Teachers' Retirement System of the State of Illinois
(A Component Unit of the State of Illinois)

Financial Report
For the Year Ended June 30, 2014

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

McGladrey

Assurance ▪ Tax ▪ Consulting

Teachers' Retirement System
of the State of Illinois

Financial Audit

For the Year Ended June 30, 2014

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Teachers' Retirement System
of the State of Illinois

Financial Statement Report
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System Officials

Executive Director	Richard W. Ingram
Chief Investment Officer	Stan Rupnik, CFA
Director of Administration	Jana Bergschneider, CPA
General Counsel	Thomas Gray
Director of Internal Audit	Stacy Smith, CPA

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Summary

The audit of the accompanying financial statements of the Teachers' Retirement System of the State of Illinois (System) was performed by McGladrey LLP.

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

Summary of Findings

The auditors identified a matter involving the System's internal control over financial reporting that they considered to be a significant deficiency. The significant deficiency is described in the accompanying Schedule of Findings on pages 40-41 of this report as item 2014-001 (Controls over Census Data).

Exit Conference

In correspondence received from the Teachers' Retirement System of the State of Illinois on November 25, 2014, the System elected to waive a formal exit conference. The response to the recommendation was provided by Jana Bergschneider, Director of Administration, in correspondence dated November 25, 2014.

McGladrey

Independent Auditor's Report

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

Board of Trustees, Teachers' Retirement System of the State of Illinois

Report on the Financial Statements

As Special Assistant Auditors for the Auditor General, we have audited the accompanying Statement of Net Position of the Teachers' Retirement System of the State of Illinois (System), a component unit of the State of Illinois, as of and for the year ended June 30, 2014, and the related Statement of Changes in Net Position for the year then ended, and the related notes to the financial statements, which collectively comprise the basic financial statements, as listed in the table of contents.

Management's Responsibility for the Financial Statements

Management is responsible for the preparation and fair presentation of these financial statements in accordance with accounting principles generally accepted in the United States of America; this includes the design, implementation, and maintenance of internal control relevant to the preparation and fair presentation of financial statements that are free from material misstatement, whether due to fraud or error.

Auditor's Responsibility

Our responsibility is to express an opinion on these financial statements based on our audit. 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 from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and fair presentation of the financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. Accordingly, we express no such opinion. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of significant accounting estimates made by management, as well as evaluating the overall presentation of the financial statements.

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinion.

Opinion

In our opinion, the financial statements referred to above present fairly, in all material respects, the net position of the Teachers' Retirement System of Illinois as of June 30, 2014, and the changes in net position for the year then ended in accordance with accounting principles generally accepted in the United States of America.

Emphasis of Matter

As discussed in Note B, Section 4 on page 14 of the financial statements, in 2014, the System adopted Governmental Accounting Standards Board Statement No. 67, *Financial Reporting for Pension Plans*. As required by Statement No. 67, the actuarially determined pension liability is dependent on several assumptions including the assumption that future required contributions from all sources are made based on statutory requirements in existence as of the date of this report. These assumptions are discussed in Note A, Section 6 of the financial statements on page 13. Our opinion is not modified with respect to this matter.

Other Matters

Required Supplementary Information:
Accounting principles generally accepted in the United States of America require that the management's discussion and analysis on pages 4 through 7 and the schedule of changes in the net pension liability, the schedule of the net pension liability, schedule of investment returns and the schedule of contributions from employers and other contributing entities on pages 33 and 34 be presented to supplement the basic financial statements. Such information, although not a part of the basic financial statements, is required by the Governmental Accounting Standards Board who considers it to be an essential part of financial reporting for placing the basic financial statements in an appropriate operational, economic, or historical context. We have applied certain limited procedures to the required supplementary information in accordance with auditing standards generally accepted in the United States of America, which consisted of inquiries of management about the methods of preparing the information and comparing the information for consistency with management's responses to our inquiries, the basic financial statements, and other knowledge we obtained during our audit of the basic financial statements. We do not express an opinion or provide any assurance on the information because the limited procedures do not provide us with sufficient evidence to express an opinion or provide any assurance.

Other Information:
Our audit for the year ended June 30, 2014 was conducted for the purpose of forming an opinion on the System's basic financial statements. The other supplementary information as listed in the table of contents is presented for purposes of additional analysis and are not a required part of the basic financial statements.

The other supplementary information for the year ended June 30, 2014 is the responsibility of management and was derived from and relates directly to the underlying accounting and other records used to prepare the financial statements. The supplementary information has been subjected to the auditing procedures applied in the audit of the basic financial statements for the year ended June 30, 2014 and certain additional procedures, including comparing and reconciling such information directly to underlying accounting and other records used to prepare the financial statements, or to the financial statements themselves, and other additional procedures in accordance with auditing standards generally accepted in the United States of America. In our opinion, the supplementary information is fairly stated in all material respects, in relation to the financial statements as a whole for the year ended June 30, 2014.

We have also previously audited, in accordance with auditing standards generally accepted in the United States of America, the System's financial statements as of and for the year ended June 30, 2013 (not presented herein), and have issued our report thereon dated December 16, 2013, which contained an unmodified opinion on those financial statements. The accompanying supplementary information which consisted of supporting schedules, for the year ended June 30, 2013 is presented for purposes of additional analysis and is not a required part of the financial statements. Such information is the responsibility of management and was derived from and relates directly to the underlying accounting and other records used to prepare the 2013 financial statements. The supplementary information has been subjected to the auditing procedures applied in the audit of the 2013 financial statements and certain additional procedures, including comparing and reconciling such information directly to the underlying accounting and other records used to prepare those financial statements or to those financial statements themselves, and other additional procedures in accordance with auditing standards generally accepted in the United States of America. In our opinion, the supplementary information is fairly stated, in all material respects, in relation to the financial statements as a whole for the year ended June 30, 2013.

Other Reporting Required by *Government Auditing Standards*

In accordance with *Government Auditing Standards*, we have also issued our report dated January 6, 2015 on our consideration of the System's internal control over financial reporting and on our tests of its compliance with certain provisions of laws, regulations, contracts, 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 internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* in considering the System's internal control over financial reporting and its compliance.

McGladrey LLP

Schaumburg, Illinois
January 6, 2015

MANAGEMENT'S DISCUSSION AND ANALYSIS

This discussion and analysis of the Teachers' Retirement System of the State of Illinois provides an overview of financial activities for the fiscal year ended June 30, 2014. Please read it in conjunction with the Financial Statements and related notes that follow this discussion.

FINANCIAL HIGHLIGHTS

- The net position of TRS at June 30, 2014 was $45.8 billion.
- During FY14, the net position of TRS increased $6.0 billion.
- Contributions from members, employers, and the State was $4.5 billion, an increase of $744 million or 19.7 percent for FY14.
- Total investment gain was $6.8 billion, compared to an investment gain of $4.6 billion in FY13, an increase of $2.2 billion.
- Benefits and refunds paid to members and annuitants was $5.3 billion, an increase of $339 million or 6.8 percent.
- The total actuarial accrued liability was $103.7 billion at June 30, 2014.
- The unfunded actuarial accrued liability was $61.6 billion at June 30, 2014. The funded ratio was 40.6 percent at June 30, 2014. The unfunded liability and funded ratio are calculated using a smoothed value of assets, as required under Public Act 96-0043.
- The total pension liability was $106.7 billion at June 30, 2014.
- The net pension liability was $60.9 billion at June 30, 2014. The Plan Fiduciary Net Position, as a percentage of total pension liability, was 43.0 percent.

The Financial Statements consist of:

Statement of Fiduciary Net Position. This statement reports the pension trust fund's net position which represents the difference between the other statement elements comprised of assets and liabilities. It is the balance sheet for the pension system and reflects the financial position of the Teachers' Retirement System as of June 30, 2014.

Statement of Changes in Fiduciary Net Position. This statement details transactions that occurred during the fiscal year. It is the income statement of TRS and reflects the revenues and expenses recorded throughout the fiscal year. This statement supports the change in the value of net position reported on the Statement of Fiduciary Net Position.

Notes to the Financial Statements. The notes are an integral part of the financial statements and include additional information not readily evident in the statements themselves. The required supplementary information and other schedules following the notes to the financial statements provide historical and additional detailed information considered useful in evaluating the pension system's financial condition. The following are condensed comparative financial statements of the TRS pension trust fund.

Condensed Comparative Statements of Fiduciary Net Position as of June 30

	2014	Percentage Change	2013
Cash	$60,859,067	315.2%	$14,659,145
Receivables and prepaid expenses	5,430,213,496	21.0	4,488,401,761
Investments	45,435,578,617	14.5	39,681,752,953
Invested securities lending collateral	2,798,549,336	44.8	1,932,554,323
Capital assets	4,114,038	(5.6)	4,358,587
Total assets	**53,729,314,554**	**16.5**	**46,121,726,769**
Total liabilities	**7,904,932,040**	**26.2**	**6,262,958,270**
Net position restricted for pensions	**$45,824,382,514**	15.0%	**$39,858,768,499**

Condensed Comparative Statements of Changes in Fiduciary Net Position for the Years Ended June 30

	2014	Percentage Change	2013
Contributions	$4,525,463,343	19.7%	$3,781,914,113
Net investment income	6,782,031,720	48.7	4,561,768,383
Total additions	11,307,495,063	35.5	8,343,682,496
Benefits and refunds	5,320,662,979	6.8	4,981,481,783
Administrative expenses	21,218,069	4.7	20,257,553
Total deductions	5,341,881,048	6.8	5,001,739,336
Net increase in net position	**5,965,614,015**		**3,341,943,160**
Net position restricted for pensions - beginning of year	**39,858,768,499**	**9.2**	**36,516,825,339**
Net position restricted for pensions - end of year	**$45,824,382,514**	15.0%	**$39,858,768,499**

FINANCIAL ANALYSIS

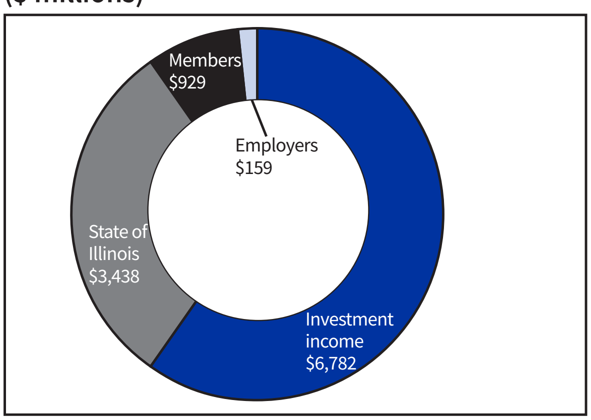
TRS was created to provide retirement, survivor, and disability benefits to qualified members. Increases or decreases in the plan's net position serve as useful indicators of TRS's financial position. The net position available to pay benefits was $45.8 billion at June 30, 2014.

CONTRIBUTIONS

Contributions increased $744 million during FY14. During FY14, member contributions increased $7 million and employer contributions from school districts increased $2 million. The net increase in employer contributions from school districts in FY14 is attributable to an increase in federal funds contributions and a decrease in both employer early retirement and excess salary increase contributions.

The State of Illinois makes appropriations to TRS. Receipts from the State of Illinois increased $735 million in FY14 . The increase in FY14 was mainly due to the continued recognition of FY09 losses in the FY12 actuarial value of assets that was used to determine the FY14 funding requirements. State funding law provides for a 50-year funding plan that included a 15-year phase-in period and a goal of 90 percent funding in the year 2045.

Revenues by Type for the Year Ended June 30, 2014 ($ millions)

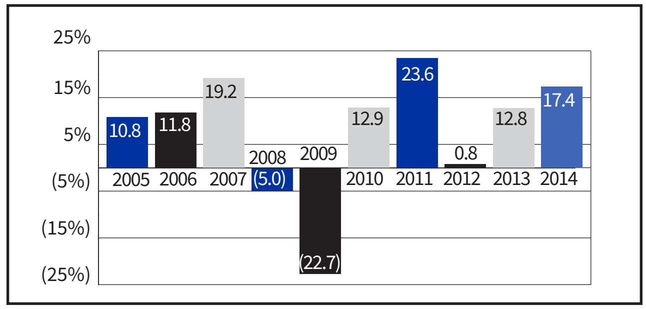


INVESTMENTS

The TRS trust fund is invested according to law under the "prudent person rule" requiring investments to be managed solely in the interest of fund participants and beneficiaries. Principles guiding the investment of funds include preserving the long-term principal of the trust fund and maximizing total return within prudent risk parameters.

The TRS investment portfolio returned 17.4 percent, net of fees, for the fiscal year ended June 30, 2014. Total TRS investment assets increased approximately $5.8 billion during the year.

Annual Rate of Return (net of investment expenses)

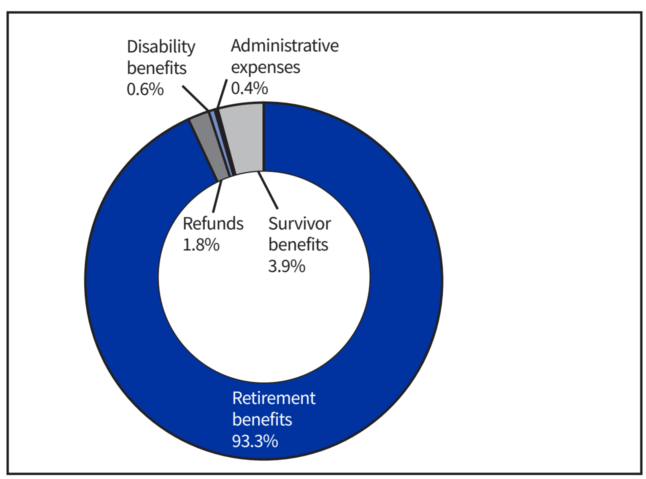


BENEFITS AND REFUNDS

Retirement, survivor, and disability benefit payments increased $332 million during FY14. Benefit payments increased to $5.2 billion with 112,333 recipients in FY14. The overall increase in benefit payments for FY14 is due to an increase in retirement benefits and the number of retirees. Retirement benefits were higher as a result of annual increases in retirement benefits and an increase in the number of retirees from 97,899 as of June 30, 2013 to 101,184 as of June 30, 2014.

Refunds of contributions increased $7 million in FY14. The increase during FY14 is the result of a greater number of member and retirement refunds.

Expenses by Type for the Year Ended June 30, 2014



ACTUARIAL

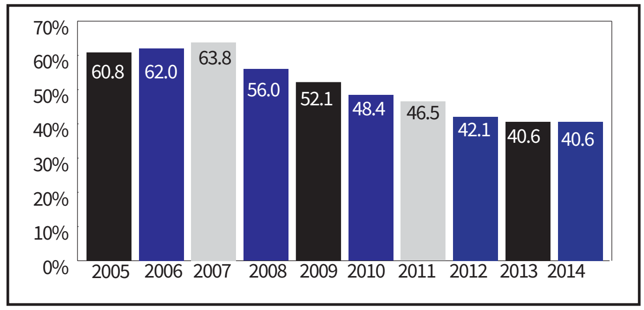
For statutory funding and financial reporting, an actuarial valuation is performed annually and measures the total liability for all benefits earned to date. The actuarial accrued liability is a present value estimate of all the benefits that have been earned to date but not yet paid. The actuarial accrued liability based on statutory funding requirements increased $9.9 billion in FY14 to $103.7 billion at June 30, 2014. The actuarial unfunded liability is the present value of future benefits payable that are not covered by the actuarial value of assets as of the valuation date. The actuarial unfunded liability increased $5.9 billion during FY14 to $61.6 billion at June 30, 2014. The funded ratio reflects the percentage of the actuarial accrued liability covered by the actuarial value of assets. The funded ratio was unchanged from FY13, staying at 40.6 percent on June 30, 2014.

In FY14, the actuarial unfunded liability and funded ratio is based on a smoothed value of assets. Public Act 96-0043 required the five state retirement systems to begin smoothing actuarial gains and losses on investments over a five-year period, beginning with the valuation for the year ended June 30, 2009.

When the funded ratio was based on the fair value of assets, the reported funded ratio was impacted immediately by changes in market conditions. State funding requirements based on fair value assets also were impacted immediately and therefore were more volatile. Using the smoothed value of assets results in more stable reported funded ratios and State funding requirements over time.

During fiscal year 2014, TRS implemented GASB Statement No. 67, "Financial Reporting for Pension Plans." As a result of implementing the new statement, TRS is required to disclose the net pension liability and total pension liability in the Financial Statement Notes and Required Supplementary Information in accordance with criteria which differs from the actuarial accrued liability and actuarial unfunded liability. The total pension liability is $106.7 billion at June 30, 2014, while the net pension liability is $60.9 billion at June 30, 2014.

Funded Ratio Based on Actuarial Value of Assets



The funded ratio in this chart is the ratio of actuarial assets to the actuarial liability. An increase in this ratio indicates an improvement in TRS's ability to meet future benefit obligations. The actuarial value of assets was based on fair value through 2008 with five-year smoothing beginning in 2009.

LEGISLATIVE

In December of 2013, Governor Pat Quinn signed into law Public Act 98-0599, legislation designed to fix the System's long-term financial problems.

This new law's intent was to eliminate the TRS unfunded liability by 2044 and the long-term stabilization of the System's finances. This was accomplished by, among other things, reducing the annual cost of living adjustment, capping the pensionable earnings of Tier I members, delaying the retirement date of members under age 45, reducing Tier I member contributions, guaranteeing adequate annual State contributions, earmarking extra funds to help pay off the unfunded liability and calculating the System's liabilities under standard actuarial practices.

However, the implementation of the new law was suspended due to a lawsuit which alleged the act violated a provision in the Illinois Constitution that prohibits pension benefits from being "diminished or impaired." Members of Illinois' public pension systems contended that the law resulted in reduced pension benefits for both active and retired members.

On November 21, 2014, Sangamon County Circuit Court Judge John Belz ruled that the Public Act 98-0599 was a violation of the Illinois Constitution's "pension protection clause." In December the Illinois Attorney General, charged with defending the constitutionality of the act, appealed Judge Belz's decision directly to the Illinois Supreme Court. The case is not expected to be resolved until sometime in 2015, at the earliest.

FINANCIAL STATEMENTS

Teachers' Retirement System of the State of Illinois
Statement of Fiduciary Net Position
June 30, 2014

	2014
Assets	
Cash	$60,859,067
Receivables and prepaid expenses:	
Member contributions	57,529,290
Employer contributions	14,367,466
State of Illinois	372,984,303
Investment income	106,358,243
Pending investment sales	4,876,016,116
Prepaid expenses	2,958,078
Total receivables and prepaid expenses	5,430,213,496
Investments, at fair value:	
Fixed income	8,413,584,938
Equities	19,151,133,896
Real estate	5,638,680,343
Short-term investments	1,432,002,394
Private equity investments	5,038,446,122
Real return	3,055,818,516
Absolute return	2,618,256,628
Foreign currency	84,850,132
Derivatives	2,805,648
Total investments	45,435,578,617
Invested securities lending collateral:	
Short-term investments	2,718,126,389
Fixed income	12,965,947
Securities lending collateral with the State Treasurer	67,457,000
Total invested securities lending collateral	2,798,549,336
Capital assets, net of accumulated depreciation	4,114,038
Total assets	53,729,314,554
Liabilities	
Benefits and refunds payable	8,324,286
Administrative and investment expenses payable	45,714,593
Pending investment purchases	5,052,429,964
Securities lending collateral	2,798,463,197
Total liabilities	7,904,932,040
Net position restricted for pensions	$45,824,382,514

See accompanying Notes to Financial Statements.

Teachers' Retirement System of the State of Illinois
Statement of Changes in Fiduciary Net Position
for the Year Ended June 30, 2014

	2014
Additions	
Contributions:	
Members	$928,745,853
State of Illinois	3,438,382,892
Employers	
Early retirement	23,392,170
Federal funds	74,484,109
2.2 benefit formula	55,181,100
Excess salary/sick leave	5,277,219
Total contributions	4,525,463,343
Investment income:	
Net increase in fair value of investments	5,804,678,228
Interest	236,947,917
Real estate operating income, net	311,383,726
Dividends	515,858,875
Private equity income	117,978,674
Other investment income	81,912,282
Securities lending income	7,541,948
Less investment expenses:	
Direct investment expense	(300,257,270)
Securities lending management fees	(863,807)
Securities lending borrower rebates	6,851,147
Net investment income	6,782,031,720
Total additions	11,307,495,063
Deductions	
Retirement benefits	4,986,155,845
Survivor benefits	208,424,078
Disability benefits	30,626,905
Refunds	95,456,151
Administrative expenses	21,218,069
Total deductions	5,341,881,048
Net increase in net position	5,965,614,015
Net position restricted for pensions	
Beginning of year	39,858,768,499
End of year	$45,824,382,514

See accompanying Notes to Financial Statements.

NOTES TO FINANCIAL STATEMENTS

A. PLAN DESCRIPTION

1. REPORTING ENTITY

The Teachers' Retirement System of the State of Illinois (TRS) is the administrator of a cost-sharing, multiple-employer defined benefit public employee retirement system (PERS). Membership is mandatory for all full-time, part-time and substitute public school personnel employed outside of Chicago in positions requiring certification. Persons employed at certain State agencies also are members. Established by the State of Illinois, TRS is governed by the Illinois Pension Code (40 ILCS 5/16). TRS is a component unit of the State of Illinois and is included in the State's financial statements as a pension trust fund.

TRS uses criteria established by the Governmental Accounting Standards Board (GASB) to determine whether other entities should be included within its financial reporting entity. Based on the criteria, TRS includes no other entities in these financial statements.

2. EMPLOYERS

Members of TRS are employed by school districts, special districts and certain State agencies. Each employer remits member contributions to TRS. Employers are responsible for employer contributions for teachers paid from federal funds, employer contributions for the 2.2 formula increase and for the employer's portion of the Early Retirement Option contributions. As a result of Public Act 94-0004, which became law on June 1, 2005, employers are also required to pay the cost of pension benefits resulting from salary increases of more than 6 percent. Public Act 94-1057, which became law on July 31, 2006, provides additional exemptions from employer contributions for excess salary increases. Some of these exemptions are permanent while others were available for a limited time period. Employers also pay a contribution for sick leave days granted in excess of the member's normal annual allotment and used for service credit at retirement. The contributions do not apply to salary increases awarded or sick leave granted under contracts or collective bargaining agreements entered into, amended, or renewed prior to June 1, 2005. In addition, the State of Illinois is a nonemployer contributing entity that provides employer contributions. For information about employer contributions made by the State of Illinois, see the Schedule of Contributions from Employers and Other Contributing Entities.

Number of Employers (as of June 30)

	2014
Local school districts	859
Special districts	136
State agencies	18
Total	**1,013**

3. MEMBERS

TRS Membership (as of June 30)

	2014
Retirees and beneficiaries	112,333
Inactive members	122,964
Active members	159,838
Total	**395,135**

4. BOARD OF TRUSTEES

TRS is governed by a 13-member Board of Trustees. Trustees include the state superintendent of education, six trustees appointed by the governor, four trustees elected by contributing TRS members, and two trustees elected by TRS annuitants.

The president of the Board of Trustees, by law, is the Illinois superintendent of education. The Board of Trustees elects its vice president from among its members. The Board of Trustees appoints an executive director who also serves as the secretary of the Board of Trustees. The executive director is responsible for daily operations at TRS.

5. BENEFIT PROVISIONS

Governed by the Illinois Pension Code (40 ILCS 5/16), which is subject to amendment by the Illinois General Assembly and approval by the governor, TRS provides retirement, death and disability benefits. Membership is mandatory for all full-time, part-time, and substitute school personnel employed in Illinois outside the city of Chicago.

Public Act 96-0889, which was signed into law in the spring of 2010, added a new section to the Pension Code that applies different benefits to anyone who first contributes to TRS on or after January 1, 2011 and does not have any other previous service credit with one of the reciprocal retirement systems in Illinois. Members who first participate on or after that date are members of Tier II.

The act does not apply to anyone who made contributions to TRS prior to January 1, 2011. They remain participants of Tier I.

TIER I BENEFITS

A member qualifies for an age retirement annuity after meeting one of the following requirements: age 62 with five years of service credit; age 60 with 10 years; or age 55 with 20 years. If a member retires between the ages of 55 and 60 with fewer than 35 years of service, the annuity will be reduced at the rate of 0.50 percent for each month the member is under age 60. A member who is age 55 and has at least 20 but fewer than 35 years of service credit may use the Early Retirement Option (ERO) to avoid a discount for early retirement if retirement occurs within six months of the last day of service requiring contributions and if the member and employer both make a one-time contribution to TRS. A member with fewer than five years of creditable service and service on or after July 1, 1947, is entitled to a single-sum benefit payable at age 65.

A retirement benefit is determined by the average of the four highest years of creditable earnings within the last 10 years of creditable service and the percentage of average salary to which the member is entitled. Most members retire under a formula that provides 2.2 percent of final average salary up to a maximum of 75 percent with 34 years of service. The 2.2 percent formula became effective July 1, 1998 but service earned before that date can be upgraded to the 2.2 formula with a member contribution. The cost of the upgrade can be reduced if members upgrade and continue teaching after 1998. A graduated formula applies to service earned before 1998 and provides a maximum benefit of 75 percent of average salary with 38 years of service.

Tier I members who contributed to TRS before July 1, 2005 receive a money purchase (actuarial) benefit if it provides a higher benefit than the 2.2 or graduated formulas. The 75 percent cap does not apply to the money purchase benefit.

Essentially all retirees receive an annual 3 percent increase in the current retirement benefit beginning January 1 following the attainment of age 61 or on January 1 following the member's first anniversary in retirement, whichever is later.

Disability and death benefits are also provided.

If a member leaves covered employment, TRS will refund a member's retirement contributions upon request. The refund consists of actual contributions, excluding the 1 percent death benefit contribution.

Tier I members contribute 9.4 percent of their creditable earnings to TRS and an additional contribution to a retiree health insurance program that is not administered by TRS.

TIER II BENEFITS

Changes from Tier I include raising the minimum eligibility to draw a retirement benefit to age 67 with 10 years of service. A discounted annuity can be paid at age 62 with 10 years of service. The Tier II law caps creditable earnings and contributions used for retirement purposes at a level that is lower than the Social Security Wage Base. Post retirement increases are limited to the lesser of 3 percent or half the annual increase in the Consumer Price Index and are not compounded.

The 2.2 retirement formula also applies to Tier II but the final average salary is based on the highest consecutive eight years of creditable service rather than the last four. The single-sum benefit is also payable at age 65 to Tier II members with fewer than five years of service. Tier II members cannot retire under ERO, and the money purchase (actuarial) benefit is not available to them.

Disability and refund provisions for Tier II are identical to those that apply to Tier I. Death benefits are payable under a formula that is different from Tier I.

Tier II members also contribute 9.4 percent of their creditable earnings to TRS and an additional contribution to a retiree health insurance program that is not administered by TRS.

6. ACTUARIAL MEASUREMENTS

The Schedule of Changes in the Net Pension Liability, Schedule of the Net Pension Liability, and the Schedule of Contributions from Employers and Other Contributing Entities may be found in the Required Supplementary Information.

Member, employer, and State contributions are statutorily defined by the Illinois Pension Code (40 ILCS 5/16), which is subject to amendment by the Illinois General Assembly and approval by the governor. Since July 1, 1995, State appropriations have been made through a continuing appropriation.

Effective July 1, 2005, member contributions increased from 9 percent to 9.4 percent of salary. These contributions are allocated as follows: 7.5 percent for retirement; 0.5 percent for post-retirement increases; 1 percent for death benefits; and 0.4 percent to help cover the cost of Early Retirement Option (ERO), which is refundable if the member does not retire using ERO or if the ERO program is terminated.

Employer contributions are made by or on behalf of employers from several sources. The State of Illinois provides the largest source of contributions through State appropriations from the Common School Fund. Employers also make contributions for the 2.2 benefit formula and for teachers who are paid from federal funds. Additionally, employers contribute their portion of the cost of ERO and any excess salary increase or sick leave costs due.

State funding law provides for a 50-year funding plan that includes a 15-year phase-in period.

Public Act 96-0043, which was effective July 15, 2009, required TRS to use a five-year smoothing method for asset valuation beginning on June 30, 2009. It first affected State contribution requirements in FY11.

Administrative expenses are budgeted and approved by the TRS Board of Trustees. Funding for these expenses is included in the employer contribution, as determined by the annual actuarial valuation.

PENSION LIABILITY

The long-term rate of return as of June 30, 2014 is 7.5 percent, as adopted by the Board of Trustees. The prior year long-term rate of return was 8.0 percent. The assumptions as of June 30, 2014 were assumed to be in effect at the beginning of the fiscal year as well. The long-term rate of return assumption is based on a 2014 asset liability study conducted by the TRS investment consultant and additional analysis conducted by the TRS actuary.

The TRS actuary used the following assumed rates of returns by asset class, excluding 3.00 percent for the assumed rate of inflation.

Expected Arithmetic Real Returns over 30 Years

Asset Class	Return
U.S. large cap	8.23%
Global equity excluding U.S.	8.58
Aggregate bonds	2.27
U.S. TIPS	3.52
NCREIF	5.81
Opportunistic real estate	9.79
ARS	3.27
Risk parity	5.57
Diversified inflation strategy	3.96
Private equity	13.03

GASB Statement No. 67 requires the discount rate to be a blended rate, which includes the long-term expected rate of return and a municipal bond rate (the S & P Municipal Bond 20 Year High Grade Rate Index) as of the end of the current year. Based on projections discussed below, the System can utilize the long-term expected rate of return as the discount rate. Therefore, the long-term expected rate of return and the discount rate are the same, 7.5 percent for the year ended June 30, 2014.

TRS, with the assistance of the actuary, projected that the Plan's fiduciary net position will be sufficient to provide for all benefit payments to current plan members. Projected contributions from members, employers, and the State of Illinois (non-employer contributing entity) assume that all statutorily required contributions are made through FY2112 and that Public Act 98-0599 does not go into effect. Estimated contributions from employers and the State of Illinois, of which the majority of the contribution (approximately 98 percent) is provided by the State of Illinois, are projected to be $3.6 billion in 2015 and growing to $8.8 billion in 2045 based on current statutory requirements for current members. Tier I's liability is partially funded by Tier II members, as the Tier II member contribution is higher than the cost of Tier II benefits. Due to this subsidy, contributions from future members in excess of the service cost are also included in the determination of the discount rate.

The actuarial cost method required for financial reporting purposes is the entry age normal method. For TRS, Total Pension Liability (TPL) is developed and rolled forward to the fiscal year end based on a valuation date and member census one year prior. TPL is projected to June 30, 2014, based on a valuation date of June 30, 2013. Assets, referred to as Fiduciary Net Position, are measured at fair value.

Net Pension Liability

	June 30, 2014
Total pension liability	$106,682,654,886
Plan fiduciary net position	45,824,382,514
Net pension liability	$60,858,272,372
Plan fiduciary net position as a percentage of the total pension liability	43.0%

Sensitivity of the Net Pension Liability to Changes in the Discount Rate

	1% Decrease	Current	1% Increase
Discount rate	6.5%	7.5%	8.5%
Net pension liability	$75,156,979,079	$60,858,272,372	$49,017,312,800

Most of the actuarial assumptions are based on the actuarial experience analysis dated August 2012, which covered the period July 1, 2006 through June 30, 2011. Its recommendations were adopted in the June 30, 2012 actuarial valuation. New assumptions for the assumed rate of investment return, salary increases, inflation and related economic assumptions were adopted in the June 30, 2014 actuarial valuation.

Additional Information Regarding Assumptions used for Financial Reporting Disclosure and the Actuarial Valuation follow:

	June 30, 2014
Actuarial Cost Method:	
For financial reporting purposes	Entry age normal
Amortization Method:	
For financial reporting purposes	Level percent of payroll
Remaining Amortization Period:	
For financial reporting purposes	30 years, open
Asset Valuation Method:	
For financial reporting purposes	Fair value
Actuarial Assumptions:	
Investment rate of return (long-term)	7.5%
Real rate of investment return (long-term)	4.5%
Projected salary increases	4.75% (at age 69) to 9.90% (at age 20), composite 5.75%. Includes inflation and real wage growth (productivity) assumptions.
Group size growth rate	0%
Assumed inflation rate	3.00%
Real wage growth (productivity)	0.75%
Post-retirement increase	Tier I: 3% compounded; Tier II: Lesser of 3% or ½ of the CPI increase, not compounded
Mortality table	RP - 2000 Mortality Tables with future mortality improvements on a generational basis.

B. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

1. BASIS OF ACCOUNTING

The financial transactions of TRS are recorded using the economic resources measurement focus and the accrual basis of accounting. Member and employer contributions are recognized as revenues when due, pursuant to formal commitments, as well as statutory or contractual requirements. Benefits and refunds are recognized as expenses when they are due and payable in accordance with the terms of the plan.

2. USE OF ESTIMATES

The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of additions to and deductions from net position during the reporting period. Actual results could differ from these estimates. TRS uses an actuary to determine the total pension liability for the defined benefit plan and to determine the actuarially required contribution.

3. RISKS AND UNCERTAINTIES

TRS investments are diversified and include various investment securities. Investment securities are exposed to a variety of risk including credit, market and interest rate risk. Due to the level of risk associated with certain investment securities, it is at least reasonably possible that value changes will occur in the near-term and such changes could materially affect the amounts reported in the Statement of Fiduciary Net Position.

4. NEW ACCOUNTING PRONOUNCEMENTS

GASB Statement No. 65, "Items Previously Reported as Assets and Liabilities," was established to improve financial reporting by clarifying the appropriate use of the financial statement elements deferred outflows of resources and deferred inflows of resources to ensure consistency in financial reporting. TRS implemented this statement for the year ended June 30, 2014, with no significant financial impact.

GASB Statement No. 67, "Financial Reporting for Pension Plans," established standards for defined benefit pension plans' financial reports and specifies the required approach to measuring the pension liability of employers and nonemployer contributing entities for benefits provided through the pension plan (the net pension liability), about which information is required to be presented. TRS implemented this statement for the year ended June 30, 2014.

GASB Statement No. 68, "Accounting and Financial Reporting for Pensions," was established to set standards for measuring and recognizing liabilities, deferred outflows of resources, deferred inflows of resources and expenses/expenditures related to pensions. This statement identifies the methods and assumptions that should be used to project benefit payments, discount projected benefit payments to their actuarial present value and attribute that present value to periods of employee service. TRS will assist employers in their implementation of this statement for the year ended June 30, 2015.

GASB Statement No.71, "Pension Transition for Contributions Made Subsequent to the Measurement Date," was established to improve accounting and financial reporting by addressing an issue in GASB Statement No. 68, concerning transition provisions related to certain pension contributions made to defined benefit pension plans prior to implementation of the statement by employers and nonemployer contribution entities. TRS will assist employers in implementing this statement simultaneously with the provisions of GASB Statement No. 68.

5. METHOD USED TO VALUE INVESTMENTS

TRS reports investments at fair value. Fair value for publicly traded real return funds, equities, foreign currency and exchange traded derivatives is determined by using the closing price listed on national securities exchanges as of June 30. Fair value for fixed income securities and over-the-counter derivatives is determined primarily by using quoted market prices provided by independent pricing services. Short-term investments are generally reported at average cost, which approximates fair value. Appraisals are used to determine fair value on directly-owned real estate investments. Fair value for private equity investments, absolute return funds, non-publicly traded real return funds and partnership interests in real estate funds is determined by TRS staff and the general partners or investment managers in accordance with the provisions in the individual agreements. These agreements also require that an independent audit be performed on an annual basis.

6. CAPITAL ASSETS

Equipment is stated on the basis of historical cost. Depreciation is computed using the straight-line method based upon the estimated useful lives of the assets. Capital assets activity for the year ended June 30, 2014 was as follows:

	Beginning Balance	Additions/ Transfers In	Disposals/ Transfers Out	Ending Balance
Land	$235,534	$ -	$ -	$235,534
Mineral Lease Rights	2,643	-	-	2,643
Office building	7,217,795	233,269	-	7,451,064
Site improvement	1,088,635	-	-	1,088,635
Equipment and furniture	2,306,363	260,296	113,204	2,453,455
Software	1,193,413	288,759	-	1,482,172
	12,044,383	782,324	113,204	12,713,503
Less accumulated depreciation:				
Office building	5,085,533	373,216	-	5,458,749
Site improvement	456,468	76,654	-	533,122
Equipment and furniture	1,744,467	256,704	103,212	1,897,959
Software	399,328	310,307	-	709,635
	7,685,796	1,016,881	103,212	8,599,465
	$4,358,587	($234,557)	$9,992	$4,114,038

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

Office building	40 years
Equipment and furniture	3 -10 years
Software	3 - 5 years

7. COMPENSATED ABSENCES

When employment is terminated, TRS employees are entitled to receive compensation for all accrued unused vacation time and one-half of all unused sick leave earned through December 31, 1997. (Lump-sum payments for sick leave earned prior to January 1, 1984, are subject to a maximum of 60 days or 420 hours.) Sick time earned after December 31, 1997 is not compensable at termination.

At June 30, 2014, the System had a liability of $1,881,735 for compensated absences. The liability is included in administrative and investment expenses payable on the Statement of Fiduciary Net Position. For non-investment staff, the increase or decrease in liability is reflected in the financial statements as administrative expense. For investment staff, the increase or decrease is reflected as investment expense. Compensated absences payable for the year ended June 30, 2014 was as follows:

	Beginning Balance	Additions	Reductions	Ending Balance
Compensated absences payable	$1,689,265	$1,053,087	$860,617	$1,881,735

The estimated amount due within one year is: $100,000

8. RECEIVABLES

Receivables consist primarily of 1) member and employer contributions owed and yet to be remitted by the employing districts, 2) interest, dividends, real estate and private equity income owed to TRS, 3) appropriations not yet received from the State of Illinois as of June 30, and 4) pending investment sales.

TRS assesses penalties for late payment of contributions and may collect any unpaid amounts from the employing districts by filing a claim with the appropriate regional superintendent of education or the Office of the Comptroller against future state aid payments to the employer. TRS considers these amounts to be fully collectible.

9. RISK MANAGEMENT

TRS, as a component unit of the State of Illinois, provides for risks of loss associated with workers' compensation and general liability through the State's self-insurance program. TRS obtains commercial insurance for fidelity, surety and property. No material commercial insurance claims have been filed in the last three fiscal years.

C. CASH

Custodial credit risk for deposits is the risk that, in the event of a bank failure, TRS's deposits may not be returned. TRS has a formal policy to address custodial credit risk. The policy is designed to minimize custodial credit risk through proper due diligence of custody financial institutions and investment advisors; segregate safekeeping of TRS assets; establish investment guidelines; and work to have all investments held in custodial accounts through an agent, in the name of custodian's nominee, or in a corporate depository or federal book entry account system. For those investment assets held outside of the custodian, TRS will follow the applicable regulatory rules.

The non-investment bank balance and carrying amount of TRS's deposits was $60,859,067 at June 30, 2014. Of the bank balance, $60,858,942 was on deposit with the State treasurer at June 30, 2014. State treasurer deposits are in an internal investment pool collateralized at a third party custodial bank and are not subject to custodial credit risk. Certain investments of TRS with maturities of 90 days or less would be considered cash equivalents; these consist of bank-sponsored, short-term investment funds, commercial paper and repurchase agreements. For financial statement presentation and investment purposes, TRS reports its cash equivalents as short-term investments in the Statement of Fiduciary Net Position. Included in the reported balances is the State Street Global Advisors Short-Term Investment Fund (STIF) with a value of $1,061,378,315 at June 30, 2014. The STIF fund has an average credit quality rating of A1P1 and a weighted average maturity of 40.0 days.

For purposes of this disclosure, foreign currency held by investment managers is considered a deposit. However, for financial statement presentation and investment purposes, TRS considers foreign currency an investment asset. Uncollateralized foreign currency subject to custodial credit risk was $84,850,132 at June 30, 2014.

D. INVESTMENTS

1. INVESTMENT POLICIES

Through the Board of Trustees, as authorized in the Illinois Pension Code, TRS serves as fiduciary for the members' trust funds and is responsible for investment of those funds under the "prudent person rule."

The Board of Trustees, through the investment policy, has the responsibility of establishing and maintaining broad policies and objectives for all aspects of the System's operations, including the allocation of invested assets. Plan assets are managed on a total return basis with a long-term objective of achieving and maintaining a fully-funded status for the benefits provided through the pension plan. The following table summarizes the Board-adopted, long-term allocation targets in effect as of June 30, 2014. Long-term asset allocation targets remained the same in FY14 as no significant investment policy changes were made during the fiscal year.

Long-term Asset Allocation Policy Mix	
Global equity	40%
Global fixed income	16
Real estate	14
Private equity	12
Real return	10
Absolute return	8
Short-term	0
Total	**100%**

2. INVESTMENT RISK

CUSTODIAL CREDIT RISK

Custodial credit risk for investments is the risk that, in the event of a financial institution failure, TRS would not be able to recover the value of the investments in the possession of an outside party. The TRS investment policy adopted by the Board of Trustees includes a formal process to address custodial credit risk. This policy requires the custodian to provide safekeeping of the System's assets in segregated accounts and to have the assets registered in TRS's name, custodian's nominee name or in a corporate depository or federal book entry system.

CONCENTRATION OF CREDIT RISK

Concentration of credit risk is the risk of loss that may be attributed to the magnitude of an investment in any one issuer. Investment parameters established in the Investment Management Agreements with external managers restrict holdings to no more than 5 percent of a single issuer within an account. The TRS portfolio has no investments in any one issuer that comprise 5 percent or more of the System's total investments.

CREDIT RISK

Credit risk is the risk that an issuer or other counterparty to an investment will not fulfill its obligations to TRS. Credit risk exposure is dictated by each investment manager's agreement. Each portfolio is managed in accordance with investment guidelines that are specific as to permissible credit quality ranges, exposure levels within individual security quality rating tiers and/or the average credit quality of the overall portfolio. Most guidelines allow managers to hold bonds rated Caa2 or better. However, in circumstances where position downgrades occur, investment managers have been given permission to hold securities below this rating due to circumstances such as a higher peer group rating from another nationally recognized statistical rating organization, the investment manager's internal ratings or other mitigating factors.

As of June 30, 2014, TRS held the following fixed income investments with respective Moody's quality ratings or equivalent rating. Obligations of the U.S. government or obligations explicitly guaranteed by the U.S. government are not considered to have credit risk.

Quality Rating	Corporate Debt Securities	Foreign Debt Securities	U.S. Treasuries & Agency Obligations	Municipals	Commingled Funds	Securities Lending Collateral	Total
Aaa	$394,494,781	$335,260,934	$1,323,283,564	$1,788,384	$ -	$ -	$2,054,827,663
Aa1	24,457,586	354,953,328	-	5,543,944	-	-	384,954,858
Aa2	16,393,116	47,406,071	-	12,070,424	-	-	75,869,611
Aa3	42,694,279	116,621,066	-	6,799,044	116,434,912	-	282,549,301
A1	118,807,882	33,318,843	-	-	-	-	152,126,725
A2	115,572,081	117,518,313	1,071,349	8,888,638	-	-	243,050,381
A3	226,946,290	192,543,266	-	3,619,754	-	-	423,109,310
Baa1	225,358,646	161,346,601	-	308,280	-	-	387,013,527
Baa2	382,806,804	399,251,093	-	-	-	-	782,057,897
Baa3	365,000,507	259,672,993	-	-	-	-	624,673,500
Ba1	158,412,859	185,691,372	-	-	56,602,591	-	400,706,822
Ba2	121,366,996	46,691,213	-	-	54,500,838	-	222,559,047
Ba3	204,708,203	52,988,979	-	-	488,868,642	-	746,565,824
B1	204,192,707	56,570,406	-	-	198,940,753	-	459,703,866
B2	83,700,516	65,882,544	-	-	19,194,996	-	168,778,056
B3	75,118,416	27,918,958	-	-	-	-	103,037,374
Caa1	28,263,803	18,790,925	-	-	-	-	47,054,728
Caa2	20,979,112	1,470,000	-	-	-	-	22,449,112
Caa3	18,690,919	30,120,403	-	-	-	-	48,811,322
Ca	10,238,853	-	-	-	-	-	10,238,853
C	6,484,993	-	-	-	99,113,693	-	105,598,686
Not available	2,247,148	13,224,470	-	-	497,136,121	-	512,607,739
Not rated	25,160,598	115,504,411	-	-	-	12,965,947	153,630,956
Withdrawn	10,736,417	417,937	3,421,373	-	-	-	14,575,727
Total bonds, corporate notes & government obligations	**$2,882,833,512**	**$2,633,164,126**	**$1,327,776,286**	**$39,018,468**	**$1,530,792,546**	**$12,965,947**	**$8,426,550,885**

INTEREST RATE RISK

Interest rate risk is the risk that changes in interest rates will adversely affect the fair value of an investment. TRS's fixed income investments are managed in accordance with operational guidelines that are specific as to the degree of interest rate risk that can be taken. TRS manages the interest rate risk within the portfolio using various methods including effective duration, option adjusted duration, average maturity and segmented time distribution, which reflect the total fair value of investments maturing during a given time period. The segmented time distribution of the various investment types of TRS debt securities as of June 30, 2014 is as follows:

		Maturity in Years					
Type	**2014 Fair Value**	**Less Than 1 year**	**1 to 5 years**	**5 to 10 years**	**10 to 20 years**	**More Than 20 years**	**Other***
U.S. treasuries	$235,144,805	$15,443,309	$102,415,450	$79,719,444	$6,404,809	$31,161,793	$ -
U.S. federal agencies	57,382,591	2,848,915	16,141,234	35,495,156	2,794,135	103,151	-
U.S. government index-linked bonds	713,871,733	12,507,477	361,392,808	173,992,292	131,693,603	34,285,553	-
U.S. government-backed mortgages	321,377,157	13,469,425	9,242,615	18,301,699	55,220,446	225,142,972	-
Municipals	39,018,468	594,922	263,913	1,295,309	6,619,350	30,244,974	-
Asset-backed securities	317,429,427	-	142,804,654	50,500,650	53,772,079	70,352,044	-
Commercial mortgage-backed securities	134,062,799	-	-	3,156,625	10,720,120	120,186,054	-
Collateralized mortgage obligations	202,394,617	-	4,424,007	24,561,288	28,655,470	144,753,852	-
Commingled funds (U.S. & International)**	1,530,792,546	-	242,134,711	769,174,943	-	-	519,482,892
Corporate convertible bonds	38,328,098	2,079,821	18,821,475	6,287,226	5,611,149	5,528,427	-
Domestic credit obligations	2,190,618,571	139,522,789	960,268,602	776,681,258	79,722,171	234,423,751	-
Foreign debt/corporate obligations	2,633,164,126	310,006,333	1,018,077,075	868,228,854	217,786,379	219,065,485	-
Total bonds, corporate notes and government obligations	**8,413,584,938**	**496,472,991**	**2,875,986,544**	**2,807,394,744**	**598,999,711**	**1,115,248,056**	**519,482,892**
Securities lending collateral	12,965,947	12,965,947	-	-	-	-	-
Derivatives	2,805,648	(1,849,893)	8,010,378	(641,164)	1,208,083	(3,921,756)	-
Total bonds, corporate notes, government obligations, securities lending collateral and derivatives	**$8,429,356,533**	**$507,589,045**	**$2,883,996,922**	**$2,806,753,580**	**$600,207,794**	**$1,111,326,300**	**$519,482,892**

** Maturity date is not available or applicable.*

*** Weighted average maturity figures were used if available to plot the commingled funds within the schedule.*

FOREIGN CURRENCY RISK

Foreign currency risk is the risk that changes in exchange rates will adversely impact the fair value of an investment. TRS's currency risk exposure, or exchange rate risk, is primarily derived from its holdings in foreign currency-denominated equity and fixed income investments, as well as foreign currency. According to TRS's Investment Policy and investment manager agreements, international equity and global fixed income managers, at their discretion, may or may not hedge the portfolio's foreign currency exposures with currency forward contracts or options, depending upon their views on a specific country or foreign currency relative to the U.S. dollar. TRS's exposure to foreign currency risk in U.S. dollars as of June 30, 2014 is as follows:

Currency	Foreign Currency	Equities	Fixed Income	Derivatives	Total
Australian dollar	$143,730	$317,793,612	$57,857,376	$794,004	$376,588,722
Brazilian real	3,740,293	149,579,379	91,025,495	(935,002)	243,410,165
British pound	11,615,801	1,553,356,641	278,267,701	(161,849)	1,843,078,294
Canadian dollar	4,842,394	563,570,497	53,519,075	843,868	622,775,834
Chilean peso	296,781	12,123,993	2,978,816	-	15,399,590
Columbia peso	26,175	3,161,387	9,651,685	-	12,839,247
Czech koruna	4,525	3,544,138	-	-	3,548,663
Danish krone	346,865	85,009,366	21,764,354	-	107,120,585
Emirati dirham	24,035	1,199,191	-	-	1,223,226
Egyptian pound	404,691	541,699	-	-	946,390
Euro	30,642,223	1,941,544,596	614,172,866	(1,511,018)	2,584,848,667
Ghana cedi	144,138	-	15,925,931	-	16,070,069
Hong Kong dollar	2,830,950	524,697,463	-	-	527,528,413
Hungarian forint	1,231,491	12,304,240	51,541,938	-	65,077,669
Indian rupee	531,343	148,552,341	5,442,606	-	154,526,290
Indonesian rupiah	183,026	64,655,773	14,575,221	-	79,414,020
Israeli shekel	238,337	28,644,185	-	-	28,882,522
Japanese yen	11,993,205	1,177,759,122	6,413,875	(1,889,572)	1,194,276,630
Malaysian ringgit	883,102	81,666,049	18,291,082	-	100,840,233
Mexican peso	1,999,574	60,482,458	153,629,251	422,203	216,533,486
Moroccan dirham	604	-	-	-	604
New Taiwan dollar	585,373	233,256,390	-	66,194	233,907,957
New Zealand dollar	1,187,107	16,200,495	60,516,629	(200,413)	77,703,818
Norwegian krone	1,147,992	82,268,718	14,543,638	-	97,960,348
Philippine peso	109,404	46,778,022	16,376,597	-	63,264,023
Polish zloty	2,157,135	38,295,265	48,865,970	-	89,318,370
Qatari rial	860	1,249,354	-	-	1,250,214
Russian ruble	-	8,029,047	-	-	8,029,047
Serbian dinar	78,098	-	13,731,706	-	13,809,804
Singapore dollar	1,418,060	185,083,323	23,223,444	-	209,724,827
South African rand	748,601	155,257,225	-	-	156,005,826
South Korean won	4,536,955	290,685,300	93,716,234	(87,024)	388,851,465
Sri Lanka rupee	316,450	-	11,883,355	-	12,199,805
Swedish krona	2,232,313	169,586,422	31,161,207	-	202,979,942
Swiss franc	501,949	645,707,420	-	-	646,209,369
Thailand baht	322,296	77,291,069	14,200,866	-	91,814,231
Turkish lira	(4,187,965)	71,017,791	-	-	66,829,826
Ukraine hryvnia	(198,621)	-	540,648	-	342,027
Uruguayo peso	1,770,842	-	54,241,880	-	56,012,722
Total subject to foreign currency risk	**84,850,132**	**8,750,891,971**	**1,778,059,446**	**(2,658,609)**	**10,611,142,940**
Investments in international securities payable in U.S. dollars	-	1,331,099,450	910,458,982	1,231,270	2,242,789,702
Total international investment securities (including domestic securities payable in foreign currency)	**84,850,132**	**10,081,991,421**	**2,688,518,428**	**(1,427,339)**	**12,853,932,642**
Domestic investments (excluding securities payable in foreign currency)	-	9,069,142,475	5,725,066,510	4,232,987	14,798,441,972
Total fair value	**$84,850,132**	**$19,151,133,896**	**$8,413,584,938**	**$2,805,648**	**$27,652,374,614**

In addition to the above, the fair value of TRS's investments in foreign currency denominated real estate and private equity funds was $92,599,449 and $352,760,196 at June 30, 2014, respectively. Currencies included euro, British pound, Canadian dollar and South Korean won.

3.SECURITIES LENDING PROGRAM

The Board of Trustees' policies permit TRS to use investments to enter into securities lending transactions, which are loans of securities to broker-dealers or other approved entities. The borrower of a security must post collateral in excess of the fair value of the security. TRS receives both cash and non-cash (i.e., securities) collateral. Eligible forms of collateral include cash consisting of U.S. dollar, euro, sterling and yen, U.S. treasuries, government agency securities, certificates of deposit, letters of credit issued by approved banks and specific types of corporate debt obligations and common stock. Initial collateral received from the borrower must be at least 102 percent of the fair value of all loaned securities except non-U.S. securities, which require 105 percent. Securities on loan are marked to market daily and collateral for the loan is required not to fall below minimum levels established by TRS and its lending agent. Agreements are in place for TRS to return the collateral in exchange for the original securities upon demand or when the security is no longer borrowed. TRS does not have the authority to pledge or sell collateral securities, without borrower default; as such, the collateral security or non-cash collateral is not reported in TRS's financial statements.

As of June 30, 2014, Citibank, N.A. served as the third-party securities lending agent for the fixed income, domestic equity and international equity lending programs. In this capacity, TRS reduces credit risk by allowing Citibank to lend securities to a diverse group of dealers on behalf of TRS. At fiscal year end, TRS has no credit risk exposure to borrowers because the amount TRS owes the borrowers exceeds the amount the borrowers owe TRS. The contract with TRS's lending agent requires the agent to indemnify TRS if the borrowers fail to return the securities (and if the collateral is inadequate to replace the securities lent) or fail to pay TRS for income distributions by the securities issuers while the securities are on loan. Securities on loan can be recalled on demand by TRS, or the borrower can return the loaned securities at any time, although the weighted average term of the loans is 22 days. Since loans are terminable at will, the maturity of loans generally does not match the maturity of collateral investments. TRS may enter into term loan agreements, which are evaluated on an individual basis; however, there were no term loans as of June 30, 2014.

The cash collateral received is invested in a separate account managed by the lending agent, with a weighted average maturity of 55 days at June 30, 2014. There were no significant violations of legal or contractual provisions, and there were no borrower or lending agent default losses known to the securities lending agent.

As of June 30, 2014, TRS had outstanding loaned investment securities with a fair value of $2,652,759,472, against which it had received cash and non-cash collateral with a fair value of $2,735,112,052. The securities on loan remain on TRS's Statement of Fiduciary Net Position in their respective investment categories. As of June 30, 2014, TRS cash collateral received and reported as securities lending obligation on the Statement of Fiduciary Net Position totaled $2,731,006,197; whereas, the fair value of reinvested cash collateral reported as securities lending collateral was $2,731,092,336. The change in fair value of the reinvested cash collateral is included as net appreciation/depreciation within investment income in the Statement of Changes in Fiduciary Net Position. TRS also reports securities lending collateral with the Office of the Illinois State Treasurer on the Statement of Fiduciary Net Position. Further detail on this amount can be found in the Illinois State Treasurer's financial report.

Income earned and costs related to securities lending activities are reported on the Statement of Changes in Fiduciary Net Position. For fiscal year 2014, the System earned net income of $13,529,288 from securities lending. Additional detail regarding securities lending activity is included within the Investments Section.

4. DERIVATIVES

TRS, through its investment managers, invests in derivative securities as a fundamental part of the overall investment process. All TRS derivatives are considered investments and the fair value is reported in the Statement of Fiduciary Net Position. TRS does not directly invest in derivatives but allows certain external managers to utilize these instruments within the investment portfolio for a variety of purposes. TRS managers may hold derivatives to hedge investment transactions accounted for at fair value. The term “hedge” in this context denotes the broad economic activity of entering into contracts intended to offset risks associated with certain transactions, such as the changes in interest rates on investments in debt securities, commodities or instruments denominated in a foreign currency. Assets and liabilities that are measured at fair value, such as investments, do not qualify as hedgeable items and do not meet the requirements for hedge accounting.

A derivative security is an investment whose return depends upon the value of another financial instrument or security such as stocks, bonds, commodities, or a market index. The derivative investments in TRS’s portfolio are used primarily to enhance performance and reduce volatility. TRS’s investments in derivatives are not leveraged through borrowing. In the case of an obligation to purchase (long a financial future or call option), the full value of the obligation is primarily held in cash or cash equivalents. For obligations to sell (short a financial future or put option), the reference security is held in the portfolio.

To varying degrees, derivative transactions involve credit risk, sometimes known as default or counterparty 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 the established contract terms. To eliminate credit risk, derivative securities can be acquired through a clearinghouse that guarantees delivery and accepts the risk of default by either party.

Market risk is the possibility that a change in interest, currency or other pertinent market rates will cause the value of a financial instrument to decrease or become more costly to settle. Imposing limits on the types, amounts and degree of risk that investment managers may undertake restricts the market risk associated with the constantly fluctuating prices of derivatives. These limits are approved by the Board of Trustees and senior management, and the derivative positions of the investment managers are reviewed on a regular basis to monitor compliance.

As of June 30, 2014, derivative investments in the TRS investment portfolio included currency forward contracts, rights, warrants, futures, options, swaps and swaptions. Within the financial statements, currency forward contracts are reflected as investment payables/receivables, rights and warrants are reflected as equities, and all futures, options, swaps and swaptions are classified as derivatives. The change in fair value of derivative investments is included in investment income on the Statement of Changes in Fiduciary Net Position.

The following tables summarize the derivatives held within the TRS investment portfolio and the change in fair value of derivative investments, realized and unrealized, during the fiscal year. The notional amounts shown represent TRS’s financial exposure to these instruments in U.S. dollars. Investments in limited partnerships and commingled funds may include derivatives that are not covered in the following disclosure.

As of June 30, 2014, the TRS investment portfolio held the following derivatives.

Investment Derivatives	Fair Value at June 30, 2014	Change in Fair Value	Shares/Par	Notional
Rights	$385,671	$1,820,571	2,462,609	$2,462,609
Warrants	113	486,768	241,707	241,707
Currency forwards	(13,875,149)	(8,607,544)	-	-
Equity futures long	-	27,671,381	584,504	253,634,760
Equity futures short	-	(11,099,154)	(146,287,638)	(87,165,715)
Fixed income futures long	-	9,974,093	1,706,565,647	1,779,414,072
Fixed income futures short	-	(12,777,285)	(839,658,745)	(970,341,242)
Commodity futures long	-	(2,994,982)	8,269,500	80,007,220
Commodity futures short	-	5,910,065	(5,079,000)	(57,986,843)
Currency futures long	-	(191,304)	-	-
Currency futures short	-	(68,858)	-	-
Equity options purchased	1,906,530	(5,046,469)	1,184,300	13,229,280
Equity options written	(1,520,502)	3,272,432	(1,582,910)	12,694,722
Currency forward options purchased	118,804	(1,364,362)	132,215,741	3,053,622
Currency forward options written	(221,954)	1,465,910	(37,136,825)	6,298,655
Options on futures purchased	423,601	(469,459)	1,687,900	17,543,515
Options on futures written	(335,535)	1,557,850	(501,900)	4,581,191
Swaptions purchased	1,861,532	(3,373,194)	169,197,045	23,389,244
Swaptions written	(3,057,383)	14,298,753	(1,143,955,439)	244,448,238
Credit default swaps buying protection	695,347	(1,311,606)	44,360,469	45,190,028
Credit default swaps selling protection	5,103,587	3,285,263	353,159,178	358,379,435
Index swaps	252,591	3,035,612	51,367,277	63,558,888
Pay fixed interest rate swaps	(6,990,209)	(9,768,590)	279,825,848	280,246,525
Receive fixed interest rate swaps	5,254,975	(434,668)	628,083,899	633,479,414
Pay fixed inflation swaps	(685,736)	243,660	53,000,000	52,314,638
Grand totals	**($10,683,717)**	**$15,514,883**		**$2,758,673,963**

CURRENCY FORWARD CONTRACTS

Objective: Currency forward contracts are agreements to exchange one currency for another at an agreed upon price and settlement date. TRS's investment managers use these contracts primarily to hedge the currency exposure of its investments.

Terms: Currency forward contracts are two-sided contracts in the form of either forward purchases or forward sales. Forward purchases obligate TRS to purchase specific currency at an agreed upon price. Forward sales obligate TRS to sell specific currency at an agreed upon price. As of June 30, 2014, TRS had currency forward purchase or sale contracts for 34 different currencies with various settlement dates.

Fair Value: As of June 30, 2014, TRS's open currency forward contracts had a net fair value (unrealized loss) of ($13,875,149).

FINANCIAL FUTURES

Objective: Financial futures are agreements to purchase or sell a specific amount of an asset at a specified delivery or maturity date for an agreed upon price. These derivative securities are used to improve yield, adjust the duration of the fixed income portfolio, protect against changes in interest rates or replicate an index.

Terms: Futures contracts are standardized and traded on organized exchanges, thereby minimizing TRS's credit risk. As the daily 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. As of June 30, 2014, TRS had outstanding futures contracts with a notional value, or exposure, of $997,562,252. Notional values do not represent the actual values in the Statement of Fiduciary Net Position. The contracts have various expiration dates through March 2017.

Fair Value: Gains and losses on futures contracts are settled daily based on the change of the index or commodity price for the underlying notional value. Because of daily settlement, the futures contracts have no fair value. TRS's realized gain on futures contracts was $19,921,916 during FY14. TRS had the following futures contracts at June 30, 2014.

Type	Number of Contracts	Notional Principal
Commodity Futures		
Commodity futures - long	2,489	$80,007,220
Commodity futures - short	(1,233)	(57,986,843)
Equity Futures		
U.S. stock index futures - long	505	45,195,450
International equity index futures - long	6,216	208,439,310
International equity index futures - short	(4,273)	(87,165,715)
Fixed Income/Cash Equivalent Futures		
Fixed income index futures – long	3,442	437,852,852
Fixed income index futures – short	(5,545)	(938,941,758)
International fixed income index futures – long	422	100,825,345
International fixed income index futures – short	(156)	(31,399,484)
Cash equivalent (Eurodollar) futures – long	5,017	1,240,735,875
Total futures (net)	**6,884**	**$997,562,252**

FINANCIAL OPTIONS

Objective: Financial options are agreements that give one party the right, but not the obligation, to buy or sell a specific amount of an asset for a specified price, called the strike price, on or before a specified expiration date. The owner (buyer) of an option has all the rights, while the seller (writer) of an option has the obligations of the agreement. As a writer of financial options, TRS 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. Premiums received are recorded as a liability when the financial option is written. The Options Clearing Corporation (OCC) performs much the same function for options markets as the clearinghouse does for futures markets.

Terms: As of June 30, 2014, the TRS investment portfolio held U.S. equity options with notional value of $25,924,002, currency forward options with notional value of $9,352,277, and options on futures with underlying notional value of $22,124,706. Contractual principal/notional values do not represent the actual values in the Statement of Fiduciary Net Position. The contracts have various expiration dates through February 2019.

Fair Value: Fluctuations in the fair value of financial options are recognized in TRS's financial statements as incurred rather than at the time the options are exercised or expire. As of June 30, 2014, the fair value of all option contracts, gross of premiums received, was $370,944. The fair value represents the amount needed to close all positions as of that date. The following table presents the aggregate contractual principal (notional value) of outstanding contracts as of June 30, 2014. Notional principal amounts are often used to express the volume of these transactions but do not reflect the extent to which positions may offset one another. Options on futures represent the corresponding futures exposure.

Type	Number of Contracts	Notional Principal
Equity Options		
Equity index call options - purchased	89	$399,534
Equity index call options - written	(8)	44,959
Equity index put options - purchased	6,830	5,692,681
Equity index put options - written	(979)	709,213
ETF/Stock put options - purchased	4,330	7,137,065
ETF/Stock put options - written	(14,096)	11,940,550
Currency Forward Options		
Currency forward call options - purchased	4	6,970
Currency forward call options - written	2	6,033,798
Currency forward put options - purchased	3	3,046,652
Currency forward put options - written	3	264,857
Options on Futures		
Fixed income call options on futures USD - purchased	519	4,683,520
Fixed income call options on futures USD - written	(500)	4,565,000
Fixed income put options on futures USD - purchased	1,186	12,859,995
Fixed income put options on futures USD - written	(19)	16,191

SWAPTIONS

Objective: 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. An interest-rate swaption gives the buyer the right to pay or receive a specified fixed interest rate in a swap in exchange for a floating rate for a stated time period. TRS has both written and purchased interest rate swaptions in its portfolio. In a written call swaption, the seller (writer) is obligated to pay a fixed rate in exchange for a floating rate for a stated period of time and in a written put swaption, the seller is obligated to receive a fixed rate in exchange for a floating rate if the swaption is exercised. A purchased (long) call swaption gives the buyer the right to receive a fixed rate in exchange for a floating rate for a stated period of time while a purchased (long) put swaption gives the buyer the right to pay a fixed rate in exchange for a floating rate if the swaption is exercised.

The TRS investment portfolio also holds credit default swaptions. A credit default swaption gives the holder the right, but not the obligation to buy (call) or sell (put) protection on a specified entity or index for a specified future time period.

As the writer of a swaption, TRS receives a premium at the outset of the agreement. Premiums are recorded as a liability when the swaption is written. As the purchaser of a swaption, TRS pays an upfront premium.

Terms: As of June 30, 2014, TRS had outstanding written call swaption exposure of $178,089,492, written put swaption exposure of $66,358,746, purchased call swaption exposure of $10,118,030, and purchased put swaption exposure of $13,271,214. The contracts have various maturity dates through May 2024. Exposure amounts for swaptions do not represent the actual values in the Statement of Fiduciary Net Position.

Fair Value: Fluctuations in the fair value of swaptions are recognized in TRS's financial statements as incurred rather than at the time the swaptions are exercised or when they expire. As of June 30, 2014, the fair value of swaption contracts was ($1,195,851).

CREDIT DEFAULT SWAPS/INDEX SWAPS

Objective: Credit default swaps are financial instruments used to replicate the effect of investing in debt obligations of corporate bond issuers as a means to manage bond exposure, effectively buying or selling insurance protection in case of default. Credit default swaps may be specific to an individual security or to a specific market sector (index swaps). The risk of the credit default/index swap is comparable to the credit risk of the underlying debt obligations of issuers that comprise the credit default/index swap, with the primary risk being counterparty risk. The owner/buyer of protection (long the swap) pays an agreed upon premium to the seller of protection (short the swap) for the right to sell the debt at a previously agreed upon value in the event of a default by the bond issuer. The premium is paid periodically over the term of the swap or until a credit event of the bond issuer occurs. In the event of a default, the swap is called, and the seller of protection makes a payment to the buyer, which is usually based on a fixed percentage of total par.

Purchased credit default swaps decrease credit exposure (buying protection), providing the right to sell debt to the counterparty in the event of a default. A buyer of credit protection against a basket of securities pays an upfront or periodic payment until either maturity or default. In the event of a default, the buyer receives a lump-sum payment. If no default occurs, the buyer loses only the premium paid.

Written credit default swaps increase credit exposure (selling protection), obligating the portfolio to buy debt from counterparties in the event of a default. A seller of credit protection against a basket of securities receives an upfront or periodic payment to compensate against potential default events. If a default event occurs, the seller must pay the buyer the full notional value of the obligation in exchange for the obligation. If no default occurs, the seller will have earned the premium paid.

Terms: As of June 30, 2014, TRS had credit default/index swaps in its portfolio with various maturity dates through January 2043. The notional values as of June 30, 2014 included written credit default swaps (selling protection) of $358,379,435, purchased credit default swaps (buying protection) of $45,190,028 and index swaps of $63,558,888.

Fair Value: The fair value of credit default swaps, including index swaps, held by TRS was $6,051,525 as of June 30, 2014. This represents the amount due to or (from) TRS under the terms of the counterparty agreements.

INTEREST RATE SWAPS

Objective: Interest rate swaps are agreements between parties to exchange a set of cash flow streams over a period of time. In the most common type of interest rate swap arrangement, one party agrees to pay fixed interest payments on designated dates to a counterparty who, in turn, agrees to make return interest payments that float with some reference rate. Long positions (receive fixed) increase exposure to long-term interest rates; short positions (pay fixed) decrease interest rate/risk exposure.

Terms: As of June 30, 2014, TRS held interest rate swaps in various currencies with various expiration/maturity dates ranging from 2014 to 2044. Swap agreements typically are settled on a net basis, with a party receiving or paying only the net amount of the fixed/floating payments. Payments may be made at the conclusion of a swap agreement or periodically during its term.

Fair Value: The table below presents the fair value of TRS's interest rate swap exposure as of June 30, 2014.

	As of June 30, 2014
Receive floating/pay fixed	($6,990,209)
Receive fixed/pay floating	5,254,975

INFLATION-LINKED SWAPS

Objective: Inflation-linked swaps are agreements where a fixed payment is exchanged for a variable payment linked to an inflation index. These swaps can protect against unfavorable changes in inflation expectations and are used to transfer inflation risk from one counterparty to another.

Terms: As of June 30, 2014, TRS was a party to inflation-linked swaps denominated in various currencies with expiration dates through May 2023. TRS receives a fixed rate for all current positions, reducing inflation risks in certain countries. Inflation-linked swaps initially have no net value; the value of the swap's outstanding payments will change as interest and inflation rates change. The value may be either positive or negative.

Fair value: The fair value of the inflation-linked swaps held by TRS was ($685,736) as of June 30, 2014.

DERIVATIVE INTEREST RATE RISK

Interest rate risk for derivative securities is disclosed in the Financial Note D. 2. Both interest rate and inflation rate swaps have fair values that are sensitive to interest rate changes.

TRS had the following interest rate and inflation swaps at June 30, 2014.

Asset Description	Par	Gross Notional	TRS Receives	TRS Pays	Maturity Date	Fair Value 6/30/14
Pay Fixed Interest Rate Swaps:						
Interest rate swap USD	20,200,000	$20,406,464	U.S. CPI URNSA	1.77%	3/26/2016	$206,464
Interest rate swap USD	16,800,000	16,915,097	U.S. CPI URNSA	1.75	3/27/2016	115,097
Interest rate swap USD	39,970,000	39,993,836	3 month LIBOR	2.79	3/31/2024	(680,743)
Interest rate swap USD	3,600,000	3,600,000	3 month LIBOR	2.75	6/18/2024	(44,876)
Interest rate swap USD	1,300,000	1,300,481	3 month LIBOR	2.75	6/20/2042	136,646
Interest rate swap USD	15,000,000	15,001,140	3 month LIBOR	2.75	6/19/2043	1,627,773
Interest rate swap USD	14,000,000	14,001,155	3 month LIBOR	3.25	12/18/2043	156,613
Interest rate swap USD	12,600,000	12,601,028	3 month LIBOR	3.50	12/18/2043	(482,537)
Interest rate swap USD	19,030,000	19,041,356	3 month LIBOR	3.49	3/31/2044	(603,289)
Interest rate swap USD	18,300,000	18,301,298	3 month LIBOR	3.75	6/18/2044	(1,611,947)
Interest rate swap USD	7,300,000	7,300,000	3 month LIBOR	3.50	12/17/2044	(167,505)
Interest rate swap CAD	26,500,000	24,879,125	3 month CDOR	3.50	6/20/2044	(1,190,732)
Interest rate swap EUR	8,500,000	11,657,760	6 month EURIBOR	2.00	1/29/2024	(658,471)
Interest rate swap EUR	9,900,000	13,554,588	6 month EURIBOR	2.75	9/17/2044	(1,711,777)
Interest rate swap GBP	900,000	1,538,864	6 month LIBOR	3.50	9/17/2044	(71,270)
Interest rate swap JPY	6,090,000,000	60,154,333	6 month JPY LIBOR	1.00	9/18/2023	(2,009,655)
Total pay fixed interest rate swaps:		**$280,246,525**				**($6,990,209)**
Receive Fixed Interest Rate Swaps:						
Interest rate swap USD	24,600,000	$24,698,874	0.75%	3 month LIBOR	9/17/2015	$98,874
Interest rate swap USD	116,400,000	117,406,976	1.50	3 month LIBOR	3/18/2016	1,006,976
Interest rate swap USD	16,500,000	16,530,380	1.50	3 month LIBOR	12/16/2016	30,380
Interest rate swap USD	32,700,000	32,686,180	1.75	3 month LIBOR	6/15/2017	(13,820)
Interest rate swap USD	128,300,000	129,513,112	3.00	3 month LIBOR	9/21/2017	1,213,112
Interest rate swap USD	24,900,000	24,687,612	1.00	Fed Fund Effective Rate	10/15/2017	(212,388)
Interest rate swap USD	12,800,000	13,158,021	2.50	3 month LIBOR	12/18/2020	346,465
Interest rate swap USD	45,100,000	45,732,444	4.00	3 month LIBOR	6/19/2024	632,444
Interest rate swap AUD	8,300,000	7,944,215	3.50	6 month Australian Bank Bill	12/11/2018	95,275
Interest rate swap AUD	14,900,000	14,409,448	3.75	6 month Australian Bank Bill	12/11/2018	317,259
Interest rate swap AUD	13,600,000	13,273,613	4.00	6 month Australian Bank Bill	6/18/2019	419,011
Interest rate swap BRL	700,000	317,916	10.41	3 month Brazilian CDI	1/2/2015	327
Interest rate swap BRL	1,800,000	761,349	8.22	3 month Brazilian CDI	1/2/2017	(55,311)
Interest rate swap BRL	4,500,000	1,910,543	8.30	3 month Brazilian CDI	1/2/2017	(131,106)
Interest rate swap BRL	13,300,000	5,727,804	8.64	3 month Brazilian CDI	1/2/2017	(306,405)
Interest rate swap BRL	13,800,000	5,988,227	8.86	3 month Brazilian CDI	1/2/2017	(272,832)
Interest rate swap BRL	10,600,000	4,579,242	8.94	3 month Brazilian CDI	1/2/2017	(229,977)
Interest rate swap BRL	300,000	129,931	9.10	3 month Brazilian CDI	1/2/2017	(6,179)
Interest rate swap BRL	5,100,000	2,311,956	10.91	12 month Brazilian CDI	1/2/2017	(1,913)
Interest rate swap BRL	2,200,000	1,007,148	11.47	3 month Brazilian CDI	1/2/2017	9,008
Interest rate swap BRL	15,900,000	7,156,284	11.68	3 month Brazilian CDI	1/4/2021	(57,545)
Interest rate swap BRL	11,700,000	5,425,220	12.56	3 month Brazilian CDI	1/4/2021	116,931

(continued)

(continued)

Asset Description	Par	Gross Notional	TRS Receives	TRS Pays	Maturity Date	Fair Value 6/30/14
Interest rate swap CAD	15,400,000	$15,300,218	3.30%	3 month CDOR	6/19/2024	$826,517
Interest rate swap CAD	31,600,000	30,905,254	3.40	3 month CDOR	6/20/2029	1,208,083
Interest rate swap MXN	1,100,000	88,102	5.60	28 day Mexican TIIE	9/6/2016	3,126
Interest rate swap MXN	54,000,000	4,324,184	5.50	28 day Mexican TIIE	9/13/2017	157,877
Interest rate swap MXN	70,000,000	5,621,049	5.70	28 day Mexican TIIE	1/18/2019	209,849
Interest rate swap MXN	500,000	40,499	6.35	28 day Mexican TIIE	6/2/2021	1,821
Interest rate swap MXN	1,500,000	113,458	5.50	28 day Mexican TIIE	9/2/2022	(2,361)
Interest rate swap MXN	8,000,000	615,926	5.75	28 day Mexican TIIE	9/2/2022	(1,823)
Interest rate swap MXN	1,600,000	122,225	5.75	28 day Mexican TIIE	6/5/2023	(1,404)
Interest rate swap MXN	1,200,000	93,346	6.00	28 day Mexican TIIE	6/5/2023	615
Interest rate swap MXN	30,000,000	2,322,492	7.74	28 day Mexican TIIE	5/29/2024	9,997
Interest rate swap MXN	145,000,000	11,221,566	7.65	28 day Mexican TIIE	5/30/2024	44,506
Interest rate swap NZD	100,000,000	87,354,600	4.00	3 month NZD Bank Bill	12/11/2015	(200,414)
Total receive fixed interest rate swaps:		**$633,479,414**				**$5,254,975**
Pay Fixed Inflation-Linked Swaps:						
Inflation swap USD	500,000	$492,418	U.S. CPI URNSA	2.42%	2/12/2017	($7,582)
Inflation swap USD	25,400,000	25,047,898	U.S. CPI URNSA	2.25	7/15/2017	(352,476)
Inflation swap USD	3,800,000	3,817,450	U.S. CPI URNSA	2.09	10/11/2017	17,450
Inflation swap USD	3,000,000	3,006,414	U.S. CPI URNSA	2.21	10/11/2018	6,414
Inflation swap USD	18,200,000	17,880,608	U.S. CPI URNSA	2.50	7/15/2022	(319,392)
Inflation swap USD	2,100,000	2,069,850	U.S. CPI URNSA	2.56	5/8/2023	(30,150)
Total Pay Fixed Inflation-Linked Swaps:		**$52,314,638**				**($685,736)**

CDI - Cetip Interbank Deposit (interbank lending rate)
CPI - Consumer Price Index
TIIE - Mexico Interbank Equilibrium Interest Rate
CDOR - Canadian Dollar Offered Rate
LIBOR - London Interbank Offered Rate
URNSA - Urban Consumers NSA Index Rate

DERIVATIVE CREDIT RISK

Credit risk is the possibility that a loss may occur because a party to a transaction fails to perform according to the established terms. In order to eliminate credit risk, derivative securities are traded through a clearing house which guarantees delivery and accepts the risk of default by either party. Derivatives which are exchange traded are not subject to credit risk and are evaluated within the investment risk disclosure.

Non-exchange traded derivative instruments may expose TRS to credit/counterparty risk. TRS investment managers reduce credit risk by evaluating the credit quality and operational capabilities of the counterparties. Because the counterparty risk of a security will fluctuate with market movements, all TRS managers using non-exchange traded derivatives operate a collateral call process ensuring full collateralization of these derivatives. TRS does not have a policy regarding master netting arrangements.

As of June 30, 2014, the aggregate fair value of non-exchange traded derivative instruments in asset positions was $35,623,112. All applicable futures, options and swaps are in compliance with Dodd-Frank requirements and cleared through the appropriate futures and swaps exchanges. The counterparty risk exposure below is primarily unsettled currency forward contracts. This represents the maximum loss that would be recognized at the reporting date if all counterparties failed to perform as contracted.

Counterparty Ratings for Non-Exchange Traded Derivatives

Quality Rating	Fair Value at June 30, 2014
Aa2	$312,237
Aa3	6,771,065
A1	8,549,001
A2	7,354,386
A3	4,091,229
Baa1	8,087,002
Baa2	386,645
Baa3	71,547
Total subject to credit risk	**$35,623,112**

Although the derivative instruments held within the TRS investment portfolio are executed with various counterparties, approximately 94 percent of the net market value exposure to credit risk is for non-exchange traded derivative contracts held with 10 counterparties.

5. INVESTMENT COMMITMENTS

As of June 30, 2014, TRS had commitments for the future purchase of investments in real estate of $819.4 million and private equity partnerships of $3.7 billion.

6. RATE OF RETURN

For the year ended June 30, 2014, the annual money-weighted rate of return on pension plan investments, net of investment expense, was 17.4 percent. The money-weighted rate of return expresses investment performance, net of investment expense, adjusted for the timing of cash flows and the changing amounts actually invested.

E. RESERVES

TRS maintains statutory reserve accounts in accordance with the provisions of 40 ILCS 5/16-101 et seq. In 1997, the Illinois General Assembly passed legislation that allowed the crediting of income at fair value, as opposed to book value, to the Benefit Trust Reserve.

1. BENEFIT TRUST

	2014
Balances at June 30	$45,817,133,317

This reserve serves as a clearing account for TRS income and expenses. The reserve is credited with contributions from the State of Illinois that are not specifically allocated to the Minimum Retirement Annuity Reserve, member and employer contributions, income from TRS invested assets, and contributions from annuitants who qualify for automatic annual increases in annuity.

The reserve accumulates, with 6 percent interest, the contributions by members prior to retirement. Contributions have been 7.5 percent of salary since July 1, 1998. Contributions are fully refundable upon withdrawal from TRS, excluding interest credited thereon. The interest accrued is refundable only in the event of death. Interest is credited as of the date of retirement or death of those retiring or dying during the year and as of the end of the fiscal year for all other members. Interest is computed annually based upon the individual member's balance in the reserve at the beginning of the fiscal year.

This reserve is charged for transfers to the Minimum Retirement Annuity Reserve and all

- refunds to withdrawing members,
- retirement annuity payments (except as provided by the Minimum Retirement Annuity Reserve),
- benefits that are paid to disabled members,
- death benefits paid and
- refunds to annuitants for survivor benefit contributions.

The expected benefit payments do not equal the present value of the reserve. The additional amount needed (the unfunded actuarial accrued liability) as calculated by the actuary was $61.6 billion in FY14, based on the actuarial value of assets.

2. MINIMUM RETIREMENT ANNUITY

	2014
Balances at June 30	$7,249,197

The minimum annuity is set by law at $25 per month for each year of creditable service to a maximum of $750 per month after 30 or more years of creditable service. To qualify, annuitants are required to make a one-time contribution that is credited to the reserve. Interest at 6 percent is credited to the reserve annually based upon the average reserve balance. The State of Illinois also appropriated funds necessary to pay the minimum benefits. All benefits paid under this program are charged to the reserve. This reserve is fully funded.

F. PENSION AND OTHER POST-EMPLOYMENT BENEFITS FOR TRS EMPLOYEES

TRS employees are covered by either the State Employees' Retirement System of Illinois or the Teachers' Retirement System of the State of Illinois. Also, most employees are eligible for other types of post-employment benefits.

STATE EMPLOYEES' RETIREMENT SYSTEM (SERS)

1. PLAN DESCRIPTION FOR SERS

TRS employees who do not participate in TRS are covered by the State Employees' Retirement System (SERS), a pension trust fund in the State of Illinois reporting entity. SERS is a single-employer defined benefit public employee retirement system. SERS provides retirement, disability and death benefits to plan members and beneficiaries. Automatic annual post-retirement increases are provided. SERS is governed by Article 14 of the Illinois pension code, 5 ILCS 40/14-101 and following as well as the Illinois Administrative Code, Title 80, Subtitle D, Chapter I. SERS issues a publicly available financial report that includes financial statements and required supplemental information. It may be obtained at **www.state.il.us/srs** or by writing to SERS at 2101 South Veterans Parkway, Springfield, Illinois, 62794-9255. SERS's financial position and results of operations are also included in the State of Illinois *Comprehensive Annual Financial Report*. This report may be obtained at **www.ioc.state.il.us**, or by writing to the Office of the Comptroller, Financial Reporting Department, 325 West Adams Street, Springfield, Illinois, 62704-1858.

2. FUNDING POLICY FOR SERS

The contribution requirements of SERS members and the State are established by state statute and may be amended by action of the General Assembly and the Governor. TRS employees covered by SERS contribute 4.0 percent of their annual covered salaries. The State contribution rate for the year ended June 30, 2014 was determined according to a statutory schedule.

TRS contribution rate to SERS for its SERS-covered employees for the year ended June 30, 2014 was 40.312 percent. TRS paid the required contributions of $2,196,556.

TEACHERS' RETIREMENT SYSTEM (TRS)

1. PLAN DESCRIPTION FOR TRS

A summary description of the TRS plan can be found within these notes to the financial statements at "A. Plan Description."

2. FUNDING POLICY FOR TRS

TRS employees who participate in TRS are required to contribute 9.4 percent of their annual covered salaries. For employees who were members of TRS on August 17, 2001 and for employees hired on or after that date, TRS contributes 0.58 percent of the employees' annual covered salaries. Additional employer contributions for these employees are paid by the State of Illinois and are included in the annual State contribution to TRS. TRS's contributions for participating employees for the year ended June 30, 2014 was $26,296. This amount represents 100 percent of the required contributions.

OTHER POST-EMPLOYMENT BENEFITS FOR TRS EMPLOYEES

The State provides health, dental, vision and life insurance benefits for retirees and their dependents in a program administered by the Department of Central Management Services (CMS). Substantially all State employees become eligible for post-employment benefits if they eventually become annuitants of one of the State-sponsored pension plans. Health, dental, and vision benefits include basic benefits for annuitants and dependents under the State's self-insurance plan and insurance contracts currently in force. Annuitants may be required to contribute towards health, dental, and vision benefits with the amount based on factors such as date of retirement, years of credited service with the State, whether the annuitant is covered by Medicare, and whether the annuitant has chosen a managed health care plan. Employees of the System who retired before January 1, 1998 and are vested in either SERS or TRS do not contribute towards health and vision benefits. A premium is required for dental. For annuitants who retired on or after January 1, 1998, the annuitant's contribution amount is reduced 5 percent for each year of credited service with the State allowing those annuitants with 20 or more years of credited service to not have to contribute towards health and vision benefits. A premium is required for dental. 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.

Public Act 97-0695 was signed into law on June 21, 2012. Effective July 1, 2013, all retirees within state retirement systems began paying a premium for health and vision benefits at a rate determined by CMS. The rate was a percentage of the retiree's annuity and differed depending on whether the retiree was enrolled in Medicare. Due to an Illinois Supreme Court decision in July of 2014, Public Act 97-0695 was suspended and the collection of premiums was stopped. All premiums collected are expected to be refunded.

The State pays the TRS 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 for 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 for CMS. A copy of the financial statements may be obtained by writing to their office, Department of Central Management Services, 704 Stratton Office Building, Springfield, Illinois, 62706.

G. SUBSEQUENT EVENTS

On December 5, 2013, Governor Pat Quinn signed into law Public Act 98-0599. This new law significantly altered the funding structure of TRS and reduced the retirement benefits for Tier I members. The act was set to take effect on June 1, 2014.

In December of 2013 and January of 2014, lawsuits were filed that challenged the constitutionality of Public Act 98-0599. A court injunction was issued in May of 2014 to delay the implementation of the new pension law pending the outcome of the court challenge.

On November 21, 2014, a Sangamon County Circuit Court ruled that Public Act 98-0599 was unconstitutional and void in its entirety. The State, represented by the Illinois attorney general, appealed that decision directly to the Illinois Supreme Court. A decision from the high court is expected during 2015.

REQUIRED SUPPLEMENTARY INFORMATION

Schedule of Changes in the Net Pension Liability for Fiscal Year:

	2014
Total pension liability	
Service cost	$1,894,351,211
Interest	7,561,104,814
Changes of benefit terms	-
Difference between expected and actual experience	39,950,212
Change of assumptions*	-
Benefit payments, including refund of member contributions	(5,320,662,979)
Net change in total pension liability	4,174,743,258
Total pension liability - beginning	102,507,911,628
Total pension liability - ending (a)	$106,682,654,886
Plan fiduciary net position	
Contributions - employer	$158,334,598
Contributions - nonemployer contributing entity	3,438,382,892
Contributions - member	928,745,853
Net investment income	6,782,031,720
Benefit payments, including refund of member contributions	(5,320,662,979)
Administrative expense	(21,218,069)
Other	-
Net change in plan fiduciary net position	5,965,614,015
Plan fiduciary net position - beginning	39,858,768,499
Plan fiduciary net position - ending (b)	$45,824,382,514
Employers' net pension liability - ending (a) - (b)	$60,858,272,372

**No value is shown for Change of assumptions because both the beginning and the ending total pension liability are based on the actuarial assumptions adopted in the June 30, 2014 valuation.*
Assumptions: See GASB Statement No. 67 assumptions in table on page13.

Schedule of the Net Pension Liability* for Fiscal Year:

	2014
Total pension liability	$106,682,654,886
Plan fiduciary net position	45,824,382,514
Net pension liability*	$60,858,272,372
Net pension liability – beginning of year	$62,649,143,129
Change in net pension liability	1,790,870,757
Plan fiduciary net position as a percentage of the total pension liability	43.0%
Covered-employee payroll	$9,512,809,680
Net pension liability as a percentage of covered-employee payroll	639.8%

** Combined for nonemployer contributing entity and employers*
Assumptions: See GASB Statement No. 67 assumptions in table on page 13.

Schedule of Investment Returns for Fiscal Year:

	2014
Annual money-weighted rate of return, net of investment expense	17.4%

Schedule of Contributions from Employers and Other Contributing Entities
Last 10 Fiscal Years
($ thousands)

	2014	2013	2012	2011	2010	2009	2008	2007	2006	2005
Actuarially determined contribution (ADC)	$4,091,978	$3,582,033	$3,429,945	$2,743,221	$2,481,914	$2,109,480	$1,949,463	$2,052,396	$1,679,524	$1,683,212
Contributions in relation to the actuarially determined contribution:*										
State	3,437,478	2,702,278	2,405,172	2,169,518	2,079,129	1,449,889	1,039,195	735,515	531,828	903,928
Federal & Employer Contributions	157,228	155,787	153,409	154,150	170,653	151,716	130,578	81,155	69,645	83,434
Total contributions	3,594,706	2,858,065	2,558,581	2,323,668	2,249,782	1,601,605	1,169,773	816,670	601,473	987,362
Contribution deficiency	$497,272	$723,968	$871,364	$419,553	$232,132	$507,875	$779,690	$1,235,726	$1,078,051	$695,850
Covered-employee payroll	$9,512,810	$9,394,741	$9,321,098	$9,205,603	$9,251,139	$8,945,021	$8,521,717	$8,149,849	$7,765,752	$7,550,510
Contributions as a percentage of covered-employee payroll	37.8%	30.4%	27.4%	25.2%	24.3%	17.9%	13.7%	10.0%	7.7%	13.1%

** Contributions for minimum benefits from the state and for excess sick from employers do not count towards actuarial funding requirements. Beginning in FY08, employer ERO contributions are included because the costs of the ERO program are now included in the actuarial accrued liability. Beginning in FY06, employer contributions for excess salary increases are included. However, employer contributions for excess sick leave, which also began in FY06, are not included because there is no assumption for excess sick leave and it is not included in the funding requirements.*

NOTES TO REQUIRED SUPPLEMENTARY INFORMATION

The Schedule of Contributions from Employers and Other Contributing Entities compares actual and actuarially determined contributions. There is a difference between these amounts because actual contributions are based on state statute under a methodology that does not conform to that used to determine the actuarially determined contribution.

The following assumptions were used to determine the statutory and actuarially determined contributions for FY14:

	For Funding per State Statute	For Determining the Actuarially Determined Contribution
Valuation Used to Determine Funding Amount	June 30, 2012	June 30, 2012
Actuarial Cost Method:	Projected unit credit	Projected unit credit
Amortization Method:	15-year phase-in to a level percent of payroll reached in FY10; then level percent of payroll until a 90 percent funding level is achieved in FY45	Level percent of payroll
Remaining Amortization:	31 years, closed	30 years, open
Asset Valuation Method:	Actuarial value of assets	Actuarial value of assets

OTHER SUPPLEMENTARY INFORMATION

Schedule of Administrative Expenses
for the Years Ended June 30

	2014	2013
Personnel services		
Salaries	$10,015,342	$9,481,562
Retirement contributions	2,223,899	2,097,086
Insurance and payroll taxes	3,648,898	3,904,026
	15,888,139	15,482,674
Professional services		
Actuarial services	569,979	315,309
External auditors	128,282	166,629
Legal services	446,242	532,242
Internal audit consulting	0	68,028
Legislative consulting	84,000	84,000
Salary review consulting	0	35,721
Information systems consulting	46,150	17,250
Operations consulting	50,329	237,008
Other	15,040	4,657
	1,340,022	1,460,844
Communications		
Postage	192,065	253,734
Printing and copying	171,855	131,484
Telephone	260,206	225,360
	624,126	610,578
Other expenses		
Administrative services	193,276	208,255
Building operations and maintenance	601,630	491,791
EDP supplies and equipment	164,654	262,683
Equipment repairs, rental and maintenance	286,121	284,505
Insurance	385,017	11,762
Memberships and subscriptions	34,854	30,320
Office equipment and furniture	27,253	13,953
Office supplies	30,422	34,081
Software licenses and maintenance	350,673	250,271
Travel, conferences, education	169,425	203,943
	2,243,325	1,791,564
Depreciation expense	1,122,457	911,893
Total administrative expenses	$21,218,069	$20,257,553

Schedule of Investment Expenses for the Year Ended June 30, 2014

	2014
Investment manager fees	$245,952,483
Master custodian fees	
State Street Bank and Trust Company	1,900,000
Consulting services	
Albourne America, L.L.C.	151,190
Callan Associates, Inc.	255,500
LP Capital Advisors, L.L.C.	65,000
RVK, Inc.	485,000
Real Asset Portfolio Management, L.L.C.	55,050
Risk Resources	67,116
Stout Risius Ross, Inc.	265,000
TorreyCove Capital Partners, L.L.C.	966,903
Legal services	
Jackson Walker, L.L.P.	461,456
Tax advisory services	
Ernst & Young, L.L.P.	66,615
KPMG, Ltd.	10,621
Other investment expenses	
Private equity expenses	20,343,738
Foreign tax expense	16,100,190
Dividend expense	3,280,099
Investment activity expenses	5,410,584
Personnel costs	3,729,269
Investment analytical systems	305,129
Auditing costs	182,438
Education, meetings and travel	96,231
Research, subscriptions and memberships	15,061
Other costs	92,597
Total investment expense	$ 300,257,270

Schedule of Professional Services for the Years Ended June 30

	2014	2013
Actuarial services		
Buck Consultants, L.L.C.	$569,979	$315,309
External auditors		
Office of the Auditor General	128,282	166,629
Legal services		
Cavanagh & O'Hara	28,895	27,292
Holland & Knight, L.L.P.	385,311	388,842
Howard & Howard Attorneys PC	7,056	65,480
Jackson Walker, L.L.P.	0	3,060
Kopec White & Spooner	3,027	13,759
Loewenstein Hagen & Smith	18,734	25,608
Sorling Northrup	3,219	8,201
	446,242	532,242
Internal audit consulting		
Investment Training & Consulting Institute	0	68,028
Legislative consulting		
Leinenweber Baroni Daffada, L.L.C.	84,000	84,000
Salary review consulting		
The Waters Consulting Group	0	35,721
Information systems consulting		
AT&T Global Services, Inc.	2,700	0
Brent Ozar PLF, L.L.C.	5,500	16,600
CommVault Systems, Inc.	9,800	0
CTG Inc. of Illinois	28,150	0
ISI Telemanagement Solutions	0	650
	46,150	17,250
Operations consulting		
Graham & Hyde	15,094	5,558
Laserfiche Solutions Group	0	178,200
LRWL, Inc.	15,123	0
Management Association	20,112	0
McAfee, Inc.	0	34,750
Securance, Inc.	0	18,500
	50,329	237,008
Other	15,040	4,657
Total professional services	$1,340,022	$1,460,844

McGladrey

Independent Auditor's 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
Springfield, Illinois

Board of Trustees
Teachers' Retirement System of the State of Illinois
Springfield, Illinois

As Special Assistant Auditors for the Auditor General, we have 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 Statement of Plan Net Position and Statement of Changes in Plan Net Position of the Teachers' Retirement System of the State of Illinois (System), as of and for the year ended June 30, 2014, and the related notes to the financial statements, and have issued our report thereon dated January 6, 2015.

Internal Control Over Financial Reporting

In planning and performing our audit of the financial statements, we considered the System's internal control over financial reporting (internal control) to determine the audit procedures that are appropriate in the circumstances for the purpose of expressing our opinion on the financial statements, but not for the purpose of expressing an opinion on the effectiveness of the System's internal control. Accordingly, we do not express an opinion on the effectiveness of the System's internal control.

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. 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.

Our consideration of internal control was for the limited purpose described in the first paragraph of this section and was not designed to identify all deficiencies in internal control that might be material weaknesses or significant deficiencies, and therefore, material weaknesses or significant deficiencies may exist that were not identified. Given these limitations, during our audit we did not identify any deficiencies in internal control of the System that we consider to be material weaknesses. However, material weaknesses may exist that have not been identified. We did identify a deficiency in internal control, described in the accompanying schedule of findings as item 2014-001 that we consider to be a significant deficiency.

Compliance and Other Matters

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

Response to Findings

The System's response to the finding identified in our audit is described in the accompanying schedule of findings. The System's response was not subjected to the auditing procedures applied in the audit of the financial statements and, accordingly, we express no opinion on the response.

Purpose of this Report

The purpose of this report is solely to describe the scope of our testing of internal control and compliance and the results of that testing, and not to provide an opinion on the effectiveness of the System's internal control or on compliance. This report is an integral part of an audit performed in accordance with *Government Auditing Standards* in considering the System's internal control and compliance. Accordingly, this communication is not suitable for any other purpose.

McGladrey LLP

Schaumburg, Illinois
January 6, 2015

Government Auditing Standards

Finding No. 2014-001   Controls over Census Data

The Teachers' Retirement System of the State of Illinois (System) has weaknesses in controls over creditable earnings and member census data reported by its participating employers.

During testing of the System's internal controls over creditable earnings and member census data, it was noted that creditable earnings and member census data for the System is accumulated from multiple participating employers which increases the likelihood of errors within the data. The System's current processes and controls for verifying the data rely heavily on the reporting of the information by the participating employers and there are limited controls in place by the System to verify the creditable earnings and member census information.

System management is responsible for the design, implementation, and maintenance of internal control relevant to the preparation and fair presentation of financial statements that are free from material misstatement, whether due to error or fraud. System controls should encompass effective management processes and controls to sufficiently address the appropriate risks and verify the underlying payroll records of participating employer census data which would include completeness and accuracy of census data. This includes processes and controls over significant elements of census data which originates in multiple locations across the System's participating employers.

The Fiscal Control and Internal Auditing Act (30 ILCS 10/3001) requires all State agencies, including the System, to establish and maintain a system or systems, of internal fiscal administrative controls, such that information is properly recorded and accounted for to permit the preparation of reliable financial and statistical reports.

System management indicated the System did not have procedures in place to conduct employer audits or other controls to verify census data.

Certain financial statement assertions relating to cost-sharing plans (that is, the Total Pension Liability (TPL) and revenues and receivables relating to Contributions) are dependent on the completeness and accuracy of census data. Weaknesses in controls over the significant elements of census data could lead to a misstatement in the valuation of the TPL, a required disclosure to the System's financial statements. In addition, a misstatement could lead to a misstatement in contributions which directly impacts valuation of Plan Net Position and the financial statements of the System directly. A misstatement within the financial statements will impact the calculation of the Net Pension Liability (NPL) as required under GASB statement No. 67, *Financial Reporting for Pension Plans - An Amendment to GASB Statement No. 25*. A misstatement of the NPL will also impact the allocation of the NPL and related pension activity to participating employers under GASB Statement No. 68, *Accounting and Financial Reporting for Pensions – An Amendment of GASB Statement No. 27*. The auditors consider the weaknesses to be significant deficiencies in the System's internal control over financial and fiscal operations. (Finding Code No. 2014-001)

Recommendation:

We recommend the System update current processes and controls to include the verification of significant elements of census data.

Government Auditing Standards

Finding No. 2014-001 Controls over Census Data (Continued)

System Response:

The System concurs with this finding and will implement processes and controls to include verification of census data from our members.