STATE OF ILLINOIS
STATE UNIVERSITIES RETIREMENT SYSTEM

FINANCIAL REPORT
YEAR ENDED JUNE 30, 2009

PERFORMED AS SPECIAL ASSISTANT AUDITORS
FOR THE AUDITOR GENERAL, STATE OF ILLINOIS

State of Illinois
State Universities Retirement System

Financial Audit

For the Year Ended June 30, 2009

Contents

We will issue under a separate cover the Compliance Examination Report for the year ended June 30, 2009.

State of Illinois
State Universities Retirement System

Financial Statement Report
June 30, 2009

Summary

The audit of the accompanying financial statements of the State of Illinois, State Universities Retirement System (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 Findings

The auditors identified matters involving the System's internal control over financial reporting that they considered to be significant deficiencies. The significant deficiencies are described on pages 32-34 as Finding 09-1, *Member Earnings and Contributions* and Finding 09-2, *Valuation of Securities Lending Collateral.*

Exit Conference

The findings and recommendations appearing in this report were discussed with System personnel at an exit conference on January 8, 2010. Attending were:

	System
Judith A. Parker	Associate Executive Director
Dan L. Allen	Chief Investment Officer
Douglas Wesley	Deputy Chief Investment
Shelley Porter	Chief Financial Officer
Kelly Jenkins	General Counsel
Steven L. Hayward	Internal Auditor
W. Douglas Taylor	Internal Auditor
John Engstrom	Audit Committee Chairman
	McGladrey & Pullen, LLP
Joseph Evans	Partner
Rolake Adedara	Director
Josh Peacock	Supervisor
	Office of the Auditor General
Thomas L. Kizziah	Audit Manager

The responses to the recommendations were provided by Steven L. Hayward, in a letter dated January 13, 2010.

McGladrey & Pullen
Certified Public Accountants

INDEPENDENT AUDITOR'S REPORT

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

Board of Trustees, State Universities Retirement System of Illinois

As Special Assistant Auditors for the Auditor General, we have audited the accompanying Statement of Plan Net Assets of the State Universities Retirement System of Illinois (System), a component unit of the State of Illinois, as of June 30, 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. The prior year comparative information has been derived from the System's financial statements as of June 30, 2008 and for the year then ended, on which we expressed an unqualified opinion in our report dated January 21, 2009.

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 audit provides 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 State Universities Retirement System of Illinois as of June 30, 2009, and the changes in 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, under separate cover, our report dated January 21, 2010 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 over financial reporting or 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 the schedules of funding progress and employer contributions 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 System's basic financial statements. The accompanying supporting schedules in the financial section and the accompanying introductory, investment, actuarial and statistical sections are presented for purposes of additional analysis and are not a required part of the basic financial statements. The 2009 supporting schedules in the financial section have been subjected to the auditing procedures applied in the audit of the basic financial statements and, in our opinion, are fairly stated, in all material respects, in relation to the basic financial statements as of and for the year ended June 30, 2009, taken as a whole. We have also previously audited, 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, the System's basic financial statements for the year ended June 30, 2008, which are not presented with the accompanying financial statements. In our report dated January 21, 2009, we expressed an unqualified opinion on those statements. In our opinion, the 2008 supporting schedules in the financial section are fairly stated, in all material respects, in relation to the basic financial statements for the year ended June 30, 2008, taken as a whole. The introductory, investment, actuarial, and statistical sections listed in the table of contents have not been subjected to the auditing procedures applied in the audit of the basic financial statements and, accordingly, we express no opinion on them.

McGladrey & Pullen, LLP

Schaumburg, Illinois
January 21, 2010

Management's Discussion and Analysis

This section presents management's discussion and analysis of the State Universities Retirement System's (SURS or the System) financial statements and the major factors affecting the operations and investment performance of the System during the year ended June 30, 2009, with comparative reporting entity totals for the year ended June 30, 2008.

Overview of Financial Statements and Accompanying Information

- The financial statements presented in this report are the Statement of Plan Net Assets as of June 30, 2009 and the Statement of Changes in Plan Net Assets for the year ended June 30, 2009. These statements present separate totals for the defined benefit plan and the self-managed plan, with reporting entity totals for the years ended June 30, 2009 and 2008. The Statement of Plan Net Assets presents the assets on hand as of June 30, 2009 and 2008 and available to be used in the payment of benefits. The Statement of Changes in Plan Net Assets presents the additions to and deductions from the plan net assets during the years ended June 30, 2009 and 2008.
- The notes to the financial statements are an integral part of the financial statements and provide facts and detailed information to assist the reader in understanding the statements. Disclosures include the description of the plan, summary of significant accounting policies, and detailed presentations of major assets and liabilities.
- Required supplementary information presents schedules related to employer contributions and the funding of the plan.
- Other supplementary schedules consist of detailed information supporting administrative and investment expenses, fees paid to consultants, and a summary of cash receipts and disbursements.

General Market Risk

SURS 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 SURS investment portfolios 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 SURS financial condition.

Financial Analysis of the System

The State Universities Retirement System serves 191,789 members in its defined benefit plan and 16,456 members in its self-managed plan. The funds needed to finance the benefits provided by SURS are accumulated through the collection of member and employer contributions and through income on investments. The total net assets of the System decreased from $15.2 billion as of June 30, 2008 to $11.6 billion as of June 30, 2009, chiefly due to significant investment losses.

Plan Net Assets

The summary of plan net assets for the System is presented below:

Condensed Statement of Plan Net Assets
Reporting Entity Total (in millions)

	2009	2008	Change Amount	Change %
Cash and short-term investments	$ 543.6	$ 797.6	$ (254.0)	(31.8)
Receivables and prepaid expenses	57.0	56.4	0.6	1.1
Pending investment sales	606.5	2,087.4	(1,480.9)	(70.9)
Investments and securities lending collateral	12,615.1	16,506.2	(3,891.1)	(23.6)
Capital assets, net	6.6	6.9	(0.3)	(4.3)
Total assets	13,828.8	19,454.5	(5,625.7)	(28.9)

Management's Discussion and Analysis

Payable to brokers–unsettled trades	878.1	2,184.5	(1,306.4)	(59.8)
Securities lending collateral	1,323.0	2,046.5	(723.5)	(35.3)
Other liabilities	21.1	20.8	0.3	1.4
Total liabilities	2,222.2	4,251.8	(2,029.6)	(47.7)
Total plan net assets	$11,606.6	$15,202.7	($3,596.1)	(23.6)

Overall, plan net assets decreased by $3.6 billion, or 23.6%, chiefly due to the decrease in investments. Of this decrease, $.75 billion represents the use of investments to pay benefits, and the remainder is due to the negative return on investments of 19.7%. The investment allocation strategy for the plans making up the reporting entity as of June 30, 2009 and 2008 is as follows:

	2009	2008
Defined Benefit Plan		
Equities	66.0%	68.0%
Opportunity Fund	2.0	0.0
Fixed income	18.0	21.0
TIPS*	4.0	5.0
Real Estate Investment Trusts	4.0	4.0
Real Estate	6.0	2.0
Total	100.0%	100.0%
Self-Managed Plan		
Equities	64.0%	75.0%
Fixed income	36.0	25.0
Total	100.0%	100.0%

*TIPS denotes Treasury Inflation Protected Securities

Proper implementation of the investment policy requires that a periodic adjustment, or rebalancing, of assets be made to ensure conformance with policy target levels. Such rebalancing is necessary to reflect sizable cash flows and performance imbalances among investment managers who are hired to manage assets with a specified strategy. SURS' rebalancing policy calls for rebalancing, as soon as practical, if a strategy exceeds or falls below its target allocation by 3%. Ongoing rebalancing of the investment portfolio occurred as needed during the year with the assistance of System cash flows. The allocation of assets within the self-managed plan is totally determined by the individual participants, and also reflects losses over the past year.

Liabilities decreased by $2.0 billion or 47.7%. This was primarily due to a decrease in the payable to brokers for unsettled trades at year end, and a decrease in the obligation for securities lending collateral.

Changes in Plan Net Assets

The summary of changes in plan net assets for the System is presented below:

Condensed Statement of Changes in Plan Net Assets
Reporting Entity (in millions)

	2009	2008	Change Amount	Change %
Employer contributions	$ 489.9	$ 383.9	$ 106.0	27.6
Participant contributions	322.1	310.1	12.0	3.9
Investment (loss)/income	(2,967.1)	(714.8)	(2,252.3)	(315.1)
Total additions	(2,155.1)	(20.8)	(2,134.3)	(10,261.1)
Benefits	1,376.7	1,279.2	97.5	7.6
Refunds	51.4	54.9	(3.5)	(6.4)
Administrative expense	12.9	12.1	0.8	6.6
Total deductions	$ 1,441.0	$ 1,346.2	94.8	7.0
Net (decrease)/increase in plan net assets	$ (3,596.1)	$ (1,367.0)	$ (2,229.1)	(163.1)

Management's Discussion and Analysis

Additions

Additions to plan net assets are in the form of employer and participant contributions and investment income or losses. For fiscal year 2009, employer contributions increased by $106.0 million due to higher employer contributions from the State of Illinois as required by Public Act 88-0593. Participant contributions increased by $12.0 million, or 3.9% due to salary increases among active members.

The investment loss for fiscal year 2009 was $2.97 billion for the System, representing a $2.3 billion decrease from the prior year. For the defined benefit plan, the overall loss was 19.7% (net of all investment management fees).

Given the long-term orientation of the SURS defined benefit investment program, it is important to track investment returns over several time periods to correctly assess performance, especially given recent market volatility. The defined benefit plan returns are as follows:

Time Period	Annualized Return
1-year	(19.7%)
3-year	(3.2%)
5-year	2.3%
10-year	2.8%
22-year	7.5%

The 22-year return corresponds to the average active service term of the System member. At 7.5%, it can be compared to the actuarial rate of return assumption, currently 8.5%. This assumed rate is determined every five years as part of the experience study performed by the System actuaries, and reviewed at least annually. Should market conditions or plan demographics of the System significantly deviate, the performance of an experience study in advance of the five-year period would be considered.

Deductions

The expenses of the Retirement System relate to the provision of retirement annuities and other benefits, refunds to terminated employees, and the cost of administering the System. These expenses for fiscal year 2009 were $1.44 billion, an increase of $94.8 million or 7.0% over expenses for 2008. This increase is primarily due to the $97 million increase in defined benefit plan retirement and survivor annuity payments, offset by a $5 million decrease in portable lump sum distributions and refunds. Administration expenses increased by $.8 million or 6.6% from fiscal year 2008 to 2009.

Future Outlook

Participant contributions are expected to grow in the future, at least at the pace of wage inflation experienced by the employers. The employer contribution, mainly provided by the State of Illinois, will increase by approximately $144 million or 19% as the determination of projected state contributions for fiscal years 2011 and beyond are at levels required by the funding plan set out by Public Act 88-0593. Under this plan contributions will be at levels sufficient to fund the employer normal cost while amortizing the unfunded accrued actuarial liability for the period of 2011 to 2045, allowing the System to reach a funding ratio of 90%.

Benefit payments are expected to continue to grow at a rate of approximately 8 –10 % annually as a result of increasing numbers of retirees and the impact of annual salary increases at the participating agencies. Even with the increase in the employer contributions as discussed above, the projected deficit of contributions over expenditures will continue in future years, forcing the System to continue to liquidate investments in order to pay current benefits. SURS will continue to structure its portfolio with the objective of maximizing returns over the long term, taking advantage of investment income to help offset the shortages in employer contributions.

Financial Statements

Statement of Plan Net Assets as of June 30, 2009
With Comparative Reporting Entity Totals as of June 30, 2008

	2009			2008
	Defined Benefit Plan	Self-Managed Plan	Total	Total
Assets				
Cash and short-term investments	$ 543,659,417	$ –	$ 543,659,417	$ 797,620,497
Receivables				
Participants	12,072,460	1,735,687	13,808,147	12,891,573
Federal, trust funds, and other	2,009,986	1,149,915	3,159,901	3,192,408
Notes receivable, long-term	598,687	–	598,687	542,701
Pending investment sales	606,501,124	–	606,501,124	2,087,413,798
Interest and dividends	39,454,498	–	39,454,498	39,705,356
Total receivables	660,636,755	2,885,602	663,522,357	2,143,745,836
Prepaid expenses	–	–	–	8,000
Investments, at fair value				
Equity investments	6,940,178,087	27,666,067	6,967,844,154	8,731,804,485
Fixed income investments	3,552,427,529	12,913,491	3,565,341,020	4,813,443,832
Real estate investments	228,712,211	38,004	228,750,215	352,275,186
Mutual fund and variable annuities	–	530,092,101	530,092,101	562,118,120
Total investments	10,721,317,827	570,709,663	11,292,027,490	14,459,641,623
Securities lending collateral	1,323,035,827	–	1,323,035,827	2,046,536,507
Capital assets, at cost, net of accumulated depreciation $16,768,688 and $16,053,476 respectively	6,583,663	–	6,583,663	6,931,226
Total assets	**13,255,233,489**	**573,595,265**	**13,828,828,754**	**19,454,483,689**
Liabilities				
Benefits payable	5,441,147	–	5,441,147	5,436,697
Refunds payable	2,437,930	–	2,437,930	2,899,940
Securities lending collateral	1,323,035,827	–	1,323,035,827	2,046,536,507
Payable to brokers for unsettled trades	878,088,978	–	878,088,978	2,184,482,162
Administrative and investment expenses payable	13,256,204	–	13,256,204	12,417,935
Total liabilities	**2,222,260,086**	**–**	**2,222,260,086**	**4,251,773,241**
Net assets held in trust for pension benefits	**$11,032,973,403**	**$573,595,265**	**$11,606,568,668**	**$15,202,710,448**

Financial Statements

Statement of Changes in Plan Net Assets For the Year Ended June 30, 2009
With Comparative Reporting Entity Totals For the Year Ended June 30, 2008

	2009			2008
	Defined Benefit Plan	Self-Managed Plan	Total	Total
Additions				
Contributions				
Employer	$ 451,617,066	$ 38,264,326	$ 489,881,392	$ 383,899,304
Participant	273,292,053	48,825,439	322,117,492	310,101,265
Total Contributions	724,909,119	87,089,765	811,998,884	694,000,569
Investment (loss) income				
Net depreciation in fair value of investments	(3,173,708,607)	(116,422,818)	(3,290,131,425)	(1,090,533,067)
Interest	183,668,534	–	183,668,534	212,932,939
Dividends	153,789,636	–	153,789,636	187,602,637
Securities lending	18,313,879	–	18,313,879	14,161,232
	(2,817,936,558)	(116,422,818)	(2,934,359,376)	(675,836,259)
Less investment expense				
Asset management expense	31,095,737	–	31,095,737	37,659,805
Securities lending expense	1,664,780	–	1,664,780	1,353,062
Net investment loss	(2,850,697,075)	(116,422,818)	(2,967,119,893)	(714,849,126)
Total	**(2,125,787,956)**	**(29,333,053)**	**(2,155,121,009)**	**(20,848,557)**
Deductions				
Benefits	1,371,990,391	4,735,998	1,376,726,389	1,279,172,742
Refunds of contributions	42,651,635	8,720,677	51,372,312	54,939,592
Administrative expense	12,922,070	–	12,922,070	12,079,244
Total deductions	**1,427,564,096**	**13,456,675**	**1,441,020,771**	**1,346,191,578**
Net decrease	**(3,553,352,052)**	**(42,789,728)**	**(3,596,141,780)**	**(1,367,040,135)**
Net assets held in trust for pension benefits				
Beginning of year	14,586,325,455	616,384,993	15,202,710,448	16,569,750,583
End of Year	**$11,032,973,403**	**$573,595,265**	**$11,606,568,668**	**$15,202,710,448**

The accompanying notes are an integral part of the financial statements.

Notes to the Financial Statements

I. Summary of Significant Accounting Policies

A. Reporting Entity

The System is a component unit of the State of Illinois. As defined by accounting principles generally accepted in the United States of America established by the Governmental Accounting Standards Board (GASB), the financial reporting entity consists of a primary government, as well as its component units, which are legally separate organizations for which the elected officials of the primary government are financially accountable, or for which the nature and significance to the primary government are such that exclusion would cause the reporting entity's financial statements to be misleading or otherwise incomplete. Financial accountability is defined as:

1. Appointment of a voting majority of the component unit's board and either (a) the ability to impose will by the primary government or (b) the possibility that the component unit will provide a financial benefit to or impose a financial burden on the primary government; or

2. Fiscal dependency on the primary government.

Based upon the required criteria, the System has no component units.

B. Measurement Focus and Basis of Accounting

For both the defined benefit plan and the self-managed plan (SMP), the financial transactions are recorded using the economic resources measurement focus and accrual basis of accounting. Member and employer contributions are recognized as revenue when due pursuant to statutory or contractual requirements. Benefits and refunds are recognized as expenses when due and payable in accordance with the terms of the plans.

C. Use of Estimates

The preparation of the System's financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities, and changes therein, and disclosure of contingent assets and liabilities. Actual results could differ from those estimates and those differences could be material. The System uses an actuary to determine the actuarial accrued liability for the defined benefit plan and to determine the actuarially required contribution.

D. Risks and Uncertainties

The System invests in various investment securities. Investment securities are exposed to various risks such as interest rate, market, and credit risk. Due to the level of risk associated with certain investment securities, it is at least reasonably possible that changes in the values of investment securities will occur in the near-term and those such changes could materially affect the amounts reported in the Statement of Plan Net Assets.

E. Description of Plans

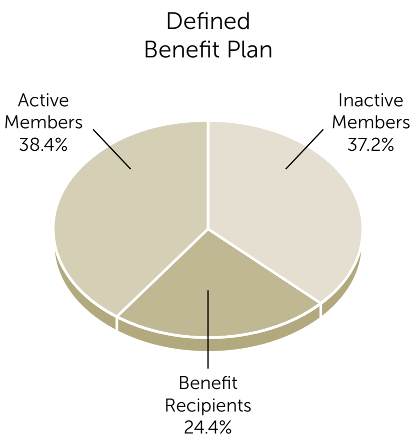
Legislation effective January 1, 1998, required State Universities Retirement System (SURS or the System) to introduce a portable benefit package to the existing defined benefit plan and to offer a defined contribution plan. The portable benefit package and the defined contribution plan are available to all participants whose employers elect to make the options available. As of June 30, 2009, the defined benefit plan has two options available. These options are known as the traditional benefit package and the portable benefit package. The defined contribution plan is known as the self-managed plan. The membership, contributions, and benefit provisions related to these plans are presented in the following summary of the provisions of SURS in effect as of June 30, 2009, as defined in the Illinois Compiled Statutes. Interested parties should refer to the SURS Member Guide or the Statutes for more complete information.

1. Defined Benefit Plan

SURS is the administrator of a cost-sharing, multiple-employer public employee retirement system established July 21, 1941, to provide retirement annuities and other benefits for staff members and employees of the state universities, certain affiliated organizations, and certain other state educational and scientific agencies and for

Notes to the Financial Statements

survivors, dependents, and other beneficiaries of such employees. SURS is included in the State of Illinois' financial reports as a component unit. SURS is governed by Chapter 40, Act 5, Article 15, of the *Illinois Compiled Statutes.* These statutes assign the authority to establish and amend the benefit provisions of the plan to the State Legislature. Operation of the System and the direction of its policies are the responsibility of the Board of Trustees of the System. It is also these statutes that define the scope of SURS' reporting entity. There are no statutory provisions for termination of the System. The Illinois Constitution provides that the pension obligation of the state *shall be an enforceable contractual relationship, the benefits of which shall not be diminished or impaired.*



At June 30, 2009 and 2008, the number of participating employers was:

	2009	2008
Universities (A)	**9**	9
Community Colleges	**39**	39
Allied Agencies	**15**	15
State of Illinois	**2**	2
	65	65

(A) In prior years, the total universities was presented as 12 which separately counted the multiple campuses of the University of Illinois and Southern Illinois University.

At June 30, 2009 and 2008, defined benefit plan membership consisted of:

	2009	2008
Benefit Recipients	**46,810**	45,346
Active Members	**73,699**	73,086
Inactive Members	**71,280**	70,657
	191,789	189,089

a. Membership

Participation is required as a condition of employment. Employees are ineligible to participate if (a) employed less than full-time and attending classes with an employer; (b) receiving a retirement annuity from SURS; or (c) excluded by subdivision (a)(7)(f) or (a)(19) of Section 210 of the Federal Social Security Act from the definition of employment given in that Section.

b. Benefit Provisions

Public Act 90-448 was enacted effective January 1, 1998, which established an alternative defined benefit program known as the portable benefit package. This option is offered in addition to the existing traditional benefit option. New employees are allowed 6 months from their date of hire to make an irrevocable election. The benefit provisions for these two defined benefit plan packages are as follows:

SURS provides retirement, disability, death and survivor benefits as authorized in Chapter 40, Act 5, Article 15, of the *Illinois Compiled Statutes.*

Retirement benefits are payable to participants meeting minimum vesting requirements of 5 years of service credit at age 62, 8 years of service credit at age 55, or 30 years of service credit regardless of age. Under both defined benefit options, the annuity is the larger of (a) a percentage of the average of the highest 4 consecutive years earnings, with the percentage based upon total service credit, or (b) an actuarially determined benefit based upon the total employee and employer contributions and the individual's age at time of retirement. Retirement benefits are payable for life and are subject to a 3 percent compounded increase each January 1.

Disability benefits are payable to all participants with at least 2 years of service credit if they are unable to reasonably perform the duties of their assigned position due to a physical or mental impairment as certified by a physician. The benefit becomes payable when sick leave payments are exhausted or after 60 days of the disability, whichever is later. The benefit is payable at a rate of 50% of the monthly rate of compensation on the date the disability began. Disability benefits are reduced by any payments received under the Workers' Compensation or the Occupational Diseases Act. If a participant remains disabled after receiving the maximum benefits due, they may be eligible for a disability retirement annuity equal to 35% of the monthly rate of compensation on the date the disability began.

Upon termination of service, a lump sum refund is available to all members. Under the traditional benefit package, this refund consists of all member contributions and interest at 4-1/2%. Under the portable benefit package, this refund consists of all member contributions and total interest credited, plus for those members with

Notes to the Financial Statements

greater than or equal to 5 years of service credit, an equal amount of employer contributions. Under both defined benefit plan options, a member with 5 or more years of service credit who does not apply for a refund may apply for a normal retirement benefit payable at age 62.

Death benefits are payable to named beneficiaries upon the death of any participant of this System. Under the traditional benefit package, monthly survivor benefits may be paid to eligible survivors if the participant established a minimum of 1.5 years of service credit prior to the date of death. If no qualified survivor exists at the date of retirement, the member is paid a refund of all survivor contributions plus interest. Under the portable benefit package, survivor benefits are available through a reduction of the retirement annuity calculated as described above. No refund of survivor contributions is available if there is no qualified survivor at the time of retirement. These provisions are designed to allow the impact of the portable benefit package's enhanced refund opportunity to be cost neutral.

Upon the death of an annuitant, SURS will pay either a death benefit to a non-survivor beneficiary or a monthly survivor benefit to an eligible survivor. The amount of the monthly survivor benefit will differ depending upon whether the annuitant had selected the traditional benefit package or the portable benefit package.

c. Funded status and funding progress

The funded status of the plan as of June 30, 2009, the most recent actuarial valuation date, is as follows (in millions):

Actuarial Value of Assets	Accrued Actuarial Liabilities	Unfunded Accrued Actuarial Liabilities	Funding Ratio*	Covered Payroll	UAAL as % of Covered Payroll
$14,282.0	$ 26,316.2	$12,034.2	54.3%	$3,463.9	347.4%

The schedule of funding progress, presented as required supplementary information (RSI) following the notes to the financial statements, presents multi-year trend information about whether the plan assets are increasing or decreasing over time relative to the actuarial accrued liabilities for benefits.

*If calculated using the market value of assets of $ 11,033.0, the funding ratio would be 41.9%.

d. Actuarial Value of Assets

The actuarial value of assets is used in determining the funding progress of the System and in establishing the employer contribution rates necessary to adhere to the statutory funding plan. The actuarial value of assets is based on a smoothed investment income rate. Investment income in excess or shortfall of the expected 8.5% rate on fair value is smoothed over a five-year period with 20% of a year's excess or shortfall being recognized each year beginning with the current year. The use of this actuarial method began with the valuation for the period ending June 30, 2009, as required by Public Act 96-0043 , which was signed into law on July 15, 2009.

Calculation of Actuarial Value of Assets (in thousands)

Actuarial Value of Assets at July 1, 2008		$ 14,586,325.5
Total investment income/(loss)	(2,850,697.1)	
Projected investment income @ 8.5%	1,210,583.8	
Investment income/(loss) in excess of projected	(4,061,280.9)	
Deferral to smooth asset values over 5 years	3,249,024.7	
Projected investment income		1,210,583.8
Recognized investment loss		(812,256.2)
Excess of contributions over disbursements		(702,655.0)
Actuarial Value of Assets at June 30, 2009		$ 14,281,998.1

e. Additional actuarial valuation information

Valuation date	June 30, 2009
Actuarial cost method	Projected unit credit
Amortization method	Level percent, open
Remaining amortization period	30 years, open
Asset valuation method	5-year smoothed market
Actuarial assumptions:	
Investment rate of return	8.5%
Projected salary increases*	5.0% - 10.0%
Postretirement benefits	3.0%

*Includes inflation and cost-of-living adjustments of 1.25%.

Notes to the Financial Statements

2. Self-Managed Plan

SURS is the plan sponsor and administrator of a defined contribution plan established as of January 1, 1998, by the Illinois General Assembly as an amendment to the Illinois Pension Code through Illinois Public Act 90-448. This plan is referred to as the self-managed plan (SMP) and is offered to employees of all SURS employers who elect to participate. This plan is a qualified money purchase pension plan under Section 401(a) of the Internal Revenue Code. The assets of the SMP are maintained under a trust administered by the SURS Board of Trustees in accordance with the Illinois Pension Code.

At June 30, 2009 and 2008, the number of SMP participating employers was:

	2009	2008
Universities (A)	**9**	9
Community Colleges	**39**	39
Allied Agencies	**13**	13
State of Illinois	**1**	1
	62	62

At June 30, 2009 and 2008, the SMP membership consisted of:

	2009	2008
Annuity Benefit Recipients	**110**	62
Active Members	**9,846**	9,988
Inactive Members	**6,500**	6,064
	16,456	16,114

(A) In prior years, the total universities was presented as 12 which separately counted the multiple campuses of the University of Illinois and Southern Illinois University.

a. Membership

A member may elect participation in the SMP if (a) all participation criteria for the defined benefit plan are met; (b) the employer has elected through Board action to offer the self-managed plan; (c) the employee is on active status at the plan offering date; and (d) the employee is not eligible to retire as of the employer plan offering date. The member election is irrevocable. New employees are allowed 6 months from the date of hire in which to make their election. If no election is received, members are considered to be part of the defined benefit plan, under the traditional benefit option.

b. Benefit Provisions

The SMP provides retirement, disability, death, and survivor benefits as authorized in Chapter 40, Act 5, Article 15, of the *Illinois Compiled Statutes*, and amended by Public Act 90-448.

Retirement benefits are payable to participants meeting minimum vesting requirements of 5 years of service credit at age 62, 8 years of service credit at age 55, or 30 years of service credit regardless of age. The distribution options available upon reaching retirement eligibility are the following: a lump sum distribution consisting of all employee and employer contributions and related investment earnings; a single life annuity; a 50% or 100% joint and survivor annuity; a single life annuity with a guaranteed period of 10, 15, or 20 years as elected by the participant; and a 50% or 100% joint and survivor annuity with a guaranteed period of 10, 15, or 20 years as elected by the participant.

Disability benefits are payable to all participants with at least 2 years of service credit if they are unable to reasonably perform the duties of their assigned position due to physical impairment as certified by a physician. The benefit becomes payable when sick leave payments are exhausted or after 60 days of the disability, whichever is later. The benefit is payable at a rate of 50% of the monthly rate of compensation on the date the disability began. Disability benefits are reduced by any payments under the Workers' Compensation or the Occupational Diseases Act.

Upon termination of service with less than 5 years of service credit, a lump sum distribution is available which consists of employee contributions and related investment earnings. The employer contributions and related investment earnings are forfeited. Upon termination of service with greater than 5 years of service credit but where the participant is not yet eligible for retirement, a lump sum distribution is available which consists of employee and employer contributions and related investment earnings.

Death benefits are payable to named beneficiaries upon the death of any participant of this plan. If the participant has less than 1.5 years of service credit, the death benefit payable is the employee contributions and related investment earnings. If the participant has 1.5 or more years of service credit, the death benefit payable is the employee and employer contributions and related investment earnings.

Notes to the Financial Statements

F. Cash and Short-Term Investments

Included in the $543,659,417 of cash and short-term investments presented in the Statement of Plan Net Assets is $122,753,705 of short-term investments with less than 90 days maturity. For purposes of the various data tables presented in Note III, this group of short-term investments is included as part of fixed income investments. Short-term investments are generally reported at cost, which approximates fair value.

G. Investments

Investments are governed by Chapter 40, Act 5, Articles 1 and 15, of the *Illinois Compiled Statutes*. The most important aspect of the statutes is the prudent expert rule, which establishes a standard of care for all fiduciaries. (A fiduciary is any person who has authority or control with respect to the management or administration of plan assets.) The prudent expert rule states that fiduciaries must discharge their duties with the care, skill, prudence, and diligence that a prudent person acting in a like capacity and familiar with such matters would use under conditions prevailing at the time.

For the defined benefit plan, investments are reported at fair value. Marketable securities (stocks, bonds, warrants, and options) are traded on public exchanges. The Northern Trust Company, SURS' custodial bank, establishes these prices using third-party pricing services. Generally, these prices are reported at the last reported sales price. Certain investments that do not have an established market value are reported at estimated fair value obtained from a custodial bank or investment management firm. These investments include commingled investment pools, where the underlying assets are individually marked to market (i.e., estimated fair value) on a daily basis and individually traded on publicly recognized exchanges. The investment manager, using methods approved by the CFA Institute (formerly known as the Association for Investment Management Research) or other industry standards, values non-marketable securities (real estate and venture capital). These methods generally include detailed property level appraisals and discounted cash flow analysis.

For the SMP, investments are reported at fair value by the Service Providers. These investments include both mutual and variable annuity funds where the underlying assets are marked to market (i.e., estimated fair value) on a daily basis and individually traded on publicly recognized exchanges. Generally, the prices on the underlying investments are reported at the last reported sales price. Purchases and sales of securities are recorded on a trade-date basis. Interest income is reported on the accrual basis. Dividends are recorded on the ex-dividend date.

H. Capital Assets

Capital assets are depreciated over the estimated useful life of each asset. Annual depreciation is computed using the straight-line method.

I. Administrative Expenses

System administrative expenses (which include amounts for both the defined benefit and self-managed plans) are budgeted and approved by the System's Board of Trustees. Funding for these expenses is included in the employer contribution as determined by the annual actuarial valuation and appropriated by the State of Illinois. This funding is included in the allocation of the state employer contribution recognized in the defined benefit plan. Therefore, expenses to administer the self-managed plan are recognized as administrative expenses in the defined benefit plan in these financial statements.

J. Prior Year Comparative Information

The basic financial statements include certain prior-year summarized comparative information in total but not at the level of detail required for a presentation in conformity with accounting principles generally accepted in the United States of America. Accordingly, such information should be read in conjunction with the System's financial statements as of and for the year ended June 30, 2008, from which the summarized comparative information was derived.

K. Reclassification

Certain items in the 2008 financial statements have been reclassified to conform to the 2009 presentation.

Notes to the Financial Statements

L. New Accounting Pronouncements

The Governmental Accounting Standards Board Statement 51 has been issued and is effective for all reporting periods beginning after June 15, 2009. This pronouncement establishes accounting and financial reporting requirements for intangible assets including easements, water rights, timber rights, patents, trademarks, and computer software. SURS plans to follow these reporting requirements for fiscal year 2010 according to this Statement.

The Governmental Accounting Standards Board Statement 53 has been issued and is effective for all reporting periods beginning after June 15, 2009. This pronouncement addresses the recognition, measurement, and disclosure of information regarding derivative instruments entered into by state and local governments. The guidance in this Statement improves financial reporting by requiring governments to measure derivative instruments, with the exception of synthetic guaranteed investment contracts that are fully benefit-responsive, at fair value. The disclosures provide a summary of the government's derivative instrument activity and the information necessary to assess the government's objectives for derivative instruments. SURS plans to follow these reporting requirements for fiscal year 2010 according to this Statement.

M. Subsequent Events

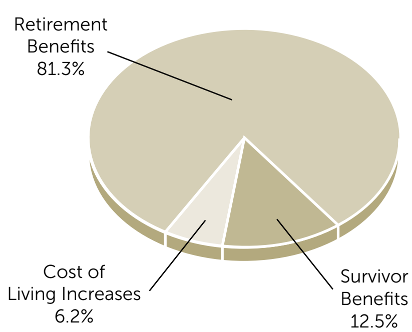
SURS has evaluated subsequent events for potential recognition and/or disclosure through January 21, 2010, the date the financial statements were available to be issued.

II. Contributions and Net Assets Designations

A. Defined Benefit Plan

1. Membership Contributions

Member Contributions



In accordance with Chapter 40, Act 5, Article 15, of the *Illinois Compiled Statutes*, members of the traditional benefit package contribute 8% of their gross earnings; 6-1/2% of those are designated for retirement annuities, 1/2% for post-retirement increases, and 1% for survivor benefits. Police officers and fire fighters contribute 9-1/2% of earnings; the additional 1-1/2% is a normal retirement contribution. Members of the portable benefit package contribute 8% of their gross earnings; 6-1/2% of those are designated for retirement annuities, 1/2% for post-retirement increases, and 1% for enhanced refund benefits. Police officers and fire fighters contribute 9-1/2% of earnings; the additional 1-1/2% is a normal retirement contribution. These statutes assign the authority to establish and amend the contribution provisions of the plan to the State Legislature. The member contributions are picked up by the employer and treated as employer contributions for income tax purposes. Retirement contributions are based on the gross earnings before the employer pick-up and are included in earnings.

All contributions on pre-1981 earnings and service credit payments, plus future other public employment, prior service, refund repayments, leave payments, military service payments, and the employee portion of Early Retirement Option payments are considered as previously taxed, unless qualifying funds are rolled over to SURS to make these purchases, or unless the payments are made in installments through employer deductions from payroll. Previously taxed contributions will be recovered tax-free when distributed to the employee in the form of benefits or payments or to his or her beneficiary as a death and/or survivor benefit.

2. Interest Credited on Member Contributions

For the traditional and portable benefit packages, the interest rate credited is fixed by the Board of Trustees and is currently 8.5%. As of July 1, 2009, the rate will be 8.0%. For purposes of lump sum refunds to former members, the traditional benefit package offers an interest rate of 4-1/2%, compounded annually, and the portable benefit package offers an interest rate equal to the credited rate, compounded annually. A change brought forth by the enactment of Public Act 94-0004 and effective July 1, 2005, calls for the Comptroller of the State of Illinois to set the interest rate credited to member contribution balances for purposes of the calculation of retirement annuities under the money purchase formula. The Comptroller set that rate at 8.5% for fiscal year 2006, 8.0% for fiscal years 2007 and 2008, and at 8.5% for fiscal year 2009. As of July 1, 2009, the rate will be 7.5%. Members certified after July 1, 2005 will not be eligible for the money purchase formula calculation. Rather their retirement annuity will be calculated using the general formula.

Notes to the Financial Statements

3. Employer Contributions

On an annual basis, an actuarial valuation is performed in order to determine the amount of statutorily required contributions from the State of Illinois. An actuarial experience study is performed every 5 years to determine the assumptions to be used in the annual valuation. The actuarial assumptions are also reviewed at least annually by the System. The last actuarial experience study was performed during fiscal year 2007. To determine the funding method, Public Act 88-0593 was passed by the Illinois General Assembly in 1994. This act, which took effect on July 1, 1995, provides a 15-year phase-in to a 35-year plan that requires the state to make continuing appropriations to meet the normal actuarially-determined cost of the System, plus amortize the unfunded accrued liability. Under this plan, the System is expected to be 90% funded by fiscal year 2045.

On June 1, 2005, Governor Blagojevich signed Public Act 94-0004 which impacted state funding and retirement benefit calculations in fiscal year 2006 and 2007. This public act authorized the following changes. First, it eliminated the money purchase calculation formula for Illinois higher education institution employees hired after June 30, 2005. Second, it transferred responsibility for determining the annual effective rate of interest to be used for the money purchase formula calculation from the SURS Board of Trustees to the State Comptroller. Finally, it required lower state contributions than the prior funding plan for the fiscal years 2006 and 2007. The decrease in state contributions was $158 million for fiscal year 2006, and $140 million for fiscal year 2007.

4. Net Asset Accounts

The System maintains two designated accounts that reflect the assignment of net assets to employee and benefit accounts:

a. The Employee Contribution Account records the pension assets contributed by each employee and the interest income earned by those contributions.

b. The Benefits from Employee and Employer Contributions Account records the net assets available for annuities in force and available for future retirement, death and disability benefits, the undistributed investment income, the unexpended administrative expense allocation, and the variations in actuarial assumptions.

Balances in these designated accounts as of June 30, 2009 are as follows:

Employee contributions	$ 5,688,943,973
Benefits from employee and employer contributions	5,344,029,430
Total Net Assets	**$ 11,032,973,403**

5. Ownership of Greater than 5 Percent of Net Assets Available for Benefits

In addition to U.S. Government and agency bond issues and treasury notes, there are investments as of June 30, 2009 in Federal National Mortgage Association (FNMA) obligations that represent 7.16% of the System's total investments.

B. Self-Managed Plan

1. Membership Contributions

In accordance with Chapter 40, Act 5, Article 15, of the *Illinois Compiled Statutes*, members contribute 8% of their gross earnings. These statutes assign the authority to establish and amend the contribution provisions of the plan to the State Legislature.

The member contributions are picked up by the employer and treated as employer contributions for income tax purposes. Retirement contributions are based on the gross earnings before the employer pick-up and are included in earnings.

Service credit purchase payments are considered as previously taxed, unless qualifying funds are rolled over to SURS to make these purchases. Previously taxed contributions will be recovered tax-free when distributed to the employee in the form of benefits or refunds or to his or her beneficiary as a death and/or survivor benefit.

Notes to the Financial Statements

2. Employer Contributions

In accordance with Chapter 40, Act 5, Article 15, of the *Illinois Compiled Statutes*, employer contributions credited to the SMP participant are at a rate of 7.6% of the participant's gross earnings, less the amount retained by SURS (currently .5%) to provide disability benefits to the participant. The amounts credited are paid into the participant's account. The State of Illinois shall make the employer contribution to SURS on behalf of the SMP participants.

3. Net Asset Accounts

The SMP maintains three designated accounts that reflect the assignment of net assets to employee contributions, disability benefits, and employer forfeiture accounts:

a. The Employee Contribution Account records the pension assets contributed by each employee and the corresponding employer contribution, and the investment income earned by those contributions.

b. The Disability Benefits Account reflects the pension assets contributed by the employer and held to fund member disability benefits.

c. The Employer Forfeiture Account reflects the pension assets contributed by the employer but forfeited from member accounts due to termination prior to reaching 5 years of service. Future employer contributions are reduced by the total forfeitures held by the defined contribution plan.

The assets related to disability benefits and employer forfeitures are commingled with the investment assets of the defined benefit plan. Investment income or loss is credited to these balances based upon the annual investment return or loss of the commingled assets. For fiscal year 2009, the investment loss credited to these balances was $10,258,625.

Balances in these designated accounts as of June 30, 2009 are as follows:

Employee contributions	$ 532,971,984
Disability benefits	36,688,771
Employer forfeitures	3,934,510
Total Net Assets	$ 573,595,265

4. Ownership of Greater than 5 Percent of Net Assets Available for Benefits

There are no significant investments in any one organization that represent 5% or more of net assets available for benefits.

III. Deposits and Investments

Custodial Credit Risk for Deposits

Custodial credit risk for deposits is the risk that in the event of a financial institution failure, State Universities Retirement System deposits may not be returned. Cash held in the investment related bank account in excess of $250,000 is uninsured and uncollateralized. SURS has no deposit policy for custodial credit risk. Deposits are under the custody of The Northern Trust Company which has a AA Long Term Deposit/Debt rating by Standard & Poor's, an Aa3 rating by Moody's and an AA/AA- rating by Fitch. At June 30, 2009, the carrying amount of cash was $420,905,712 and the bank balance was $424,621,965, of which $14,305,811 was foreign currency deposits and was exposed to custodial credit risk. The remaining $122,753,705 was made up of short-term invested funds which are considered to be investments for the purpose of assessing custodial credit risk.

Notes to the Financial Statements

Investment Policies

Investments are governed by Chapter 40, Act 5, Articles 1 and 15, of the *Illinois Compiled Statutes*. The most important aspect of the statutes is the prudent expert rule, which establishes a standard of care for all fiduciaries. (A fiduciary is any person who has authority or control with respect to the management or administration of plan assets.) The prudent expert rule states that fiduciaries must discharge their duties with the care, skill, prudence, and diligence that a prudent person acting in a like capacity and familiar with such matters would use under conditions prevailing at the time. The SURS Board of Trustees has adopted a Statement of Investment Guidelines that contains general guidelines for investments. The Investment Section of this report contains a summary of these guidelines. Within the prudent expert framework, the SURS Board of Trustees establishes specific investment guidelines in the investment management agreement of each individual investment management firm.

Investment Commitments

Private Equity Investment portfolios consist of passive interests in limited partnerships. The System had outstanding commitments to these limited partnerships of approximately $534.2 million and $494.6 million as of June 30, 2009 and 2008, respectively.

Investments

The carrying values of investments by type at June 30, 2009 are summarized below:

Equity investments	
U.S. equities	$ 4,398,286,191
Non-U.S. equities	1,747,510,141
U.S. private equity	924,143,271
Non-U.S. private equity	59,474,565
Equity futures	(161,570,015)
Fixed income investments	
U.S. government obligations	545,894,910
U.S. agency obligations	1,019,494,560
U.S. corporate fixed income	1,593,740,013
U.S. fixed income, other	124,216,305
Non-U.S. fixed income securities	291,918,374
U.S. fixed income derivatives	24,935,641
Non-U.S. fixed income derivatives	9,226,546
U.S. fixed income futures	(25,198,438)
Non-U.S. fixed income futures	(9,226,546)
U.S. short-term investments	203,351,875
Non-U.S. short-term investments	18,104,418
U.S. swaps and options	39,046,083
Non-U.S. swaps and options	5,186,422
Real estate investments	
Real Estate	228,750,215
Mutual fund and variable annuities	
Self-managed plan mutual funds and variable annuity funds	530,092,101
Total Investments	**$ 11,567,376,632**

(a) Fixed income investments presented in this table include $122,753,705 of short-term investments with maturities of less than 90 days, and $152,595,438 of investments in the form of cash and cash-equivalents. Both are included in the cash and short-term investments total on the financial statements.
(b) U.S. short-term investments principally consist of money market funds and options.
(c) Fixed income investments presented in this table include $9,619,820 of short-term bills and notes with maturities greater than 90 days.

Custodial Credit Risk

Custodial credit risk for investments is the risk that, in the event of a failure of the counterparty to a transaction, the System will not be able to recover the value of its investment or collateral securities that are in the possession of an outside party. SURS has not adopted a formal policy specific to custodial credit risk. At June 30, 2009, no investments were uninsured and unregistered, with securities held by the counterparty or by its trust department or agent but not in the System's name.

Notes to the Financial Statements

Concentration of Credit Risk

Concentration of credit risk is the risk of loss that may be attributed to the magnitude of the System's investment in a single issue. SURS has not adopted a formal policy specific to concentration of credit risk. However, this area is addressed with each of the relevant investment managers in the Investment Management Agreement between the parties. The System's investment portfolios are managed by professional investment management firms. These firms must maintain diversified portfolios and must comply with risk management guidelines specific to each of their investment management agreements. Excluding U.S. government and agency issues, the portfolios are limited to a 5% allocation in any single investment grade U.S. issuer. Allocation limits also apply to international issuers. At June 30, 2009, SURS had investments in Federal National Mortgage Association (FNMA) obligations totaling $792,640,477 that represented 7.16% of the System's total investments.

Credit Risk of Debt Securities

Credit risk is the risk that the issuer or other counterparty to an investment will not fulfill obligations. SURS has not adopted a formal policy specific to credit risk of debt securities. However, this area is addressed with each of the relevant investment managers in the Investment Management Agreement between the parties. The quality ratings of investments in fixed income securities of the System as described by Standard & Poor's rating agency at June 30, 2009 are as follows:

Quality Rating: Standard & Poor's	Domestic**	International	Total
AAA	$ 1,504,819,523	$ 96,715,422	$ 1,601,534,945
AA+	229,711,699	21,961,076	251,672,775
AA	270,330,184	24,266,486	294,596,670
AA-	52,437,049	2,526,725	54,963,774
A+	70,467,256	45,887,844	116,355,100
A	223,128,934	6,230,542	229,359,476
A-	80,101,973	27,294,431	107,396,404
BBB+	93,439,454	16,543,674	109,983,128
BBB	109,887,003	21,842,204	131,729,207
BBB-	81,630,744	5,724,652	87,355,396
BB+	4,163,299	1,882,745	6,046,044
BB	30,438,030	1,464,361	31,902,391
BB-	49,951,684	1,424,243	51,375,927
B+	20,906,644	204,000	21,110,644
B	11,776,469	140,000	11,916,469
B-	13,861,645	268,213	14,129,858
CCC+	6,902,156	3,416,159	10,318,315
CCC	42,140,669	51,166	42,191,835
CCC-	5,003,449	–	5,003,449
CC	7,476,744	–	7,476,744
C	1,370,423	33,800	1,404,223
D	649,066	144,000	793,066
Not Rated	20,400,502	13,896,631	34,297,133
Total credit risk: debt securities	$ 2,930,994,599	$ 291,918,374	$ 3,222,912,973
U.S. Government Agencies *	557,957,935	–	557,957,935
Total Debt Securities Investments	$ 3,488,952,534	$ 291,918,374	$ 3,780,870,908

* Obligations of the U.S. government or obligations explicitly guaranteed by the U.S. government are not considered to have credit risk. These obligations include fixed income securities from FHA, GNMA and FDIC. Includes $12,063,025 from self-managed plan mutual fund.

** Includes $61,170,196 from self-managed plan variable annuities and mutual funds.

Notes to the Financial Statements

Interest Rate Risk

Interest rate risk is the risk that changes in interest rates will adversely affect the fair value of an investment. The State Universities Retirement System manages its exposure to fair value loss arising from increasing interest rates by diversifying the debt securities portfolio. The System has not adopted a formal policy specific to interest rate risk. However, this area is addressed with each of the relevant investment managers in the Investment Management Agreement between the parties.

At June 30, 2009, the segmented time distribution of the various investment types of debt securities of the System are as follows:

		Maturities in Years				
Type	2009 Fair Value	Less than 1 year	1 to 5 years	6 to 10 years	10 to 20 years	More than 20 years
U.S. Gov't & Agency Fixed Income	$ 1,709,326,023	$116,836,042	$ 187,173,057	$ 222,205,120	$259,403,887	$ 923,707,917
U.S. Corporate Fixed Income	1,655,410,206	100,171,655	395,302,438	643,698,286	59,629,348	456,608,479
U.S. Fixed Income, Other	124,216,305	2,199,208	–	122,017,097	–	–
Non-U.S. Fixed Income	291,918,374	47,118,335	148,314,301	68,480,200	3,311,377	24,694,161
Total	$ 3,780,870,908	$266,325,240	$730,789,796	$1,056,400,703	$322,344,612	$1,405,010,557

Notes to the Financial Statements

Foreign Currency Risk

Foreign currency risk is the risk that changes in currency exchange rates will adversely affect the fair value of an investment or a deposit. SURS has not adopted a formal policy specific to foreign currency risk. However, this area is addressed with each of the relevant investment managers in the Investment Management Agreement between the parties. International investment management firms maintain portfolios with diversified foreign currency risk for SURS. The System's exposure to foreign currency risk derives from its positions in foreign currency and foreign currency-denominated equity and fixed income investments. At June 30, 2009 the System's exposure to foreign currency risk is as follows:

Currency	Equity	Fixed Income*	Total
Australian dollar	$ 51,024,749	$ 5,495,927	$ 56,520,676
Brazilian real	2,457,926	2,685,480	5,143,406
British pound sterling	231,069,773	8,386,255	239,456,028
Canadian dollar	53,916,126	6,531,915	60,448,041
Chinese yuan renminbi	–	15,161,773	15,161,773
Czech koruna	5,442,778	–	5,442,778
Danish krone	10,183,634	333,480	10,517,114
Egyptian pound	1,017,201	–	1,017,201
Euro	357,694,513	10,117,645	367,812,158
Hong Kong dollar	77,640,152	1,425,098	79,065,250
Indonesian rupiah	174,038	421	174,459
Japanese yen	220,939,559	15,240,950	236,180,509
Malaysian ringgit	1,874,935	(432,944)	1,441,991
Mexican peso	6,048,150	(74,127)	5,974,023
New Israeli shekel	721,874	–	721,874
New Taiwan dollar	12,686,871	581,437	13,268,308
New Zealand dollar	1,479,954	335,755	1,815,709
Norwegian krone	11,961,369	332,307	12,293,676
Philippine peso	78,441	–	78,441
Polish zloty	432,714	–	432,714
Singapore dollar	27,213,162	601,572	27,814,734
South African rand	2,168,725	–	2,168,725
South Korean won	10,023,926	69,510	10,093,436
Swedish krona	15,348,157	1,111,534	16,459,691
Swiss franc	93,340,671	57,986	93,398,657
Thai baht	4,591,013	54,438	4,645,451
Turkish lira	389,064	–	389,064
Total securities subject to foreign currency risk	**$ 1,199,919,475**	**$ 68,016,412**	**$ 1,267,935,887**
Foreign investments denominated in U.S. Dollars	**570,308,932**	**247,192,802**	**817,501,734**
Total foreign investment securities	**$ 1,770,228,407**	**$ 315,209,214**	**$ 2,085,437,621**

* Includes Swaps, Options and Short-Term Investments

Notes to the Financial Statements

Derivative Securities

The System invests 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 System's investments in derivatives are not leveraged. In the case of an obligation to purchase (long a financial future or a call option), the full value of the obligation is held in cash or cash equivalents. For obligations to sell (short a financial future or a put option), the reference security is held in the portfolio. 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. 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. These limits are approved by the Board of Trustees and senior management, and the risk positions of the investment managers are reviewed on a periodic basis to monitor compliance with the limits. During the year, SURS' derivative investments included foreign currency forward contracts, collateralized mortgage obligations (CMOs), treasury inflation protected securities (TIPS), options, futures, swaps, and swaptions.

Foreign currency forward contracts are used to hedge against the currency risk in SURS' foreign stock and fixed income security portfolios. 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.

SURS fixed income managers invest in CMOs to improve the yield or adjust the duration of the fixed income portfolio. As of June 30, 2009, the carrying value of the System's CMO holdings totaled $166,171,898.

Treasury inflation protected securities (TIPS) are used by SURS fixed income managers to provide a real return against inflation (as measured by the Consumer Price Index). In addition, SURS employs TIPS at the total fund level in order to utilize their diversification benefits. As of June 30, 2009, the fair value of the System's TIPS holdings totaled $320,992,642.

SURS 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). Additionally, SURS investment managers use futures contracts to improve the yield or adjust the duration of the fixed income portfolio. 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. Financial future positions are recorded with a corresponding offset, which results in a carrying value equal to zero. As the market value of the futures contract varies from the original contract price, a gain or loss is recognized and paid to or received from the clearinghouse. The cash or securities to fulfill these obligations are held in the investment portfolio.

SURS investment managers use options in an attempt to add value to the portfolio (collect premiums) or protect (hedge) a position in the portfolio. Financial options are an agreement that gives one party the right, but not the obligation, to buy or sell a specific amount of an asset for a specified price, called the strike price, on or before a specified expiration date. As a writer of financial options, the System receives a premium at the outset of the agreement and bears the risk of an unfavorable change in the price of the financial instrument underlying the option. All written financial options are recognized as a liability on the System's financial statements. As a purchaser of financial options, the System 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.

SURS fixed income managers invest in swaps and swaptions to manage exposure to credit, currency, inflation and interest rate risks. Swaptions are options on swaps that give the purchaser the right, but not the obligation, to enter into a swap at a specific date in the future. At June 30, 2009, the fair value of swaptions was $3.0 million. Swap agreements are privately negotiated agreements with a counterparty to exchange or swap investment cash flows, assets, foreign currencies or market-linked returns at specified, future intervals. SURS investment managers have entered into credit default, inflation-linked, interest rate and total return swap agreements.

Notes to the Financial Statements

Credit default swap agreements involve one party making a stream of payments (the buyer of protection) to another party (the seller of protection) in exchange for the right to receive a specified return in the event of a default or other credit event for the referenced entity, obligation or index. The seller of protection generally receives from the buyer of protection a fixed rate of income throughout the term of the swap provided there is no credit event. The seller effectively adds leverage to its portfolio as it is subject to investment exposure on the notional amount of the swap. At June 30, 2009, the total notional value of written credit default swaps (selling protection) was ($488.6) million and the notional value of purchased credit default swaps (buying protection) was $490.3 million. The fair value of credit default swaps at June 30, 2009, was $12.3 million.

Inflation-linked swap agreements involve a stream of fixed payments in exchange for variable payments linked to an inflation index. These swaps can protect against unfavorable changes in inflation expectations and are utilized to transfer inflation risk from one counterparty to another. At June 30, 2009, the fair value of the inflation-linked swaps was $0.3 million.

Interest rate swap agreements involve the exchange of a set of variable and fixed-rate interest payments linked to a referenced interest rate without an exchange of the underlying principal amount. These agreements are used to limit or manage exposure to fluctuations in interest rates or to obtain a marginally lower interest rate than would be available without the swap. The fair value of interest rate swaps at June 30, 2009, was $2.8 million.

Total return swap agreements involve a stream of payments based on a set rate, either fixed or variable, by one party while the other party makes payments based on the return of an underlying asset, which includes both the income it generates and any capital gains. In total return swaps, the underlying asset (reference asset), usually an equity index, loans, or bonds, is owned by the party receiving the set rate payments. These swaps allow the party receiving the total return to gain exposure and benefit from a reference asset without owning it. The fair value of total return swaps was $0.1 million at June 30, 2009.

In connection with swap agreements, securities or cash may be identified as collateral in accordance with the terms of the respective swap agreements to provide assets of value and recourse in the event of default, bankruptcy or insolvency. Swaps are marked to market daily based upon values from third party vendors or quotations from market makers to the extent available and any change in value is recorded as an unrealized gain or loss.

All derivative financial instruments are recognized as either assets or liabilities at their fair value in the balance sheet with the changes in the fair value reported in current-period earnings. These instruments are classified on the balance sheet as equity and fixed income investments, and the change in the fair value is recorded on the income statement in net depreciation in fair value of investments. For the years ended June 30, 2009 and 2008, the System recognized losses of $346,323,418 and $152,226,244, respectively, on these instruments.

Notes to the Financial Statements

The following table presents the derivative positions held by SURS as of June 30, 2009:

Derivative Contracts Outstanding

	Number of Contracts	Contractual Principal(a)	Carrying Value(b)
Domestic Index Products			
Equity futures purchased	1,469	$ 124,813,715	$ 124,813,715
Derivative offset	–	–	(124,813,715)
Domestic Interest Rate Products			
Fixed income futures purchased	3,092	2,561,900,000	687,670,181
Derivative offset	–	–	(687,670,181)
Fixed income futures sold	89	17,800,000	(43,459,969)
Derivative offset	–	–	43,459,969
Fixed income written put options	8,800,268	131,900,000	(210,085)
Fixed income written call options	15,400,384	81,700,000	(285,607)
Fixed income purchased call options	50,300,053	55,600,000	419,973
International Index Products			
Equity futures purchased	467	36,756,300	36,756,300
Derivative offset	–	–	(36,756,300)
International Interest Rate Products			
International fixed income futures purchased	253	227,528,697	63,032,178
Derivative offset	–	–	(63,032,178)
International fixed income written put options	935	769,902,431	–
Foreign Currency Products			
Foreign forward currency purchases	–	–	204,181,196
Foreign forward currency sales	–	–	(205,951,912)

a) The contractual principal amounts listed above represent the market value of the underlying assets the derivative contracts control. Contractual principal amounts are often used to express the volume of the transactions but do not reflect the extent to which positions may offset one another. Contractual principal values do not represent actual recorded values.

b) Carrying value for futures in the table above, while shown as zero, is recorded in the financial statements as an asset in an amount equal to the contractual principal and is offset by a corresponding liability.

Securities Lending

The SURS Board of Trustees policies permit the System to lend its securities to broker-dealers and other entities with a simultaneous agreement to return the collateral for the same securities in the future. Credit Suisse, New York Branch, the System's third party agent lender, lends securities in exchange for cash collateral at 102% for U.S. securities and 105% for international securities. Cash collateral is shown on the System's financial statements. Securities lent are included in the Statement of Plan Net Assets. At year-end, the System had no credit risk exposure to borrowers because the amount the System owes to the borrowers exceeds the amounts the borrowers owe to the System. The contract with the System's third party agent lender requires it to indemnify the System if the borrowers fail to return the securities (and if the collateral is inadequate to replace the securities lent) or fail to pay the System for income distributions by the securities' issuers while the securities are out on loan.

All securities loans can be terminated on demand by either the System or the borrower, although the average term of the loans is 1.38 days. Cash collateral is invested in the System's short-term investment pool, which at year end has a weighted average final maturity of 120 days and a weighted average reset of 26.83 days.

Loans outstanding as of June 30, 2009 *($ millions)*

Fair value of securities loaned	$ 1,285.1
Fair value of collateral received from borrowers	$ 1,323.0

Notes to the Financial Statements

Self-Managed Plan

The SMP participants have the ability to invest their account balances in 51 mutual and variable annuity funds. These funds are offered by two providers: Fidelity Investments and Teachers Insurance and Annuity Association College Retirement Equities Fund (TIAA-CREF). As of June 30, 2009, the SMP had investments of $570,709,663. A detailed schedule (unaudited) of the funds and balances at June 30, 2009 is located in the Investment Section of The Comprehensive Annual Financial Report.

IV. Capital Assets

Capital assets activity for the year ended June 30, 2009 was as follows:

	Beginning Balance	Additions	Disposals	Ending Balance
Land	$ 531,834	$ –	$ –	$ 531,834
Office building	6,362,571	–	–	6,362,571
Information system equipment & software	14,032,419	445,394	141,235	14,336,578
Furniture and fixtures	2,057,878	84,594	21,104	2,121,368
	22,984,702	529,988	162,339	23,352,351
Less accumulated depreciation:				
Office building	1,890,288	126,002	–	2,016,290
Information system equipment and software	12,321,974	653,849	141,235	12,834,588
Furniture and fixtures	1,841,214	97,700	21,104	1,917,810
	16,053,476	877,551	162,339	16,768,688
	$ 6,931,226	$ (347,563)	$ –	$ 6,583,663

The average estimated useful lives for depreciable capital assets are as follows:

Office building	40 years	Information systems equipment	3 years
Information systems software	10 years	Furniture and fixtures	3 years

V. Compensated Absences

The System is obligated to pay employees at termination for unused vacation and sick time. The maximum time for which any individual may be paid is 448 hours of vacation and one-half of unused sick time earned between January 1, 1984 and December 31, 1997. No sick time earned after December 31, 1997 will be compensable at termination. At June 30, 2009, the System had a liability of $1,084,979 for compensated absences, based upon the vesting method used for calculation of sick leave payable. The liability is included in the administrative and investment expenses payable on the Statement of Net Assets, and the annual increase or decrease in liability is reflected in the financial statements as an increase or decrease in salary expense.

Compensated absences payable for the year ended June 30, 2009 was as follows:

	Beginning Balance	Additions	Reductions	Ending Balance	Estimate Amount Due Within One Year
Compensated Absences Payable	$ 1,034,463	$ 122,926	$ 72,410	$ 1,084,979	$ 30,000

Notes to the Financial Statements

VI. Insurance Coverage

The System is exposed to various risks of loss related to torts; theft of, damage to, and destruction of assets; errors and omissions; injuries to employees; and natural disasters. The System has minimized the risk of loss through private insurance carriers for commercial, business owners, and automobile policies. The deductible for this insurance coverage ranges from $250 to $500 per occurrence. There has been no significant reduction of insurance coverage from the prior year. The System has not had any insurance claims filed or paid in the past four fiscal years.

VII. Post-employment Benefits

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 toward 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 Universities Retirement System do not contribute toward 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; therefore, those annuitants with twenty or more years of credited service do not have to contribute toward 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 State Universities Retirement 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.

Required Supplementary Information

Defined Benefit Plan
Schedule of Funding Progress ($ millions)

Fiscal Year**	Actuarial Value of Assets (A)	Accrued Actuarial Liabilities	Unfunded Accrued Actuarial Liabilities	Funding Ratio	Payroll	UAAL as % of Payroll
2000	$12,063.9	$ 13,679.0	$ 1,615.1	88.2%	$ 2,424.2	66.6%
2001	10,753.3	14,915.3	4,162.0	72.1%	2,474.6	168.2%
2002	9,814.7	16,654.0	6,839.3	58.9%	2,607.2	262.3%
2003	9,714.5	18,025.0	8,310.5	53.9%	2,763.4	300.7%
2004	12,586.3	19,078.6	6,492.3	66.0%	2,814.1	230.7%
2005	13,350.3	20,349.9	6,999.6	65.6%	2,939.1	238.1%
2006	14,175.1	21,688.9	7,513.8	65.4%	3,054.1	246.0%
2007	15,985.7	23,362.1	7,376.4	68.4%	3,181.0	231.9%
2008	14,586.3	24,917.7	10,331.4	58.5%	3,303.2	312.8%
2009	14,282.0	26,316.2	12,034.2	54.3%	3,463.9	347.4%

(A) Per public Act 96-0043, beginning fiscal year 2009, measures of financial soundness will be calculated using an actuarial value of assets based on a smoothed investment income rate. Investment income in excess or shortfall of the expected 8.5% rate on fair value is smoothed over a five-year period with 20% of a year's excess or shortfall being recognized each year beginning with the current year.

Schedule of Employer Contributions ($ millions)

Fiscal** Year	Total ARC*	Member Contributions	Net ER/State ARC	Actual ER/State Contribution	State Contributions as % of Net ARC	Total Contributions as % of Total ARC
2000	$ 547.8	$ 222.5	$ 325.3	$ 241.1	74.1%	84.6%
2001	548.1	221.6	326.5	247.1	75.7%	85.5%
2002	686.9	250.0	436.9	256.1	58.6%	73.7%
2003	843.8	246.3	597.5	285.3	47.7%	63.0%
2004	934.8	243.8	691.0	1,757.5	254.4%	214.1%
2005	859.7	251.9	607.8	285.4	47.0%	62.5%
2006	914.9	252.9	662.0	180.0	27.2%	47.3%
2007	968.3	262.4	705.9	261.1	37.0%	54.1%
2008	971.6	264.1	707.5	344.9	48.8%	62.7%
2009	1,147.3	273.3	874.0	451.6	51.7%	63.2%

* Annual Required Contribution as defined in GASB Statement No. 25, "Financial Reporting for Defined Benefit Pension Plans and Note Disclosures for Defined Contribution Plans."

** The source of these schedules is the annual actuarial valuation which is performed as of June 30 for each fiscal year listed.

Supporting Schedules

Defined Benefit Plan
Summary Schedule of Administrative Expenses
For the Years Ended June 30, 2009 and 2008

	2009	2008
Personnel services		
Salary and wages	$6,267,121	$6,179,016
Retirement contributions	607,784	642,268
Insurance and payroll taxes	1,570,313	1,626,001
	8,445,218	8,447,285
Professional services		
Computer services	547,346	648,252
Medical consultation	23,484	38,513
Technical and actuarial	517,885	350,243
Legal services	483,615	159,930
	1,572,330	1,196,938
Communications		
Postage	416,877	287,219
Printing and copying	122,000	109,732
Telephone	88,921	87,166
	627,798	484,117
Other services		
Equipment repairs, rental and maintenance	71,760	64,238
Building operations and maintenance	284,790	274,750
Surety bonds and insurance	396,654	158,775
Memberships and subscriptions	47,006	36,412
Transportation, travel	127,768	158,889
Education	18,138	20,916
Supplies	89,834	86,198
	1,035,950	800,178
Self-Managed plan administration		
Salary and wages	240,178	169,682
Retirement contributions	23,538	17,682
Insurance and payroll taxes	56,120	34,405
Technical and actuarial	8,000	12,580
Postage	20,869	32,860
Transportation, Travel	1,634	–
Printing	12,885	12,665
	363,224	279,874
Depreciation and amortization	877,550	870,852
Total administrative expenses	$12,922,070	$12,079,244

Supporting Schedules

Defined Benefit Plan
Summary Schedule of Consultant Payments
For the Years Ended June 30, 2009 and 2008

	2009	2008
Defined benefit plan		
Techical and actuarial services:		
Berwyn Group	$ 3,951	$ 3,342
Careerbuilders	1,400	–
Centurion	33,000	–
Economic Research	4,578	4,306
EFL Associates	78,392	–
Alice Faron	790	–
Gabriel, Roeder, Smith & Co.	166,189	102,825
GII of Illinois	15,000	18,000
Governmental Consulting Solutions	36,000	36,000
ICS/Merrill	9,394	337
INFRE	1,937	–
JP Morgan Chase	106	15,995
Lexis Nexis	–	6,460
McLagan	2,500	2,500
Meador Investigations	1,915	–
Miscellaneous	3,642	887
Morrill and Associates	48,000	48,000
Open position advertising	3,613	2,786
Reed Group	1,470	–
Smith Investigations	–	1,475
SUAA	2,043	–
The Northern Trust	85,959	83,215
University of Illinois Media Services	1,100	–
Woolard Marketing Consultants	16,906	24,115
	517,885	350,243
Legal services		
Areawide Reporting Services	1,521	3,043
Burke, Burns & Pinelli	72,746	45,629
Investors Responsibility Support Services	25,000	25,000
Mayer, Brown, LLP	331,852	39,008
Thomas, Mamer & Haughey	36,936	29,454
Winters, Featherstun, et al	15,560	17,796
	483,615	159,930
Self–managed plan		
Technical and actuarial services:		
EnnisKnupp + Associates, Inc.	8,000	7,500
Gabriel, Roeder, Smith & Co.	–	5,080
	8,000	12,580
Total consultant payments	$ 1,009,500	$ 522,753

Supporting Schedules

Defined Benefit Plan
Summary Schedule of Investment Fees, Commissions, and Administrative Expenses
For the Years Ended June 30, 2009 and 2008

	2009	2008
Master trustee & custodian		
The Northern Trust Company	$ 996,475	$ 1,003,906
Investment manager firm		
Aberdeen Asset Management	742,318	–
Adams Street Partners	3,773,464	3,191,403
Ariel Capital Management	24,802	206,360
Barclays Global Investors	2,442,227	2,186,658
BlackRock Financial Management	732,796	951,107
Calamos Advisors	431,923	–
Capital Guardian Trust Company	1,025,284	1,580,664
GlobeFlex Capital, L.P.	226,671	755,476
ING Clarion Real Estate Securities	755,899	1,107,496
Jacobs Levy Equity Management	579,368	480,491
Manager Development Program	874,703	954,629
Martin Currie, Inc.	1,343,404	1,771,692
Metropolitan West Asset Management	205,254	414,522
Mondrian Investment Partners	507,530	647,664
Muller & Monroe	625,000	375,000
Northern Trust Global Advisors	–	888,664
Northern Trust Investments	133,215	220,626
Pacific Investment Management Company	2,298,995	5,368,626
Pantheon Ventures	2,798,834	2,689,749
Paradigm Asset Management	62,088	115,932
Payden & Rygel	451,353	157,600
Piedmont Investment Advisors	169,737	107,194
Progress Investment Management Company	753,556	1,555,738
Pyramis Global Advisors Trust Company	628,798	1,373,609
RASARA Strategies	–	309,503
RhumbLine Advisers	156,885	188,931
RREEF	1,936,953	3,830,564
T. Rowe Price	825,286	172,791
Taplin, Canida & Habacht	58,888	–
UBS Realty Investors	1,181,688	1,288,944
Wellington Management Company	820,528	1,902,660
Western Asset Management	408,225	503,155
	26,975,672	35,297,448
Investment consultant, measurement & counsel		
EnnisKnupp + Associates, Inc.	343,668	360,000
Mayer, Brown, LLP	135,549	113,854
	479,217	473,854
Investment administrative expenses		
Personnel	774,149	699,100
Resources, board and travel	107,894	92,850
Performance measurement and database	97,550	92,647
	979,593	884,597
Total investment expenses	**$ 29,430,957**	**$ 37,659,805**

Supporting Schedules

Defined Benefit Plan
Summary Schedule of Cash Receipts and Disbursements
For the Year Ended June 30, 2009 ($ millions)

Beginning Cash and Short-Term Investments Balance	$ 797.6
Receipts	
Member contributions	$ 273.5
Employer contributions	451.6
Investment income (loss)	(2,819.3)
Investments redeemed	58,884.6
Total Receipts	$ 56,790.4
Disbursements	
Benefit payments	$ 1,372.4
Administrative expenses	11.4
Investment expenses	31.0
Fixed asset purchases	.5
Refunds	42.6
SMP balance transfers	1.2
Investments purchased	55,585.2
Total Disbursements	$ 57,044.3
Ending Cash and Short-Term Investments Balance	$ 543.7

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
State Universities Retirement System
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 State Universities Retirement System of Illinois (System), as of and for the year ended June 30, 2009, and have issued our report thereon dated January 21, 2010. We conducted our audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States.

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, and 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 internal control* exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent, or detect and correct misstatements on a timely basis. A *material weakness* is a deficiency, or a combination of deficiencies, in internal control such that there is a reasonable possibility that a material misstatement of the entity's financial statements will not be prevented, or detected and corrected on a timely basis.

Our consideration of internal control over financial reporting was for the limited purpose described in the first paragraph of this section and was not designed to identify all deficiencies in the 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 that we consider to be material weaknesses, as defined above. However, we identified certain deficiencies in internal control over financial reporting, described in findings 09-1 and 09-2 in the accompanying schedule of findings that we consider to be significant deficiencies in internal control over financial reporting. A *significant deficiency* is a deficiency, or a combination of deficiencies, in internal control that is less severe than a material weakness, yet important enough to merit attention by those charged with governance.

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 instances of noncompliance or other matters that are required to be reported under *Government Auditing Standards* and which are described in the accompanying schedule of findings as items 09-1 and 09-2.

The System's responses to the findings identified in our audit are presented in the accompanying schedule of findings. 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
January 21, 2010

Current Findings – *Government Auditing Standards*

Finding No. 09-1 Member Earnings and Contributions

The System does not have adequate internal control over the accuracy and completeness of individual member's earnings and contributions.

During the testing of contributions, it was noted that each participating employer of the System submits a payroll detail report at the end of each payroll period. This report details individual member contributions into the System as part of payroll deductions by the employer. The employer does not remit earnings on the payroll detail report in total or on an individual basis. Only the contribution amount by employee is listed. Since no earnings data is reported, the System assumes that the employer is remitting the statutorily required percentage of earnings. In the System's Member Subsidiary Ledger (MSL), the computer system calculates the earnings based on the contribution. This information is used for tracking and is submitted to the actuary on an annual basis for the preparation of the actuarial valuation.

The System is relying upon the participating employers to remit accurate and complete contributions to them on a regular basis. As a result, the System does not have a control in place to verify the completeness or accuracy of an individual member's contribution for a given payroll period or in total at the end of a fiscal year.

40 ILCS 5/15-157 states that "from September 1, 1969, each participating employee shall make contributions towards the retirement benefits payable as follows: 6.5% of participants' earnings………., starting September 1, 1969, each participating employee shall make additional contributions of 1/2% of earnings to finance a portion of the costs of the annual increases in retirement annuity…………and in addition to the amounts described above, additional contributions of 1% of earnings applicable under the System, " resulting in a total of 8% of participants' earnings to be contributed to the System. Good business practices require adequate internal controls to ensure that contributions from participating employers and members made to the System are complete and accurate.

According to System management, in the mid 1990's, the System re-engineered all of the major business systems, including payroll contribution processing. The goals were to improve the efficiency, timeliness and cost-effectiveness of all areas of operations. One of the changes made was to discontinue the collection of both earnings and contribution totals from the employers. The new process called for deriving the individual earnings from submitted contributions, and relying upon the employers to correctly follow statutory requirements. This would then rely on the employer payroll systems to correctly calculate the employee contribution and assumes that the employers have adequate internal controls to ensure that the information provided to the System is accurate.

System participant contributions for the fiscal year ending June 30, 2009 were $322,117,492. Error in contributions or earnings may create an error in the actuarial determined liability for the System and member distributions could be incorrect. Without adequate internal controls, the financial statements could be materially misstated. (Finding Code No. 09-1)

Recommendation:

We recommend that the System implement sufficient internal controls over contributions remitted by the participating employers. A process should be put in place to review the amounts remitted in order to identify any errors in a timely manner and to ensure the completeness and accuracy of the contribution amounts. This process should also be done on a regular basis and reviewed by an appropriate official of the System.

Current Findings – *Government Auditing Standards*

Finding No. 09-1 Member Earnings and Contributions (Continued)

System Response:

SURS accepts this finding although we feel that we have adequate internal controls in place for the process. SURS also believes that employers have the duty and responsibility to submit accurate payroll data to SURS. SURS will add earnings control totals to employer payroll reporting requirements and use this number to check the accuracy of contributions submitted. We are also considering adding certification language with which the employers need to agree prior to submitting individual payrolls to the System.

Current Findings – *Government Auditing Standards*

Finding No. 09-2 Valuation of Securities Lending Collateral

The System did not have adequate internal control over financial reporting for its securities lending transactions.

It was noted that the System did not record the fair market value of the investment of cash collateral received for securities lending transactions. The fair market value of the investment at June 30, 2009 was $1,316 million with related obligations of $1,323 million. The collateral was invested in various securities that had declined in value during the fiscal year. Management accounted for the investment at its historical par value and did not take into consideration market fluctuations. The resulting unrealized loss of $6.87 million was a proposed auditor adjustment and has not been recorded in the financial statements for the fiscal year ending June 30, 2009.

Generally Accepted Accounting Principles (GAAP) in the United States of America require that the System properly record the collateral assets, liabilities, and gains or losses related to securities lending transactions. Investments of cash collateral received from borrowers should be recorded at fair market value. In addition, the Fiscal Control and Internal Auditing Act, 30 ILCS 10/3001 requires all State agencies to establish and maintain a system, or systems, of internal fiscal and administrative controls, which provide assurance that revenues, expenses, and transfers of assets, resources, or funds applicable to operations are properly recorded and accounted for to permit the preparation of accounts and reliable financial and statistical reports and to maintain accountability over the State's resources.

System management indicated that during the financial reporting process, the book value of the collateral was used to report both the asset and the liability. The asset should have been reported at the fair (market) value and the liability at book value.

Failure to accurately record the fair value of the investment of cash collateral received for securities lending transactions could cause the financial statements to be materially misstated and not prepared in accordance with GAAP. (Finding Code No. 09-2)

Recommendation:

We recommend System management improve its controls to review all relevant investment information necessary to properly record and disclose all security lending transactions including changes in the market value of the underlying collateral, in the System's financial statements. The change in market value should flow through the System's general ledger as opposed to being a report entry.

System Response:

SURS concurs with this finding. SURS will change the financial reporting process to properly record the securities lending collateral and obligation amounts as part of year end accounting.

Prior Finding Not Repeated

A. Valuation of Alternative Investments

The State Universities Retirement System (System) needed to enhance its accounting and reporting process for determining and reviewing the fair value measurements and disclosures, enhance documentation of valuation methods and significant supporting assumptions used for its alternative investments on a timely basis. The prior year finding will not be repeated due to the System taking corrective action and the results of current year investment testing which disclosed no exceptions related to those items aforementioned related to alternative investments. (Finding Code No. 08-1)