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

Financial Statements

June 30, 2005 and 2004

(With Independent Auditors' Report Thereon)

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

FINANCIAL STATEMENT REPORT

SUMMARY

The audit of the accompanying financial statements of the Illinois State Board of Investment was performed by KPMG LLP.

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

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

Independent Auditors' Report

Honorable William G. Holland
Auditor General
State of Illinois

Board of Directors
Illinois State Board of Investment

As Special Assistant Auditors for the Auditor General, we have audited the accompanying statements of net assets of the Illinois State Board of Investment (Board), an internal investment pool of the State of Illinois, as of June 30, 2005 and 2004, and the related statements of changes in net assets for the years then ended. These financial statements are the responsibility of the Board's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with auditing standards generally accepted in the United States of America and *Government Auditing Standards*, issued by the Comptroller General of the United States. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes consideration of internal control over financial reporting as a basis for designing audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Board's internal control over financial reporting. Accordingly, we express no such opinion. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of the Illinois State Board of Investment as of June 30, 2005 and 2004, and the changes in its net assets for the years then ended, in conformity with accounting principles generally accepted in the United States of America.

In accordance with *Government Auditing Standards*, we will also issue a report dated October 28, 2005 on our consideration of the Board'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 the internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* and should be considered in assessing the results of our audits.

The accompanying management's discussion and analysis on pages 12 through 13 is not a required part of the basic financial statements but is supplementary information required by accounting principles generally accepted in the United States of America. We have applied certain limited procedures, which consisted principally of inquiries of management regarding the methods of measurement and presentation of the required supplementary information. However, we did not audit the information and express no opinion on it.

Our 2005 audit was made for the purpose of forming an opinion on the basic financial statements taken as a whole. The financial information listed in the table of contents as supplemental financial information is presented for purposes of additional analysis and is not a required part of the basic financial statements. 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 2005 basic financial statements taken as a whole.

KPMG LLP

October 28, 2005

The following Management Discussion and Analysis (MD&A) provides an introduction and overview of the Illinois State Board of Investment (ISBI or Board) financial activities for the fiscal years ended June 30, 2005 and 2004.

Financial Highlights
The net assets of the Board totaled approximately $10.9 billion at fiscal year ended June 30, 2005, compared to $10.4 billion at fiscal year ended June 30, 2004. The increase is a result of strong investment returns, but was tempered by member systems' withdrawals.

Overview of the Financial Statements
The Board's financial statements are prepared on an accrual basis in accordance with generally accepted accounting principles promulgated by the Governmental Accounting Standards Board and are comprised of the Statement of Net Assets, the Statement of Changes in Net Assets and Notes to Financial Statements.

The Statements of Net Assets presents information on the Board's assets and liabilities and the resulting net assets. This statement also reflects the Board's investments, at fair value, along with the cash and short-term investments, receivables and other assets and liabilities.

Condensed Summary of Net Assets

	June 30			2005/2004	2004/2003
	2005	2004	2003	Change	Change
	$	$	$	$	$
Cash	13,722,061	89,858	40,246	13,632,203	49,612
Receivables	294,208,301	188,503,767	270,451,708	105,704,534	(81,947,941)
Investments	10,959,676,010	10,663,805,594	8,031,882,032	295,870,416	2,631,923,562
Securities lending collateral	1,444,871,284	1,172,847,123	606,223,532	272,024,161	566,623,591
Capital assets	41,772	45,819	54,860	(4,047)	(9,041)
Total assets	12,712,519,428	12,025,292,161	8,908,652,378	687,227,267	3,116,639,783
Liabilities	1,810,039,761	1,582,553,607	1,107,631,168	227,486,154	474,922,439
Total net assets	10,902,479,667	10,442,738,554	7,801,021,210	459,741,113	2,641,717,344

The increase in investments at June 30, 2005 is a result of an investment gain of 10.1% for the fiscal year, net of expenses which are shown in the Statement of Changes in Net Assets. The gain reflects a significant improvement in market environments, in particular real estate, alternative investments and both the U.S. and international equity markets. Distributions received from private equity and real estate partnerships resulted in an increase in the cash for fiscal year 2005. The increase in liabilities for fiscal 2005 compared with 2004 consisted mainly of unsettled investment purchases. Net assets increased in fiscal year 2004 compared with fiscal year 2003, due to $1.6 billion in new funding as well as an investment gain of 16.4%.

The Statements of Changes of Net Assets present information regarding changes during the fiscal years ended June 30, 2005 and 2004. This statement reflects additions, which include the investment income derived from realized and unrealized gains/losses, member system contributions, and income received from securities lending activities. Also reflected in the statement are deductions, which include withdrawals from the member systems and operating expenses of the Board.

Condensed Summary of Changes in Net Assets

	Fiscal Years Ended June 30			2005/2004	2004/2003
	2005	2004	2003	Change	Change
	$	$		$	$
Additions:					
Net investment income	1,031,923,322	1,524,698,140	29,449,237	(492,774,818)	1,495,248,903
Member systems' contributions	0	1,554,924,744	0	(1,554,924,744)	1,554,924,744
Total additions	1,031,923,322	3,079,622,884	29,449,237	(2,047,699,562)	3,050,173,647
Deductions:					
Member systems' withdrawals	547,700,000	420,000,000	140,000,000	127,700,000	280,000,000
Administrative expenses	24,482,209	17,905,540	16,756,528	6,576,669	1,149,012
Total deductions	572,182,209	437,905,540	156,756,528	134,276,669	281,149,012
Net increase (decrease) in net assets	459,741,113	2,641,717,344	(127,307,291)	(2,181,976,231)	2,769,024,635

The net investment gains of the ISBI fund were the result of a positive movement in the securities markets. There was a substantial increase in withdrawals by the member systems. Fiscal year 2005 withdrawals were $547.7 million compared with $420 million in fiscal year 2004 and $140 million in fiscal year 2003. Withdrawals are determined by the member retirement systems based on the State's funding and the systems' benefit payment needs. The increase in expenses for fiscal year 2005 versus 2004 was mainly a result of increased investment management fees due to additional assets under management as well as a change to active investment management from passive index funds. Operating expenses increased slightly in fiscal year 2004 over 2003 by $1.1 million, mainly due to an increase in investment management fees caused by the increase in assets.

The Notes to the Financial Statements provide additional information, which is necessary to fully understand the data, provided in the financial statements.

During fiscal year 2005, the Board continued to implement changes as a result of the asset allocation study. The structure changes resulting from this review began in fiscal year 2004 and continued to be revised during fiscal year 2005. Several new managers were engaged during fiscal year 2005 as a result of shifting to more active management, as well as the Board making commitments to minority and emerging firms.

New Legislation

On June 1, 2005, Public Act 94-0004 was enacted addressing the early retirement option, benefit changes and funding reductions. 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 will result in an increase in member systems' withdrawals in fiscal years 2006 and 2007 to meet their respective funding requirements for benefit obligations.

STATEMENTS OF NET ASSETS

JUNE 30

	2005	2004
	$	$
ASSETS		
Cash	13,722,061	89,858
Receivables:		
Foreign taxes	863,925	905,038
Account receivables	690,481	315,241
Investments sold	257,790,471	171,349,098
Interest & dividends	34,863,424	15,934,390
Total receivables	294,208,301	188,503,767
Capital assets	41,772	45,819
Investments at fair value:		
Government and agency obligations	1,112,360,428	1,472,563,096
Foreign obligations	198,858,369	141,984,456
Corporate obligations	1,551,766,590	1,384,436,108
Convertible bonds	1,404,244	2,745,915
Common stock & equity funds	5,579,812,196	5,087,663,744
Preferred stock	487,946	4,590,819
Foreign equity securities	986,200,950	1,087,681,488
Real estate investments	778,951,123	616,134,095
Alternative investments	466,871,030	441,033,580
Money market instruments	283,461,008	425,397,983
Forward foreign exchange contracts	(497,874)	(425,690)
Total investments	10,959,676,010	10,663,805,594
Securities lending collateral	1,444,871,284	1,172,847,123
Total assets	12,712,519,428	12,025,292,161
LIABILITIES		
Payables:		
Investment purchases	359,224,216	404,863,823
Operating expenses	5,944,261	4,842,661
Securities lending collateral obligation	1,444,871,284	1,172,847,123
Total liabilities	1,810,039,761	1,582,553,607
Net assets	10,902,479,667	10,442,738,554

See notes to financial statements,

STATEMENTS OF CHANGES IN NET ASSETS

FISCAL YEARS ENDED JUNE 30

	2005	2004
	$	$
ADDITIONS		
Investment income		
Net increase in fair value of investments	766,090,763	1,337,966,949
Interest	142,444,438	95,062,599
Dividends	119,713,292	89,316,960
Securities lending income	27,969,384	9,540,444
Less securities lending rebates	(23,504,790)	(6,405,302)
Less securities lending expenses	(789,765)	(783,510)
Total net investment income	1,031,923,322	1,524,698,140
Member systems' contributions	0	1,554,924,744
Total additions	1,031,923,322	3,079,622,884
DEDUCTIONS		
Expenses:		
Salaries and benefits:		
Salaries	767,248	659,861
Benefits	315,097	228,229
Operating expenses:		
Rent and utilities	156,066	145,717
Audit	100,650	95,300
Other	118,101	123,398
External support:		
Custody	197,857	357,000
Consulting and professional	647,218	771,065
Investment advisors/managers	22,010,299	15,285,305
Investment services and research	169,673	239,665
Total expenses	24,482,209	17,905,540
Member systems' withdrawals	547,700,000	420,000,000
Total deductions	572,182,209	437,905,540
Increase in net assets	459,741,113	2,641,717,344
Net assets at beginning of year	10,442,738,554	7,801,021,210
Net assets at end of year	10,902,479,667	10,442,738,554

See notes to financial statements,

Note A
Summary of Significant Accounting Policies

Reporting Entity
The Illinois State Board of Investment (ISBI) is considered to be an internal investment pool of the State of Illinois, operating solely from investment income. The ISBI manages and invests the pension assets of three separate public employee retirement systems: General Assembly Retirement System, the Judges Retirement System of Illinois, and State Employees' Retirement System of Illinois.

The assets of the member systems are accounted for in a single Commingled Fund. Separate information on each system's participation is presented in Note C.

Basis of Accounting
Accounting records are maintained on an accrual basis. Shares are allocated monthly to member systems based upon percentage of ownership. Management expenses are deducted monthly from income before distribution.

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

Investment Transactions and Investment Income
Investment transactions are accounted for on a trade date (date order to buy or sell is executed) and dividend income is recognized on the ex-dividend date. Interest income is recognized on an accrual basis.

Custody and Investment Management Fees
Custody fees for the period July 1, 2004 through November 30, 2005 were computed quarterly with a base charge for all accounts. For the balance of the fiscal year, there were no base charges for custody fees.
Investment management fees for all accounts, except real estate and alternative investments, are computed quarterly as a percentage of each manager's portfolio market value.

Management fees for real estate and alternative investments are not directly charged but are included in the investment income for these investments.

Risk Management
The ISBI, as part of the State, provides for risks of loss associated with workers' compensation and general liability through the State's self-insurance program. The ISBI obtains commercial insurance for fidelity and surety and property. There have been no commercial insurance claims in the past five years.

Risks and Uncertainties
ISBI invests in various investment securities. Investment securities are exposed to various risks such as interest rate, market, and credit risks. Due to the level of risk associated with certain investment securities, it is at least reasonably possible that changes in the values of investment securities will occur in the near term and that such changes could materially affect the amounts reported in the statement of net assets.

Use of Estimates
In preparing financial statements in conformity with accounting principles generally accepted in the United States of America, the Board makes estimates and assumptions that affect the reported amounts of assets and liabilities and disclosures of contingent assets and liabilities at the date of the financial statements, as well as the reported amounts of revenue and expenses during the reporting period. Actual results could differ from those estimates and assumptions.

Adoption of New Accounting Standard
On July 1, 2004, ISBI adopted the disclosures required by the Governmental Accounting Standards Board (GASB) Statement No. 40, *Deposit and Investment Risk Disclosures, an amendment of GASB Statement No. 3.* This pronouncement requires additional disclosures presented in these notes, but has no impact on the net assets. These disclosures address common deposits and investment risks related to credit risk, concentration of credit risk, interest rate risk, and foreign currency risk. Data related to the above disclosures for the year ended June 30, 2004 were unavailable.

Note B
Deposits, Investments, and Investment Risk Disclosures

Deposits

Custodial credit risk for deposits is the risk that in the event of a financial institution failure, ISBI's deposits may not be returned. All non-investment related bank balances at year-end are insured or collateralized with securities held by the Illinois State Treasurer or agents in the name of the State Treasurer. Cash held in the investment related bank account is neither insured nor collateralized for amounts in excess of $100,000. There is no related deposit policy for custodial risk. These assets are under the custody of State Street Bank and Trust. State Street Bank and Trust has a AA Long-term Deposit/Debt rating by Standards & Poor and an Aa2 rating by Moody.

Carrying amounts at June 30, 2005	
Cash	$13,722,061
Bank balances at June 30, 2005	
Total	$13,729,252
Amount exposed to custodial credit risk	$13,501,974

Investment Policy

ISBI's investment authority and responsibilities are specified in the Illinois Compiled Statutes, 40ILCS 5/22A. These statutes provide ISBI with the authority to manage and invest the assets of any Illinois pension or education fund.

As described in Note A, ISBI currently manages and invests the assets of the General Assembly Retirement System, Judges' Retirement System, and State Employees' Retirement System. All investments undertaken by ISBI are governed by 40ILCS 5 adopted by the General Assembly in 1982, and other standards codified in the above reference to the statutes.

40ILCS 5/1-109 requires all members of the Board and other fiduciaries to "...discharge his or her duties with respect to the retirement system or pension fund solely in the interest of the participants and beneficiaries and: With the care, skill, prudence and diligence...By diversifying the investments of the retirement system or pension fund so as to minimize the risk of large losses..."

Investment Summary

The following table presents a summary of the Fund's investments at fair value by type at June 30, 2005.

	$
Government and agency obligations	1,112,360,428
Foreign obligations	198,858,369
Corporate obligations	1,551,766,590
Convertible bonds	1,404,244
Common stock & equity funds	5,579,812,196
Preferred stock	487,946
Foreign equity securities	986,200,950
Real estate investments	778,951,123
Alternative investments	466,871,030
Money market instruments	283,461,008
Forward foreign exchange contracts	(497,874)
Total investments	10,959,676,010

Note B (continued)
Deposits, Investments, and Investment Risk Disclosures

Custodial Credit Risk for Investments
The custodial credit risk for investments is the risk that, in the event of the failure of the counterparty to a transaction, ISBI will not be able to recover the value of investments or collateral securities that are in the possession of an outside party. As of June 30, 2005 , the following investments were uninsured and unregistered, with securities held by the counterparty or by its trust department or agent but not in the Board's name:

	$
Common stock	2,283,261
Government and agency obligations	16,885,000
Corporate obligations	4,725,000
Total	23,893,261

Concentration of Credit Risk and Credit Risk for Investments
The portfolio is managed by professional investment management firms. These investment management firms are required to maintain diversified portfolios. Each investment manager must comply with risk management guidelines individually assigned to them as part of their Investment Management Agreement. The Board did not have any single issuer investment that exceeded 5% of the total net assets of the fund as of June 30, 2005 and 2004. The following table presents the quality ratings of debt securities held by ISBI as of June 30, 2005.

	Moody's Quality Rating	Fair Value $
Foreign obligations	AAA	33,511,439
	AA	39,246,537
	A	25,030,605
	BAA	32,380,713
	BA	40,288,397
	B	12,747,269
	Not rated	15,653,409
Total foreign obligations		198,858,369
Corporate obligations	AAA	458,629,951
	AA	151,320,801
	A	191,083,432
	BAA	161,122,804
	BA	217,555,371
	B	300,234,513
	CAA	12,093,496
	CA	660,671
	Not rated	59,065,551
Total corporate obligations		1,551,766,590
Convertible bonds	AAA	1,111,744
	BAA	292,500
Total convertible bonds		1,404,244
Agency obligations	AAA	556,191,256
U. S. Government obligations		556,169,172
Total Government and agency obligations		1,112,360,428
Total credit risk debt securities		2,864,389,631

Note B (continued)
Deposits, Investments, and Investment Risk Disclosures

Interest Rate Risk

ISBI manages its exposure to fair value losses arising from interest rate risk by diversifying the debt securities portfolio and maintaining the debt securities portfolio to an effective weighted average rate between 80 and 120 percent of the benchmark index.

Duration is a measure of a debt investment's exposure to fair value changes arising from changing interest rates. It uses the present value of cash flows, weighted for those cash flows as a percentage of the investment's full price. The effective duration measures the sensitivity of market price to parallel shifts in the yield curve. ISBI benchmarks its debt security portfolio to Lehman Brothers Aggregate. At June 30, 2005 the effective duration of the Lehman Brothers Aggregate was 4.2. At the same point in time, the effective duration of the ISBI debt security portfolio was 4.0.

Investment Type	Fair Value $	Effective Weighted Duration
Government & agency obligations		
U.S. Treasury	556,169,172	4.5
Federal agency	544,212,466	2.8
Municipal	11,978,790	4.8
Foreign obligations	198,858,369	4.5
Corporate obligations		
Bank and finance	392,252,843	2.9
Collateralized mortgage obligations	68,338,116	3.3
Industrials	798,619,662	4.9
Other	292,555,969	4.2
Convertible bonds	1,404,244	30.5
	2,864,389,631	

Foreign Currency Risk
The international portfolio is constructed on the principles of diversification, quality growth and value. Risk of loss arises from changes in currency exchange rates. International managers may also engage in transactions to hedge currency at their discretion. The following table presents the foreign currency risk by type of investment as of June 30, 2005.

	Foreign Equity Securities	Foreign Obligations
	$	$
Australian Dollar	47,593,913	(228,293)
Brazilian Real	1,278,605	0
Canadian Dollar	30,812,582	1,851,713
Cayman Islands Dollar	31,956	0
Chinese Yuan	194,278	0
Danish Krone	11,599,786	0
English Pound Sterling	202,514,123	798,051
Euro Currency	282,661,685	3,056,801
Finnish Markka	0	54,634
Hong Kong Dollar	45,015,304	0
Indian Rupee	2,251,086	0
Indonesian Rupian	691,050	0
Israeli New Shekel	518,923	0
Japanese Yen	228,925,684	7,558,941
Malaysian Ringgit	103,494	0
Mexican Peso	0	2,573,969
New Zealand Dollar	519,315	2,741,363
Norwegian Krone	5,641,689	0
Philippine Peso	110,031	0
Polish Zolty	0	74,147
Singapore Dollar	9,859,571	0
South African Rand	1,914,821	0
South Korean Won	21,385,395	0
Swedish Krona	28,388,258	0
Taiwan Dollar	2,786,713	0
Turkish Lira	1,069,802	0
Swiss Franc	52,437,403	0
Foreign investments denominated in U.S. Dollars	7,895,483	180,377,043
Total	986,200,950	198,858,369

Securities Lending
Effective December 1, 2004, the master custodian is State Street Bank & Trust Company. ISBI participates in a securities lending program with State Street who acts as securities lending agent. Securities are loaned to brokers and, in return, the 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 ISBI with counterparty default indemnification. ISBI had no credit risk as a result of its securities lending program as the collateral held exceeded the fair value of the securities lent. As of June 30, 2005 and 2004, there were outstanding loaned investment securities having fair 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 ISBI does not have the ability to pledge or sell.

Note B (continued)
Deposits, Investments, and Investment Risk Disclosures

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

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

Forward foreign currency contracts are used to hedge against the currency risk in ISBI's foreign stock and fixed income portfolios. Forward foreign currency contracts are agreements to buy or sell specific amounts of a foreign currency at a specified delivery or maturity date for an agreed upon price. As the fair value of the forward contracts varies, the 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 fair value 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	47,581,929	47,044,166	537,763
Total gain/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 gain/loss			(425,690)

Note B (continued)
Deposits, Investments, and Investment Risk Disclosures

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

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

The 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, ISBI received 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, ISBI pays a premium at the outset of the agreement and the counterparty bears the risk of an unfavorable change in the price of the financial instrument underlying the option.

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

	2005		2004	
	Number of Contracts	Contract Principal* $	Number of Contracts	Contract Principal* $
Domestic				
Equity futures purchased	0	0	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 call options	218	133,779,531	0	0
Fixed income purchased put options	131	77,660,000	0	0

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

Note B (continued)
Deposits, Investments, and Investment Risk Disclosures

Investment Commitments

Real estate and private equity investment portfolios consist of passive interests in limited partnerships. ISBI had outstanding commitments to these limited partnerships of approximately $524 million and $270 million, as of June 30, 2005 and 2004, respectively. Also, at the end of fiscal year 2005, the Board had an outstanding commitment of $60 million to a separate real estate account.

Note C
Member Systems' Participation

	General Assembly	Judges	State Employees'	Combined*
Member Systems' Income and Expenses Fiscal Year Ended June 30, 2005	$	$	$	$
Interest and dividends	1,972,498	13,156,830	247,028,402	262,157,730
Net securities lending income	27,650	184,428	3,462,751	3,674,829
Net realized gain on investments	3,814,933	25,316,348	476,037,549	505,168,830
Net unrealized gain on investments	1,953,669	13,149,695	245,818,569	260,921,933
Management expenses	(183,631)	(1,230,222)	(23,068,356)	(24,482,209)
Net investment income	7,585,119	50,577,079	949,278,915	1,007,441,113
Member Systems' Changes in Net Assets Fiscal Year Ended June 30, 2005				
Net assets at beginning of year	81,287,682	521,372,992	9,840,077,880	10,442,738,554
Member systems' net (withdrawals)	(8,100,000)	(21,600,000)	(518,000,000)	(547,700,000)
Net investment income	7,585,119	50,577,079	949,278,915	1,007,441,113
Net assets at end of year	80,772,801	550,350,071	10,271,356,795	10,902,479,667

The source of net assets of the member systems since inception at June 30, 2005, is as follows:

	General Assembly	Judges	State Employees'	Combined*
Member systems' net contributions (withdrawals)	(20,659,495)	10,567,270	486,913,244	476,821,019
Accumulated net investment income	101,432,296	539,782,801	9,784,443,551	10,425,658,648
Net assets at fair value	80,772,801	550,350,071	10,271,356,795	10,902,479,667

** Combined column for the member systems is presented for information purposes only and does not indicate that the assets of one system may be used for another system.*

Note C *Member Systems' Participation*	General Assembly	Judges	State Employees'	Combined*
Member Systems' Income and Expenses Fiscal Year Ended June 30, 2004	$	$	$	$
Interest and dividends	1,449,966	9,122,119	173,807,474	184,379,559
Net securities lending income	18,493	116,346	2,216,793	2,351,632
Net realized gain on investments	5,703,850	36,057,122	687,466,890	729,227,862
Net unrealized gain on investments	4,795,760	29,468,647	574,474,680	608,739,087
Management expenses	(140,541)	(887,816)	(16,877,183)	(17,905,540)
Net investment income	11,827,528	73,876,418	1,421,088,654	1,506,792,600
Member Systems' Changes in Net Assets Fiscal Year Ended June 30, 2004				
Net assets at beginning of year	47,386,171	317,541,091	7,436,093,948	7,801,021,210
Member systems' contributions	22,073,983	129,955,483	982,895,278	1,134,924,744
Net investment income	11,827,528	73,876,418	1,421,088,654	1,506,792,600
Net assets at end of year	81,287,682	521,372,992	9,840,077,880	10,442,738,554

The source of net assets of the member systems since inception at June 30, 2004, are as follows:

Member systems' net contributions (withdrawals)	(12,559,495)	32,167,270	1,004,913,244	1,024,521,019
Accumulated net investment income	93,847,177	489,205,722	8,835,164,636	9,418,217,535
Net assets at fair value	81,287,682	521,372,992	9,840,077,880	10,442,738,554

** Combined column for the member systems is presented for information purposes only and does not indicate that the assets of one system may be used for another system.*

Note D
Pensions

Plan Description
All of the ISBI employees participate in the State Employees' Retirement System (SERS), which is a pension trust fund in the State of Illinois reporting entity. The SERS is a single-employer, defined-benefit, public employee retirement system (PERS) in which State employees participate, except those covered by the State Universities, Teachers', General Assembly, and Judges' Retirement Systems. The financial position and results of operations of the SERS for fiscal years 2005 and 2004 are included in the State of Illinois' Comprehensive Annual Financial Report (CAFR). The SERS also issues a separate CAFR that may be obtained by writing to the SERS, 2101 Veterans Parkway, Springfield, IL 62794-9255 or by calling 217/785-7202. The State of Illinois CAFR may be obtained by writing to the State Comptroller's Office, Financial Reporting Department, 325 West Adams Street, Springfield, IL 62704-1858 or by calling 217/782-2053.

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

Funding Policy
ISBI pays employer retirement contributions based upon an actuarially determined percentage of payroll. For fiscal years 2005 and 2004 the employer contribution rates were 16.107% and 13.439%, respectively. Effective for pay periods beginning after December 31, 1991, the State opted to pay the employee portion or retirement for most State agencies with employees covered by the State Employees' and Teachers' Retirement Systems. Generally, this "pickup" of employee retirement was part of the budget process and was, in part, a substitute for salary increases. The pickup is subject to sufficient annual appropriations and those employees covered may vary across employee groups and State agencies. Currently, State officers, judges, general assembly members, and State university employees are not eligible for the employee pickup.

Post-retirement Benefits
In addition to providing pension benefits, the State provides certain health, dental and life insurance benefits to annuitants who are former State employees. This includes annuitants of the ISBI. Substantially all State employees may become eligible for post-employment benefits if they eventually become annuitants. Health and dental benefits include basic benefits for annuitants under the State's self-insurance plan and insurance contracts currently in force. Life insurance benefits are limited to five thousand dollars per annuitant age 60 and older.

Currently, the State does not segregate payments made to annuitants from those made to current employees for health, dental and life insurance benefits. The cost of health, dental and life insurance benefits is recognized on a pay-as-you-go basis.