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

Compliance Examination

Year ended June 30, 2005

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

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

Table of Contents

The annual financial statements of the Illinois State Board of Investment for the year ended June 30, 2005 were issued under a separate cover.

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

Agency Officials

Executive Director	Mr. William R. Atwood
Deputy Director	Ms. Katherine A. Spinato

Illinois State Board of Investment Office is located at:

180 N. LaSalle Street
Suite 2105
Chicago, Illinois 60601

ILLINOIS STATE BOARD OF INVESTMENT
180 North LaSalle Street, Suite 2015
Chicago, Illinois 60601
(312) 793-5718

Management Assertion Letter

October 28, 2005

KPMG LLP
303 East Wacker Drive
Chicago, Illinois 60601

Ladies and Gentlemen:

We are responsible for the identification of, and compliance with, all aspects of laws, regulations, contracts, or grant agreements that could have a material effect on the operations of the Illinois State Board of Investment (Board). We are responsible for and we have established and maintained an effective system of internal controls over compliance requirements. We have performed an evaluation of the Board's compliance with the following assertions during the year ended June 30, 2005. Based on this evaluation, we assert that during the year ended June 30, 2005, the Board has materially complied with the assertions below.

A. The Board has obligated, expended, received, and used public funds of the State in accordance with the purpose for which such funds have been appropriated or otherwise authorized by law.

B. The Board has obligated, expended, received, and used public funds of the State in accordance with any limitations, restrictions, conditions, or mandatory directions imposed by law upon such obligation, expenditure, receipt or use.

C. The Board has complied, in all material respects, with applicable laws and regulations, including the State uniform accounting system, in its financial and fiscal operations.

D. The State revenues and receipts collected by the Board are in accordance with applicable laws and regulations and the accounting and recordkeeping of such revenues and receipts is fair, accurate, and in accordance with law.

E. The money or negotiable securities or similar assets handled by the Board on behalf of the State or held in trust by the Board have been properly and legally administered, and the accounting and recordkeeping relating thereto is proper, accurate, and in accordance with law.

Very truly yours,

ILLINOIS STATE BOARD OF INVESTMENT

William Atwood
Executive Director

Katherine Spinato
Deputy Executive Director

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

Compliance Report

Summary

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

Auditors' Reports

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

Summary of Audit Findings

	This report	Prior report
Number of:		
Findings	1	1
Repeated findings	—	—
Prior recommendations implemented or not repeated	1	—

Details of findings are presented in a separately tabbed report section.

Schedule of State Findings and Questioned Costs

Current Year Findings:

Item No.	Page	Description
05-1	9	Deposit Custodial Credit Risk

Prior Findings Not Repeated:

Item No.	Page	Description
05-2	11	Final Work Product not Specified in Professional Services Contracts

Exit Conference

The Board reviewed the entire report and waived a formal exit conference.

KPMG LLP
303 East Wacker Drive
Chicago, IL 60601-5212

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

Honorable William G. Holland
Auditor General
State of Illinois

Compliance

As Special Assistant Auditors for the Auditor General, we have examined the Illinois State Board of Investment's compliance with the requirements listed below, as more fully described in the Audit Guide for Financial Audits and Compliance Attestation Engagements of Illinois State Agencies (Audit Guide) as adopted by the Auditor General, during the year ended June 30, 2005. The management of the Illinois State Board of Investment (the Board) is responsible for compliance with these requirements. Our responsibility is to express an opinion on the Board's compliance based on our examination.

A. The Board has obligated, expended, received, and used public funds of the State in accordance with the purpose for which such funds have been appropriated or otherwise authorized by law.

B. The Board has obligated, expended, received, and used public funds of the State in accordance with any limitations, restrictions, conditions, or mandatory directions imposed by law upon such obligation, expenditure, receipt, or use.

C. The Board has complied, in all material respects, with applicable laws and regulations, including the State uniform accounting system, in its financial and fiscal operations.

D. The State revenues and receipts collected by the Board are in accordance with applicable laws and regulations and the accounting and recordkeeping of such revenues and receipts is fair, accurate, and in accordance with law.

E. Money or negotiable securities or similar assets handled by the Board on behalf of the State or held in trust by the Board have been properly and legally administered and the accounting and recordkeeping relating thereto is proper, accurate, and in accordance with law.

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

In our opinion, the Illinois State Board of Investment complied, in all material respects, with the aforementioned requirements during the year ended June 30, 2005. However, the results of our procedures disclosed an instance of noncompliance with those requirements, which is required to be reported in accordance with criteria established by the Audit Guide, issued by the Illinois Office of the Auditor General and which is described in the accompanying schedule of State findings and questioned costs as finding 05-1.

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

Internal Control

The management of the Board is responsible for establishing and maintaining effective internal control over compliance with the requirements of laws and regulations. In planning and performing our examination, we considered the Board’s internal control over compliance with the aforementioned requirements in order to determine our examination procedures for the purpose of expressing our opinion on compliance and to test and report on internal control over compliance in accordance with the Audit Guide, issued by the Illinois Office of the Auditor General.

Our consideration of internal control over compliance with the aforementioned requirements would not necessarily disclose all matters in internal control that might be material weaknesses. A material weakness is a reportable condition in which the design or operation of one or more internal control components does not reduce to a relatively low level the risk that noncompliance with applicable requirements of laws and regulations caused by error or fraud that would be material in relation to one or more of the aforementioned requirements being examined may occur and not be detected within a timely period by employees in the normal course of performing their assigned functions. We noted no matters involving internal control over compliance that we consider to be material weaknesses.

There were no immaterial findings relating to internal control deficiencies that have been excluded from this report.

Supplementary Information for State Compliance Purposes

As Special Assistant Auditors for the Auditor General, we have audited the basic financial statements of the Board as of and for the years ended June 30, 2005 and 2004, and have issued our report thereon dated October 28, 2005. The accompanying supplementary information, as listed in the table of contents as Supplementary Information for State Compliance Purposes, is presented for purposes of additional analysis and is not a required part of the basic financial statements of the Board. Such information, except for that portion marked “unaudited” on which we express no opinion, has been subjected to the auditing procedures applied in the audit of the basic financial statements and, in our opinion, is fairly stated in all material respects in relation to the basic financial statements taken as a whole.

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

KPMG LLP

Chicago, Illinois
October 28, 2005

KPMG LLP
303 East Wacker Drive
Chicago, IL 60601-5212

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

Honorable William G. Holland
Auditor General
State of Illinois

As Special Assistant Auditors for the Auditor General, we have audited the basic financial statements of the Illinois State Board of Investment (the Board), an internal investment pool of the State of Illinois, as of and for the year ended June 30, 2005, and have issued our report thereon dated October 28, 2005. We conducted our audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States.

Internal Control over Financial Reporting

In planning and performing our audit, we considered the Board's internal control over financial reporting in order to determine our auditing procedures for the purpose of expressing our opinion on the financial statements and not to provide an opinion on the internal control over financial reporting. Our consideration of the internal control over financial reporting would not necessarily disclose all matters in the internal control that might be material weaknesses. A material weakness is a reportable condition in which the design or operation of one or more of the internal control components does not reduce to a relatively low level the risk that misstatements caused by error or fraud in amounts that would be material in relation to the financial statements being audited may occur and not be detected within a timely period by employees in the normal course of performing their assigned functions. We noted no matters involving the internal control over financial reporting and its operation that we consider to be material weaknesses.

Compliance and Other Matters

As part of obtaining reasonable assurance about whether the Board's financial statements are free of material misstatement, we performed tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreement 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*. However, we noted certain matters which are reported as a State compliance finding in the schedule of State findings and questioned costs. We also noted certain matters which we have reported to management of the Board in a separate letter dated October 28, 2005.

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

KPMG LLP

Chicago, Illinois
October 28, 2005

Finding #05-1 – Deposit Custodial Credit Risk

The Illinois State Board of Investment (Board) identified deposits in their June 30, 2005 financial statements that were exposed to custodial credit risk. In addition, the Board disclosed they did not have a formal deposit policy to address custodial credit risk.

The Board's financial statements are prepared in accordance with generally accepted accounting standards (standards). The Governmental Accounting Standards Board (GASB) establishes those standards. GASB Statement No. 40, Deposit and Investment Risk Disclosures (GASB 40), became effective for fiscal year 2005 as a standard for the Board. GASB 40 requires the Board to disclose information regarding deposits and investments that are subject to various risks, with custodial credit risk being one of those risks. GASB 40 defines custodial credit risk as the risk that in the event of a financial institution failure, the Board would not be able to recover the value of the deposits or investments in the possession of an outside party.

At June 30, 2005, the Board had $13,501,974 of deposits held in their investment related bank account. The deposits were neither insured nor collateralized for amounts in excess of the federal deposit insurance coverage of $100,000.

The State Officers and Employees Money Disposition Act (30 ILCS 230/2c) provides that whenever funds deposited with a bank or savings and loan association exceed the amount of federal deposit insurance coverage, a bond, pledged securities, or other eligible collateral shall be obtained. Also, prudent business practices dictate that assets be protected from possible loss.

Board management indicated they have researched The State Officers and Employees Money Disposition Act (30 ILCS 230/2c) and believe that it is not applicable to the Board or any State pension funds.

Failure to address custodial credit risk subjects the deposits of the Board to a risk of loss in the event of a financial institution failure. (Finding Code No. 05-1)

Recommendation:

We recommend the Board develop a formal policy to address custodial credit risk as it relates to deposits.

(Continued)

Agency Response:

Illinois State Board of Investment (ISBI) financial statements are prepared in accordance with generally accepted accounting standards which are defined by The Governmental Accounting Standards Board (GASB). GASB Statement No. 40, *Deposit and Investment Risk Disclosures* (GASB 40), became effective for fiscal year 2005, requiring disclosure of deposits and investments exposed to custodial risk. As required by GASB 40, ISBI disclosed deposits and investments exposed to custodial risk in its fiscal year 2005 financial statements.

Further, where an entity has not adopted a formal policy regarding deposits and investments exposed to custodial credit risk, GASB 40 requires disclosure of an entity's deposit and investment policies, if any. In compliance with this disclosure requirement, ISBI stated that a formal policy regarding deposits and investments exposed to custodial credit risk did not exist.

The Illinois Pension Code authorizes the Board to adopt rules and regulations that, in its discretion, are desirable. Annual reporting required by statute includes "…a review of the policies maintained by the board and any changes therein that occurred during the year." Therefore, ISBI was in compliance with the Illinois Pension Code governing the Board.

ISBI had $13,501,974 of deposits held in investment accounts with the custodian. First, this amount represented 0.12% of the Board's total assets at June 30, 2005 and is considered to be immaterial. Secondly, ISBI counsel is of the opinion that ISBI is not subject to The State Officers and Employees Money Disposition Act (30 ILCS 230/2c).

In conclusion, the Board will consider whether adopting a policy regarding custodial credit risk is necessary. The Board is requesting an Attorney General opinion regarding the applicability of The State Officers and Employees Money Disposition Act to ISBI.

Auditors' Comment:

The State Officers and Employees Money Disposition Act (30 ILCS 230/1 *et seq*.) (the Act) applies to "[t]he officers of the Executive Department of State Government…and all other officers, boards, commissions, commissioners, departments, institutions, arms or agencies, or agents of the Executive Department of the State government…" 30 ILCS 230/1. The Board is created by State statute and performs essential State governmental functions. Therefore, the auditors believe that the Board is a part of the Executive branch of State government and is subject to the provisions of the Act. If the Board continues to disagree with the applicability of the Act to its operations, we further recommend it seeks a formal, written Attorney General opinion on this matter.

(Continued)

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

Schedule of State Findings and Questioned Costs

Prior Findings Not Repeated

Year ended June 30, 2005

Finding #05-2 – Final Work Product not Specified in Professional Services Contracts

The Illinois State Board of Investment (Board) entered into professional services contracts with two former employees that did not adequately specify the final work product. (Finding Code No. 04-1)

Status of Corrective Action

During our current year testwork, we noted the contracts tested adequately specified the final work product.

ILLINOIS STATE BOARD OF INVESTMENT
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Supplementary Information for State Compliance Purposes

Year ended June 30, 2005

Summary

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

Fiscal Schedules and Analysis:

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

Analysis of Operations:

- Board Functions and Planning Program
- Number of Employees
- Derivative Securities
- Securities Lending Program
- Subsequent Events
- Emergency Purchases
- Proceeds from General Obligation Bonds (Unaudited)
- New Legislation
- Service Efforts and Accomplishments (Unaudited)

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

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

Fiscal Schedules and Analysis

Comparative Schedule of Operations

Years ended June 30, 2005 and 2004

	2005	2004	Increase (decrease)
Investment income:			
Interest	$ 142,444,438	95,062,599	47,381,839
Dividends	119,713,292	89,316,960	30,396,332
Securities lending	3,674,829	2,351,632	1,323,197
Realized gain on investments	505,168,829	729,227,862	(224,059,033)
Unrealized gain on investments	260,921,934	608,739,087	(347,817,153)
Total investment income	1,031,923,322	1,524,698,140	(492,774,818)
Expenses:			
Salaries and benefits	1,082,345	888,090	194,255
Operating	374,817	364,415	10,402
External support	23,025,047	16,653,035	6,372,012
Total expenses	24,482,209	17,905,540	6,576,669
Net investment income	$ 1,007,441,113	1,506,792,600	(499,351,487)

ILLINOIS STATE BOARD OF INVESTMENT
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Fiscal Schedules and Analysis

Schedule of Investment Portfolio

June 30, 2005

Market value	Amount	Percentage of portfolio
Equities:		
Common stocks:		
U.S. equities:		
Consumer discretionary	$ 911,979,964	8.32%
Consumer staples	324,734,700	2.96
Energy	469,996,387	4.29
Financials	1,180,048,942	10.77
Healthcare	593,439,038	5.41
Industrials	816,251,339	7.45
Information Technology	774,874,120	7.07
Materials	140,667,815	1.28
Telecommunication Services	125,260,624	1.14
Utilities	128,350,513	1.17
Other	114,208,754	1.04
Non-U.S. equities	986,200,950	9.00
Preferred stock	487,946	—
Total equities	6,566,501,092	59.90%
Fixed income securities:		
Government obligations:		
U.S. Government	556,169,172	5.08
Federal agencies	544,212,466	4.97
Municipal	11,978,790	0.11
Foreign obligations	198,858,369	1.81
Corporate obligations:		
Bank and finance	392,252,843	3.58
Collateralized mortgage obligations	68,338,116	0.62
Industrials	798,619,662	7.29
Miscellaneous/Other	292,555,969	2.67
Convertible bonds	1,404,244	0.01
Total fixed income securities	2,864,389,631	26.14
Real estate investments	778,951,123	7.11
Alternative investments	466,871,030	4.26
Money market investments	283,461,008	2.59
Forward foreign currency contracts	(497,874)	—
Total investments	$ 10,959,676,010	100.00%

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

Fiscal Schedules and Analysis

Schedule of Investment Manager Fees

June 30, 2005 and 2004

		2005	2004
Alliance Capital	$	—	372,984
Amalgamated Bank NY		44,759	—
Ariel		599,621	587,595
Ativo		5,952	—
Atlanta Life		30,399	—
Bear Stearns and Company		925,352	117,962
Blackrock		1,078,151	874,618
Buford, Dixon		92,626	8,039
Capital Guardian		746,444	1,352,378
Channing		36,086	—
Chicago Equity Partners		145,716	—
Earnest Partners		641,283	189,677
Fifth Third Bank		436,649	159,840
Fort Washington		445,441	—
Geewax Terker		286,476	1,231,036
Globeflex Capital		230,095	—
Goldman Sachs		1,336,840	61,184
Harris Investment Management		277,072	470,198
Harris Investment Management-High Yield		510,479	—
High Pointe		156,360	16,773
Holland Capital		822,733	785,306
Howland		39,500	—
IronBridge Capital Management		754,437	247,182
LM Capital		148,290	—
LSV Asset Management		1,507,309	949,126
Lynmar		74,321	—
Martingale Asset Management		752,645	263,525
New Amsterdam		793,621	109,012
NTGI Equitization		109,846	191,942
NTGI Index		38,392	184,251
NTGI-QM Collective Daily Aggregate Bonds		23,190	148,543
NTGI-QM Collective Daily EAFE		—	394,943
NTGI-QM Collective Daily GIC Bonds		19,310	16,954
NTGI-QM Collective Daily Russell 3000		—	72,500
NTGI-QM Collective Growth Fund		—	19,755
NTGI-QM Collective Value Fund		—	6,172
NWQ		1,342,221	152,574
Opus Capital Management		146,422	37,362
Ocshsle		—	742,480
Profit		75,457	—
Rhumbline		44,902	—
Segall Bryant and Hamill		539,571	212,259
Southeastern		331,274	1,514,569
SSgA Bond Index Fund		40,330	—

(Continued)

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

Fiscal Schedules and Analysis

Schedule of Investment Manager Fees

June 30, 2005 and 2004

		2005	2004
SSgA (Cash Overlay)	$	246,520	—
SSgA Intermediate Gov./Credit Index		48,253	—
SSgA Small Cap Global		108,237	—
Templeton		1,242,999	1,107,751
Trust Fund Advisors		454,471	—
UBS Global (formerly Brinson)		998,935	996,317
Union Labor Life Investment Co. (ULLICO)		237,069	
Walter Scott		806,301	722,088
Western Asset Management		890,528	860,097
William Blair		1,347,414	108,313
	$	22,010,299	15,285,305

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

ILLINOIS STATE BOARD OF INVESTMENT
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Fiscal Schedules and Analysis

Schedule of Soft Dollar Credits (Unaudited)

Years ended June 30, 2005 and 2004

		2005	2004
Soft dollar credits outstanding, at beginning of fiscal year	$	148,817	127,370
Soft dollar credits earned		177,236	93,660
Investment expenses paid with soft dollar credits		(14,876)	(72,213)
Soft dollar credits outstanding, at end of fiscal year	$	311,177	148,817

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

ILLINOIS STATE BOARD OF INVESTMENT
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Fiscal Schedules and Analysis

Schedule of Investment Commissions (Unaudited)

Years ended June 30, 2005 and 2004

		2005	2004
Investment brokerage firms:			
ABN Amro Securities (USA) Inc.	$	—	53,628
Acento Securities		11,346	—
Archipelago		20,744	—
B Riley and Co.		5,482	5,945
B Trade Services			20,290
Banc of America Securities Inc.		26,904	14,165
Bank Julius Baer		—	11,427
Bank of New York		179,488	26,883
Bear Stearns Securities Corp.		16,721	51,240
Benchmark		40,143	5,880
Berean Capital Inc.		—	20,740
Berstein Sanford C., & Co.		—	35,020
Blair, William & Co.		19,005	33,187
Blaylock Partners		69,617	—
BMO Nesbitt Burns		28,930	—
Boston Institutional Services		8,746	—
Bridge Trading Company		—	11,697
Broadcort Capital Corp.		—	36,540
Brockhouse & Cooper		—	8,030
Cabrera Asset Management		—	104,735
Canadian Imperial Bank		86,209	—
Cantor Fitzgerald & Co.		—	40,226
Capital Institutional Services Inc.		70,548	9,616
Capital Management Group		31,452	29,959
Carnegie Inc.		—	6,338
Cazenove & Co.		39,335	—
Chase Manhattan Bank N.A.		—	8,742
Cheevers & Company		—	20,119
Cheuvreus De Virieu		79,514	11,226
CIBC World Markets Corp.		—	29,240
CISTSOF		37,180	—
Citation Group		—	—
Citigroup Smith Barney Inc.		9,244	142,447
CJS Securities		88,469	—
Collins Stewart		—	5,905
Correspondent Services Corp.		—	23,278
Credit Lyonnais Securities		—	5,339
Credit Suisse First Boston Corp.		17,358	177,611
Cromwell Weeden & Co.		24,787	—
D. A. Davidson & Co.		6,123	—
Daiwa Securities		—	8,449
Deutsche Banc Securities Inc.		15,748	129,569
Direct Trading		29,496	—

ILLINOIS STATE BOARD OF INVESTMENT
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Fiscal Schedules and Analysis

Schedule of Investment Commissions (Unaudited)

Years ended June 30, 2005 and 2004

		2005	2004
Doherty & Co.	$	15,299	—
Dresdner Kleinwort Wasserstein Securities		—	74,482
Dusable Partners		20,944	—
Edwards, A.G.		—	13,225
E. J. Securities		6,408	—
F McDonald & Co.		9,017	—
Fidelity		5,820	—
First Analysis Securities Corp.		6,975	—
First Boston		8,175	—
First Honolulu		31,443	13,895
First Southwest Co.		—	100,587
Fox Pitt Kelton		34,696	—
Frank Russell Securities Inc.		—	16,565
Gardner Rich & Co.		54,345	151,930
Gerard Klaider Mattison & Co.		121,870	—
Goldman Sachs & Company		9,487	227,896
Greentree Brokerage		38,072	—
Guzman & Co.		6,158	—
Harris Nesbitt Corp.		5,709	—
HSBC Securities Inc.		10,290	81,132
ING Bank N.V.		—	8,525
Instinet		10,812	48,062
Institutional Direct Inc.		28,006	15,632
ITG Posit		13,643	—
Ivy Securities		45,094	—
Investment Technology Group		—	460,575
J.P. Morgan Securities, Inc.		9,749	235,748
Jackson Partners		69,575	—
Janney Montgomery Scott, Inc.		—	35,451
JB Were and Sons		—	5,454
JNK Securities		60,136	—
Jefferies & Company		9,224	33,575
Johnson Rice & Co.		6,024	5,281
Jones & Associates		7,872	66,973
KBC Financial Products		25,269	
Keefe Bruyette and Woods Inc.		—	16,458
Knight Securities		12,992	20,445
Lava Trading		5,768	—
Legg Mason & Co.		8,850	84,861
Lehman Brothers Inc.		39,574	103,695
Liquidnet Inc.		91,935	11,081
LJRY		52,634	—
Loop Capital Markets		268,526	322,239
Lynch Jones & Ryan		12,740	48,649

(Continued)

ILLINOIS STATE BOARD OF INVESTMENT
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Fiscal Schedules and Analysis

Schedule of Investment Commissions (Unaudited)

Years ended June 30, 2005 and 2004

		2005	2004
M. Ramsey King Securities	$	37,696	9,808
Macquarie Securities		29,514	9,994
Magna Securities		59,210	—
Mainfirst Bank		5,158	—
McDonald and Company		—	31,261
MDB Capital		29,524	—
Melvin Securities Corp		22,033	67,673
Merrill Lynch Pierce Fenner & Smith		40,215	448,905
Mesirow Financial Inc.		—	51,490
Midwest Research Securities		95,010	—
Miller Tabak Hirsch		—	58,042
Mischler Financial Group		—	36,540
Morgan Keegan and Company		8,774	—
Morgan Stanley & Co.		12,173	253,547
Muriel Siebert		43,795	—
National Financial Services		12,452	28,143
Needham & Company		—	8,803
Nesbitt Burns Securities		—	8,306
Nomura		—	11,564
Nutmeg Securities		13,420	82,364
NYFIX		78,822	—
Oppenheimer		8,392	—
Ormes Capital Msrkets, Inc.		6,713	—
Petrie Parkman		57,785	—
Prudential Equity Group		14,631	16,751
Pulse Trading LLC		18,933	—
PXP Securities Corp		—	5,845
Quaker Securities Inc.		—	—
Raymond James		6,847	—
RBC Dain Rauscher		—	6,775
Redi Plus		10,257	—
Robert W. Baird & Co.		17,652	—
Robinson Humphery		22,680	—
Rock Island Securites		12,292	—
Roth Capital		15,017	—
Royal Bank of Canada		7,302	—
Ryan Beck		7,828	—
Sanford C. Bernstein		22,881	—
SBK Brooks		44,508	8,366
Schwab, Charles		8,232	47,485
Scotia McLeod Inc.		—	8,622
Scott & Stringfellow Investment		—	10,819
SG Cowen and Company		—	22,673
Sidoti		7,794	—

(Continued)

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

Fiscal Schedules and Analysis

Schedule of Investment Commissions (Unaudited)

Years ended June 30, 2005 and 2004

	2005	2004
Soleil Securites	$ 7,307	—
Stuart Frankel & Co.	6,572	—
Svenska Handlebank	5,420	13,923
Thompson Davis	17,410	339,200
UBS Warburg Dillon Read	42,293	84,884
U.S. Bancorp Piper Jaffray Inc.	12,572	—
USIG-bea	53,130	—
Veritas Securities	—	13,916
Wachovia Securities	—	21,685
Waterhouse	6,620	—
Wedbush Morgan Securities, Inc.	5,514	—
Weeden & Co.	9,921	27,823
Wells Fargo Securities	—	—
Westminister	—	55,736
Wheat First	37,053	—
Williams Capital Group	72,055	29,980
Various (Under $5,000)	137,461	134,808
	$ 3,316,588	5,245,618

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

ILLINOIS STATE BOARD OF INVESTMENT
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Fiscal Schedules and Analysis

Year ended June 30, 2005

Schedule of Property and Equipment

A schedule of changes in property and equipment is as follows:

	Beginning balance	Additions	Deletions	Ending balance
Cost	$ 102,381	5,813	(8,859)	99,335
Less accumulated depreciation	(56,562)	(8,895)	7,894	(57,563)
Net property and equipment	$ 45,819	(3,082)	(965)	41,772

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

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

Balance per State Treasurer at June 30, 2005	$ 127,276
Vouchers in transit	(7,191)
Balance per Board at June 30, 2005	$ 120,085

Analysis of Accounts Receivable

The Board's receivable balance at June 30, 2005 amounted to $294,208,301 which consisted of $36,417,830 of dividends, interest, foreign taxes, and accounts receivable on investments held and receivables of $257,790,471 for investments sold prior to June 30 but settled after year-end. Because the collection of this interest is relatively assured and the sale of investments is merely an issue of timing, the Board does not maintain a reserve for uncollectible receivables or age the receivable detail.

ILLINOIS STATE BOARD OF INVESTMENT
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Analysis of Operations

Year ended June 30, 2005

Board Functions and Planning Program

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

In 1978, in accordance with Article 24, the Board authorized the implementation of the State Employees' Deferred Compensation Plan (the Plan). Initial enrollment began in 1979, at which time the Department of Personnel (now Department of Central Management Services) was named as the Administrator of the Plan.

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

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

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

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

Members of the board of directors as of June 30, 2005 include:

Guy W. Alongi	Treasurer Judy Baar Topinka
Allison S. Davis	Justice Thomas E. Hoffman
Ronald E. Powell	Gordon John Mazzotti
Edward M. Smith	Representative Kurt M. Granberg

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

Auditor's Assessment

The planning program described above appears reasonable for the Illinois State Board of Investment for the year ended June 30, 2005.

Number of Employees

The Board had 10 full-time employees at June 30, 2005 and 7 full-time employees at June 30, 2004.

Derivative Securities

Some of the Board's managers invest in derivative securities. A derivative security is an investment whose payoff depends upon the value of other assets such as bond and stock prices, a market index, or commodity prices. The Board's investments in derivatives are not leveraged. Obligations to purchase (long a financial future or a call option) are held in cash or cash equivalents. In the case of obligations to sell (short a financial future or a put option), the reference security is held in the portfolio. Derivative transactions involve, to varying degrees, credit risk and market risk. Credit risk is the possibility that a loss may occur because a party to a transaction fails to perform according to terms. Market risk is the possibility that a change in interest or currency rates will cause the value of a financial instrument to decrease or become more costly to settle. The market risk associated with derivatives, the prices of which are constantly fluctuating, is regulated by imposing strict limits as to the types, amounts, and degree of risk that investment managers may undertake. The board of trustees and senior management approve these limits, and the risk positions of the investment managers are reviewed on a regular basis to monitor compliance with the limits.

During the year, derivative investments included forward foreign currency contracts, collateralized mortgage obligations (CMOs), futures, and options. The remaining derivative securities are used to improve the yields or to hedge changes in interest rates.

(Continued)

Forward foreign currency contracts are used to hedge against the currency risk in the Board's foreign stock and fixed income portfolios. Forward foreign currency contracts are agreements to buy or sell specific amounts of a foreign currency at a specified delivery or maturity date for an agreed upon price. As the market values of the forward contracts vary, the Board records an unrealized gain or loss. Forward foreign currency contracts represent an off-balance sheet obligation, as there are no balance sheet assets or liabilities associated with those contracts. The market values of forward foreign currency contracts outstanding at June 30, 2005 and 2004 were as follows:

	Cost	Fair value	Gain (loss)
June 30, 2005:			
Forward currency purchases	$ 41,391,551	40,355,914	(1,035,637)
Forward currency sales	47,581,930	47,044,166	537,763
Total loss			$ (497,874)
June 30, 2004:			
Forward currency purchases	$ 86,354,036	86,816,176	462,140
Forward currency sales	86,354,036	87,241,866	(887,830)
Total loss			$ (425,690)

The Board also invests in mortgage-backed securities to maximize yields and to hedge against a rise in interest rates. These securities are based on cash flows from principal and interest payments on underlying mortgages. Therefore, they are sensitive to prepayments by mortgagees, which may result from a decline in interest rates. As of June 30, 2005 and 2004, the fair value of the Board's CMO holdings totaled $68,338,116 and $57,368,826, respectively.

The Board's investment managers utilize financial futures to replicate an underlying security they desire to hold (sell) in the portfolio. In certain instances, it may be beneficial to own a futures contract rather than the underlying security (arbitrage). Financial futures contracts are also used to improve the yield or adjust the duration of the portfolio. Financial futures contracts are agreements to buy or sell a specified amount at a specified delivery or maturity date for an agreed upon price. The market values of the future contracts vary from the original contract price; a gain or loss is recognized and paid to or received from the clearinghouse. Financial futures represent an off-balance sheet obligation, as there are no balance sheet assets or liabilities associated with those contracts. The cash or securities to meet these obligations are held in the investment portfolio.

The Board's investment managers utilize options in an effort to add value to the portfolio (collect premiums) or protect (hedge) a position in the portfolio. Options are agreements that give one party the right, but not the obligation, to buy or sell a specific amount of an asset for a specific price (called the strike price) on or before a specified expiration date. As the writer of financial options, the Board receives a premium at the outset of the agreement and bears the risk of an unfavorable change in the price of the instrument underlying the option. As the purchaser, the Board pays a premium at the outset of the agreement and the counterparty bears the risk of an unfavorable change in the price of the financial instrument underlying the option.

The following table shows the futures and options positions held by the Board as of June 30, 2005 and 2004:

	2005		2004	
	Number of contracts	**Contract principal***	**Number of contracts**	**Contract principal***
Domestic:				
Equity futures purchased	—	$ —	808	$ 230,360,800
Fixed income futures purchased	689	453,930,689	197	20,523,243
Fixed income futures sold	523	59,071,375	678	73,536,627
Fixed income written put options	138	14,877,875	303	385,079
Fixed income written call options	172	19,378,750	467	553,900
Fixed income purchased put options	131	77,660,000	—	—
Fixed income purchased call options	218	133,779,531	—	—

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

Securities Lending Program

Effective December 1, 2004, the master custodian is State Street Bank & Trust Company. The Board participates in a securities lending program with State Street who acts as securities lending agent. Securities are loaned to brokers and, in return, the Board has rights to a portion of a collateral pool. All of the securities are eligible for the securities lending program. Collateral consists solely of cash, letters of credit, commercial paper and government securities having a market value equal to or exceeding 102% of the value of the loaned securities (105% for non-U.S. securities). In the event of borrower default, State Street provides the Board with counterparty default indemnification. The Board had no credit risk as a result of its securities lending program as the collateral held exceeded the market value of the securities lent. As of June 30, 2005, and 2004 there were outstanding loaned investment securities having market values of $1,442,715,435 and $1,146,769,008 respectively, against which collateral was received with a value of $1,476,263,962 and $1,402,058,848, respectively. Collateral received at June 30, 2005 and 2004 consisted of $1,444,871,284 and $1,172,847,123, respectively, in cash and $31,392,678 and $266,896,652, respectively, in securities for which the Board does not have the ability to pledge or sell.

Subsequent Events

There were no subsequent events during fiscal year 2005.

Emergency Purchases

There were no emergency purchases made during fiscal year 2005.

Proceeds from General Obligation Bonds, Pension Funding Series June 2003 (Unaudited)

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

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

The State Employees' Retirement System, General Assembly Retirement System, and Judges' Retirement System received an allocation of bond proceeds equal to $1,544,924,744 on July 1, 2003. The monies were deposited into the Master Trust Account with the Illinois State Board of Investment, on July 2, 2003. The Board initially approved investing the pension bond precedes in separate index funds. These index funds were subsequently liquidated and combined with the Board's other investments and invested in accordance with the asset allocation policy of the Board during the year ended June 30, 2004. The Board estimates the return of the pension bond proceeds earned an annual rate of return of 10.1% during the year ended June 30, 2005, which is the same as the overall return for the Board's investment portfolio.

New Legislation

On June 1, 2005, Public Act 94-0004 was enacted addressing the early retirement option, benefit changes and funding reductions to the retirement systems. The legislation includes funding reductions of approximately $496.4 million and $429.4 million in fiscal years 2006 and 2007, respectively, for employer contributions to the State Employees', Judges' and General Assembly Retirement Systems. This reduction in funding will result in an increase in member systems' withdrawals in fiscal years 2006 and 2007 to meet their respective funding requirements for benefit obligations.

Service Efforts and Accomplishments (Unaudited)

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

Overall Rates of Return

	2005	2004	2003	2002	2001
Annual total return	10.1%	16.4%	0.3%	(6.9)%	(7.1)%
Compound annual rate of return since July 1, 1982	10.7	10.8	10.5	11.1	12.1

ILLINOIS STATE BOARD OF INVESTMENT
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Analysis of Operations

Year ended June 30, 2005

Investment Returns – Benchmark and Actual

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

- At least equal to the assumed actuarial interest rate, currently 8.5% per year
- At least equal to the return of a composite benchmark of market indices in the same proportions as the Board's asset allocation policy targets

The Board earned a total rate of return of 10.1% for the year ended June 30, 2005, which exceeded the investment objective of equaling the assumed actuarial rate, but the Board did not meet the investment objective of equaling the composite benchmark of market indices in the same proportions as the Board's asset allocation policy targets. The composite benchmark of market indices for June 30, 2005 was 10.9%.

						(Annualized)	
	2005	**2004**	**2003**	**2002**	**2001**	**3 years**	**5 years**
Total fund	10.1%	16.4%	0.3%	(6.9)%	(7.1)%	8.7%	2.1%
*Composite bench mark**	*10.9*	*16.3*	*3.5*	*(7.3)*	*(7.3)*	*10.1*	*2.8*
Consumer price index	*2.5*	*3.3*	*2.1*	*1.1*	*3.2*	*2.6*	*2.4*
U.S. equities	9.3	21.7	0.9	(14.6)	(10.3)	9.6	0.2
Wilshire 500 Index	*8.4*	*21.2*	*1.3*	*(16.6)*	*(15.3)*	*10.0*	*(1.3)*
International equities	14.8	29.8	(7.5)	(6.3)	(21.0)	11.2	0.4
MSCI-EAFE Index	*14.1*	*32.9*	*(6.1)*	*(9.2)*	*(23.3)*	*12.5*	*(0.2)*
Fixed income	6.9	0.7	8.3	5.5	9.5	5.3	6.1
Lehman U.S. Universal Bond Index	*7.4*	*1.0*	*11.5*	*7.7*	*10.8*	*6.6*	*7.6*
Real estate	14.8	9.1	2.2	11.5	7.0	8.6	8.9
NCRIEF Real Estate Index	*15.6*	*9.7*	*5.2*	*5.9*	*12.5*	*10.7*	*10.2*
Alternative investments	29.6	16.9	(4.9)	(18.4)	(6.9)	12.8	1.7

* Composite benchmark:

Effective 12/2003:	45% Wilshire 5000; 10% MSCI-EAFE; 25% Lehman Universal; 10% NCRIEF; 5% Venture Economic all Private Equity Index; 5% HFR Equity Hedged Index.
Effective 04/2002:	46% Russell 3000; 15% MS-AC Free ex U.S.; 23% Lehman Universal; 8% NCRIEF; 8% Russell 2000 +3.0%.
Prior to 04/2002:	43% Russell 3000; 20% MS-AC Free ex U.S.; 22% Lehman Aggregate; 7% NCRIEF; 8% absolute return of 12%.

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Analysis of Operations

Year ended June 30, 2005

Asset Allocations by Fund Type as of June 30, 2005

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

	Fair value ($ million)	Actual asset mix	Policy target
U.S. equity	$ 5,580	51%	45%
U.S. equity hedge funds	—	—	5
International equity	986	9	10
Fixed income[1]	2,865	26	25
Real estate	779	7	10
Alternative investments[2]	467	4	5
Cash[3]	226	3	—
Total	$ 10,903	100%	100%

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

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

[3] Includes other assets, less liabilities.