	720,745,289	-
Transfers from Illinois State Board of Investment	600,000,000	237,000,000
Interest income on cash balance	911,074	7,782,920
Claims receivable payments	6,874,476	6,283,274
Installment payments	4,020,445	5,173,247
Other	107,455	94,658
Total cash receipts	1,954,805,709	1,251,898,872
Disbursements:		
Annuity payments:		
Retirement annuities	1,237,349,115	1,164,972,311
Widow's and Survivor's annuities	89,582,037	73,853,072
Disability benefits	47,201,278	44,556,315
Lump Sum benefits	15,355,322	15,979,556
Refunds (including transfers to reciprocal systems)	15,257,661	15,798,728
Administrative expenses	12,032,748	10,587,864
Transfer to Illinois State Board of Investment	720,793,952	-
Total cash disbursements	2,137,572,113	1,325,747,846
Cash balance, end of year	$ 49,912,665	$ 232,679,069

SCHEDULE OF PAYMENTS TO CONSULTANTS & ADVISORS

	2010	2009
Legal Services	$ 39,499	$ 32,117
Actuarial Costs	125,190	173,846
Audit Expense	96,722	113,014
Physicians and Disability Inspections	336,682	274,409
Financial Planning	63,131	64,164
Management Consultants	658,058	252,782
TOTAL	$ 1,319,282	$ 910,332

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

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

As Special Assistant Auditors for the Auditor General, we have audited the financial statements of the State Employees' Retirement System of the State of Illinois (System), as of and for the year ended June 30, 2010 and have issued our report thereon dated February 17, 2011. We conducted our audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards,* issued by the Comptroller General of the United States. Other auditors audited the financial statements of the Illinois State Board of Investment, as described in our Independent Auditor's Report on the System's financial statements. This report does not include the results of the other auditors' testing of internal control over financial reporting or compliance and other matters that are reported on separately by those auditors.

Internal Control Over Financial Reporting

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

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

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

Our consideration of internal control over financial reporting was for the limited purpose described in the preceding paragraph and would not necessarily identify all deficiencies in internal control over financial reporting that might be deficiencies, significant deficiencies or material weaknesses. We did not identify any deficiencies in internal control over financial reporting of the System that we consider to be material weaknesses, as defined above.

<u>Compliance and Other Matters</u>

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

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

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

BKD, LLP

February 17, 2011

State Employees' Retirement System of the State of Illinois

Current Finding – *Government Auditing Standards*

June 30, 2010

No matters are reportable

State Employees' Retirement System of the State of Illinois
Schedule of Prior Finding Not Repeated
June 30, 2010

No matters are reportable