ILLINOIS STATE BOARD OF INVESTMENT

(An Internal Investment Pool of the State of Illinois)

Compliance Examination

Year ended June 30, 2006

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, 2006 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

KPMG LLP
303 East Wacker Drive
Chicago, Illinois 60601

February 2, 2007

Ladies and Gentlemen:

We are responsible for the identification of, and compliance with, all aspects of laws, regulations, contracts, or grants 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, 2006. Based on this evaluation, we assert that during the year ended June 30, 2006, 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 A. Spinato

Katherine Spinato
Deputy Director

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

Compliance Report

Summary

Year ended June 30, 2006

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

Accountants' 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	3	1
Repeated findings	1	—
Prior recommendations implemented or not repeated	—	—

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
06-1	9	Inadequate Process for Valuation of Alternative Investments
06-2	11	Inaccurate Allocation of Investment Earnings
06-3	13	Deposit and Investment Custodial Credit Risk

Prior Findings Not Repeated:

None.

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, 2006. 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, 2006. However, the results of our procedures disclosed instances of noncompliance with those requirements, which are required to be reported in accordance with criteria established by the Audit Guide, issued by the Illinois Office of the Auditor General and which are described in the accompanying schedule of State findings and questioned costs as finding 06-2 and 06-3.

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 dated February 2, 2007.

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.

We noted certain matters involving internal control over compliance and its operation that we consider to be reportable conditions. Reportable conditions involve matters coming to our attention relating to significant deficiencies in the design or operation of the internal control over compliance that, in our judgment, could adversely affect the Board's ability to comply with one or more of the aforementioned requirements. The reportable conditions are described in the accompanying schedule of State findings and questioned costs as findings 06-1 and 06-2.

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. Our consideration of internal control over compliance would not necessarily disclose all matters in internal control that might be reportable conditions and, accordingly, would not necessarily disclose all reportable conditions that are also considered to be material weaknesses. However, we believe that the reportable conditions described above are not 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, 2006 and 2005, and have issued our report thereon dated February 2, 2007. 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.

KPMG

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
February 2, 2007

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, 2006, and have issued our report thereon dated February 2, 2007. 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 Boards' 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. However, we noted certain matters involving the internal control over financial reporting and its operation that we consider to be a reportable condition. Reportable conditions involve matters coming to our attention relating to significant deficiencies in the design or operation of the internal control over financial reporting that, in our judgment, could adversely affect the Board's ability to initiate, record, process, and report financial data consistent with the assertions of management in the financial statements. The reportable condition is described in the accompanying schedule of State findings and questioned costs as finding 06-1.

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. Our consideration of the internal control over financial reporting would not necessarily disclose all matters in the internal control that might be reportable conditions and, accordingly, would not necessarily disclose all reportable conditions that are also considered to be material weaknesses. However, we believe that the reportable condition described above is not a material weakness.

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 State compliance findings 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 February 2, 2007.

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
February 2, 2007

Finding #06-1 – Inadequate Process for Valuation of Alternative Investments

The Illinois State Board of Investment (the Board) does not have an adequate established accounting and financial reporting process for determining the fair value measurements and disclosures, selecting appropriate valuation methods, and identifying and adequately supporting significant assumptions used for its alternative investments.

Alternative investments comprise over 20% of the Board's total investments and include real estate, private equity, and hedge funds. Based on the organizational structure and limited staff of the Board, they have traditionally relied on due diligence and valuation procedures performed by external investment managers and consultants. Board management may look to the external investment managers and consultants for guidance, but management must have sufficient information to evaluate and independently challenge the information provided by the external investment managers and consultants.

In connection with the issuance of recent guidance by the American Institute of Certified Public Accountants (AICPA) relating to auditing alternative investments and requests made from the auditors, management did perform extensive additional procedures and evaluation of alternative investment valuations. However, these procedures were performed primarily to address the current year financial statement audit requirements and were not part of an ongoing comprehensive internal control process related to the valuation of alternative investments. Additionally, there were certain areas within the alternative investments, including hedge funds, of which management had limited available information of the underlying investments.

Generally accepted accounting principles (GAAP) require the Board to report their investments at fair value. Additionally, the AICPA Practice Aid, *Alternative Investments – Audit Considerations*, states "Management is responsible for making the fair value measurements and disclosures included in the financial statements. As part of fulfilling its responsibility, management needs to establish an accounting and financial reporting process for determining the fair value measurements and disclosures, select appropriate valuation methods, identify and adequately support any significant assumptions used, prepare the valuation, and ensure that the presentation and disclosure of the fair value measurements are in accordance with GAAP. This responsibility cannot, under any circumstances, be outsourced or assigned to a party outside of the investor entity's management."

In discussing these conditions with Board officials, they stated that they have always had a process in place to monitor and evaluate all portfolio investments that utilizes joint monitoring and evaluation by the Board Staff and external investment Consultants on an ongoing basis. However, when the AICPA Practice Aid, *Alternative Investments − Audit Considerations,* was issued in July 2006, the standard was raised as to what evidence ISBI needed to produce to demonstrate that monitoring and due diligence process from an audit perspective. The late issuance of the Practice Aid forced ISBI to take a look back in approach in enhancing the current process to address the requirements as specified in the Practice Aid.

Failure to establish an adequate accounting and financial reporting process for alternative investment could result in the improper reporting of the fair value of investments and result in a qualification of the audit opinion on the Board's financial statements. In addition, because of not having an established process, there was a significant delay in completing the Board's fiscal year 2006 financial statement audit. (Finding Code No. 06-1)

Recommendation:

We recommend the Board review its current process for determining the fair value measures and disclosures for alternative investments and develop written procedures related to the determination of fair value measurements, selecting appropriate valuation methods, identifying and adequately supporting assumptions used, and assignment of responsibilities. The Board should also evaluate current staffing to determine whether appropriate resources exist and work with the external investment managers to obtain the necessary financial information on a timely basis.

Agency Response:

The Board agrees that an adequate accounting and financial reporting process for alternative investments should be established.

The Board has developed a comprehensive plan that contained additional procedures and evaluations of alternative investment valuations in response to the AICPA Practice Aid, *Alternative Investments − Audit Considerations,* issued in July 2006 for the Fiscal 2006 audit process. The primary focus of this plan was to establish a process for management to accurately validate and substantiate the fair value measurements contained in the Board’s audited financial statements for the period ended fiscal 2006.

The scope and depth of the fiscal 2006 plan has been expanded with the implementation of protocols and procedures contained in that plan as well as with additional staff resources. The Board has worked with their investment managers and consultants to significantly expand the quality and quantity of audit evidence available to substantiate the internal control procedures in place around valuation of alternative investments.

The Board is currently working with the Chief Fiscal Officers of all of the hedge funds to understand, document and test their policies and practices to gain an in-depth understanding of their valuation process. Further, the Board has worked with the hedge fund managers to document visibility into position level detail for the hedge funds.

Based on the additional work the Board has done with its external investment managers and consultants and increased staffing, we are confident that the internal control structure for alternative investments will show significant enhancements. The structure is now in place to expand this process to encompass any new asset classes and audit considerations as this area continues to develop.

(Continued)

Finding #06-2 – Inaccurate Allocation of Investment Earnings

The Illinois State Board of Investment (the Board) did not accurately allocate investment earnings to the General Assembly Retirement System, Judges Retirement System of Illinois, and the State Employees' Retirement System of Illinois (member systems) during the year ended June 30, 2006.

The Board manages and invests the pension assets of the three member systems on a pooled basis, which requires the Board to maintain records of each member's proportionate share (i.e., subaccount). The Board allocates the net change in realized and unrealized investment gains and losses to each member system on the 15 of each month based on the ending member system percentage ownership of each member system for the prior month. The Board allocates the net change in income and expenses for the month to each member system on the 30 of each month taking into account any purchases or redemption in ownership shares from each system during that month.

During our audit of the Board's financial statements, we noted the following:

- The net change in income and expenses were improperly allocated based on the cumulative net change in realized gain/loss on investments rather than the prior period's realized gain/loss on investments. This error resulted in the over allocation of income and expense to the Judges Retirement System of Illinois by $1,319,613 and the under allocation to the State Employees' Retirement System of Illinois and the General Assembly Retirement System by $569,912 and $749,701, respectively, during the year ended June 30, 2006.
- The allocation of the Board assets to member systems is performed using a spreadsheet. The use of spreadsheets for complex calculations such as the allocation of investment earnings results in a significant risk that errors may occur and not be detected as cells are copied and changed with embedded formulas. Additionally, it is imperative the Board has adequate systems in place to maintain historical information of recorded transactions and investment allocations in previously issued financial reports. The use of spreadsheets as one of the primary information systems presents significant risk that data will be lost or not adequately maintained in future years.
- There is no documented review of the allocation of investment earnings and operating expenses by a second individual at the Board.
- There is no documentation (i.e., signed agreement) the allocation methodology has been approved by the member systems.

In discussing these conditions with Board officials, they stated the inaccurate allocation was due to the use of a spreadsheet and human error.

Failure to have established accounting procedures over pooled investments resulted in the improper allocation of investment earnings to member systems. (Finding Code No. 06-2)

(Continued)

Recommendation:

We recommend the Board:

- Obtain formal approval from the member systems regarding the allocation methodology for the pooled investments.
- Establish a procedure to require the review of the investment earning allocations, including the formulas used in the allocation, by a second individual knowledgeable of investments and the allocation methodology.
- Evaluate the current process used for maintaining member system account balances and for calculating the monthly allocations of investment earnings and operating expenses to determine if there is software available to record the Board's transactions in lieu of using spreadsheets with limited control features.

Agency Response:

The Board agrees that established accounting procedures regarding allocation methodology for the member systems should be enhanced.

The Board purchased a new automated general ledger package. The implementation of the new general ledger system has been co-sourced with a consultant. The Board and the consultant have worked together to configure, populate, and develop appropriate internal controls to ensure that the integrity of the financial statements remains intact during the transfer to the new general ledger system. The majority of data populating this system, including historical balances and future transactions, will come from a direct data import generated by the custodian for the Board's investment assets.

Also as a part of this process, the Board has documented the methodology behind all of the current Board financial statements for accurate replication of all the current financial statement formats within the automated general ledger package. This will significantly mitigate the risk of human error in the generation of the quarterly and annual financial statements including the Member System Participation Statement.

Historically, the State Retirement System Chief Fiscal Officer and Accounting Manager review the quarterly Board financial statements including the Member System Participation Statement. The Board is currently reviewing its documented methodology of the allocation process and will implement enhanced policies and procedures.

Finding #06-3 – Deposit and Investment Custodial Credit Risk

The Illinois State Board of Investment (the Board) identified deposits and a number of investments in their June 30, 2006 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 U.S. generally accepted accounting principles. The Governmental Accounting Standards Board (GASB) establishes those principles. GASB Statement No. 40, *Deposit and Investment Risk Disclosures* (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, 2006, the Board had $80,566,513 of deposits held in their investment-related bank account exposed to custodial credit risk. The deposits were neither insured nor collateralized for amounts in excess of the federal deposit insurance coverage of $100,000. In addition, the Board identified the following investments that were noted as being uninsured and unregistered, with the securities held by the counterparty or by its trust department or agent but not in the Board's name:

Common stock	$ 7,540,275
Government and agency obligations	43,932,397
Corporate obligations	4,649,641
Total	$56,122,313

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.

In discussing these conditions with Board officials, they stated this issue was pending from the previous years audit and the Board was awaiting an opinion from the Attorney General, which was requested by the Board in a letter dated April 21, 2006.

Failure to address custodial credit risk subjects the deposits and investments of the Board to a risk of loss in the event of a financial institution failure. (Finding Code No. 06-3, 05-1)

Recommendation:

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

Agency Response:

The Board financial statements are prepared in accordance with U.S. 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, the Board disclosed deposits and investments exposed to custodial risk in its fiscal year 2005 and 2006 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, the Board 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, the Board was in compliance with the Illinois Pension Code governing the Board.

Common stock having fair value of $7,540,275 was issued through stock distributions and held at the broker/transfer agent during periods of restrictions or being reregistered from the name of the partnership to the Board. The Security Investor Protection Act outlines the terms of investor protection related to assets held at brokers or transfer agents

Government and agency obligations with fair value of $43,932,397 and corporate obligations with fair value of $4,649,641 represented collateral held at the broker as part of a futures transaction for the Board's benefit. The Security Investor Protection Act outlines the terms of investor protection related to assets held at brokers or transfer agents.

The Board had $80,566,513 of deposits held in investment accounts with the custodian. First, this amount represents 0.71% of the Board's total assets at June 30, 2006 and considered to be immaterial. Secondly, the Board counsel is of the opinion that the Board is not subject to The State Officers and Employees Money Disposition Act (30 ILCS 230/2c).

In a letter dated April 21, 2006, addressed to Attorney General Lisa Madigan, the Board requested an opinion on the following question:

> "Is the Illinois State Board of Investment considered a "board . . . of the Executive Department of State government," and thereby subject to the State Officers and Employees Money Disposition Act?"

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

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…." 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.

(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, 2006

None.

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

Supplementary Information for State Compliance Purposes

Year ended June 30, 2006

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
- Proceeds from General Obligation Bonds, Pension Funding Series June 2003 (Unaudited)
- Legislative Changes
- Third-Party Marketing Fees Paid (Unaudited)
- 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, 2006 and 2005

		2006	2005	Increase (decrease)
Investment income:				
Interest	$	183,047,403	142,444,438	40,602,965
Dividends		123,178,718	119,713,292	3,465,426
Securities lending		4,321,712	3,674,829	646,883
Realized gain on investments		775,805,644	505,168,829	270,636,815
Unrealized gain on investments		116,794,342	260,921,934	(144,127,592)
Total investment income		1,203,147,819	1,031,923,322	171,224,497
Expenses:				
Salaries and benefits		1,173,380	1,082,345	91,035
Operating		413,205	374,817	38,388
External support		28,556,047	23,025,047	5,531,000
Total expenses		30,142,632	24,482,209	5,660,423
Net investment income	$	1,173,005,187	1,007,441,113	165,564,074

ILLINOIS STATE BOARD OF INVESTMENT
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Fiscal Schedules and Analysis

Schedules of Investment Portfolio

June 30, 2006 and 2005

	2006		2005	
Fair value	**Amount**	**Percentage of portfolio**	**Amount**	**Percentage of portfolio**
Equities:				
Common stocks:				
U.S. equities:				
Consumer discretionary	$ 751,740,929	6.56%	$ 911,979,964	8.33%
Consumer staples	244,029,935	2.13	324,734,700	2.96
Energy	522,346,336	4.57	469,996,387	4.29
Financials	1,166,232,790	10.20	1,180,048,942	10.77
Healthcare	527,578,068	4.61	593,439,038	5.41
Industrials	788,874,178	6.90	816,251,339	7.45
Information Technology	723,628,007	6.33	774,874,120	7.07
Materials	173,292,349	1.52	140,667,815	1.28
Telecommunication Services	147,661,559	1.29	125,260,624	1.14
Utilities	137,675,225	1.20	128,350,513	1.17
Other	186,064,656	1.63	114,208,754	1.04
Non-U.S. equities	1,113,268,102	9.74	986,200,950	9.00
Preferred stock	1,057,334	0.01	487,946	0.00
Total equities	6,483,449,468	56.69	6,566,501,092	59.91
Fixed income securities:				
Government and agency obligations:				
U.S. Treasury	457,091,471	4.00	556,169,172	5.07
Federal agencies and other governments	651,309,629	5.70	570,050,982	5.20
Options	(169,563)	0.00	(251,151)	0.00
Municipal	2,688,451	0.02	3,858,953	0.04
Foreign obligations	104,455,671	0.91	88,970,486	0.81
Corporate obligations:				
Finance	306,124,824	2.68	309,725,184	2.83
Industrials	580,581,651	5.08	655,888,086	5.98
Commercial mortgage backed securities	60,372,208	0.53	42,090,108	0.38
Collateralized mortgage obligations	151,314,595	1.32	55,302,261	0.50
Asset backed	143,583,472	1.26	98,839,530	0.90
Miscellaneous	96,553,993	0.84	132,753,283	1.21
Private placement	3,330,134	0.03	9,452,238	0.09
Commingled	40,713,286	0.36	341,540,499	3.12
Total fixed income securities	2,597,949,822	22.73	2,864,389,631	26.13
Real estate investments	1,134,025,154	9.92	778,951,123	7.11
Private equity	482,264,036	4.22	466,871,030	4.26
Hedge funds	416,462,183	3.64	—	0.00
Money market investments	320,641,552	2.80	283,461,008	2.59
Forward foreign currency contracts	26,145	0.00	(497,874)	0.00
Total investments	$ 11,434,818,360	100.00%	$ 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

Years ended June 30, 2006 and 2005

		2006	2005
Amalgamated Bank NY	$	228,935	44,759
Ariel		454,835	599,621
Ativo		40,847	5,952
Atlanta Life		187,811	30,399
Bear Stearns and Company		161,697	925,352
Blackrock		851,895	1,078,151
Boston Company		211,663	—
Brandywine		339,710	—
Buford, Dixon		110,377	92,626
Capital Guardian		(183,804)	746,444
Channing		211,544	36,086
Chicago Equity Partners		204,720	145,716
Decatur		19,333	—
Earnest Partners		911,683	641,283
Fifth Third Bank		—	436,649
Fort Washington		545,888	445,441
Geewax Terker		—	286,476
Globeflex Capital		540,382	230,095
Goldman Sachs		1,455,907	1,336,840
Grosvenor Capital Management		490,863	—
Harris Investment Management		210,210	277,072
Harris Investment Management-High Yield		620,842	510,479
High Pointe		186,512	156,360
Holland Capital		696,521	822,733
Howland		76,832	39,500
IronBridge Capital Management		886,296	754,437
Ivy		772,607	—
LM Capital		204,420	148,290
LSV Asset Management		1,893,042	1,507,309
Lynmar		157,314	74,321
Martingale Asset Management		1,112,479	752,645
Mesirow		529,444	—
New Amsterdam		888,674	793,621
NTGI Equitization		—	109,846
NTGI Index		—	38,392
NTGI-QM Collective Daily Aggregate Bonds		—	23,190
NTGI-QM Collective Daily GIC Bonds		—	19,310
NWQ		1,425,478	1,342,221
Opus Capital Management		244,053	146,422
Profit		155,335	75,457
Rhumbline		66,510	44,902
Rockcreek		551,779	—
Segall Bryant and Hamill		622,923	539,571
Southeastern		—	331,274
SSgA Bond Index Fund		13,134	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

Years ended June 30, 2006 and 2005

		2006	**2005**
SSgA (Cash Overlay)	$	302,703	246,520
SSgA Intermediate Gov./Credit Index		77,408	48,253
SSgA Small Cap Global		1,908,733	108,237
SSgA Domestic Equity		50,323	—
Templeton		1,356,112	1,242,999
Trust Fund Advisors		661,740	454,471
UBS Global (formerly Brinson)		969,442	998,935
Union Labor Life Investment Co. (ULLICO)		700,295	237,069
Walter Scott		967,754	806,301
Western Asset Management		845,161	890,528
William Blair		1,496,142	1,347,414
	$	27,434,504	22,010,299

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
(An Internal Investment Pool of the State of Illinois)

Fiscal Schedules and Analysis

Schedule of Soft Dollar Credits (Unaudited)

Years ended June 30, 2006 and 2005

		2006	2005
Soft dollar credits outstanding, at beginning of fiscal year	$	311,177	148,817
Soft dollar credits earned		27,249	177,236
Investment expenses paid with soft dollar credits		(47,004)	(14,876)
Soft dollar credits outstanding, at end of fiscal year	$	291,422	311,177

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
(An Internal Investment Pool of the State of Illinois)

Fiscal Schedules and Analysis

Schedule of Investment Commissions (Unaudited)

Years ended June 30, 2006 and 2005

		2006	2005
Investment brokerage firms:			
A. G. Edwards	$	7,084	—
Acento Securities		77,035	11,346
Allen & Company		7,682	—
Archipelago		39,402	20,744
B Riley and Co.		—	5,482
Banc of America Securities Inc.		28,071	26,904
Bank of New York		59,971	179,488
Bear Stearns Securities Corp.		63,000	16,721
Benchmark		—	40,143
Berean Capital Inc.		72,648	—
Blair, William & Co.		45,580	19,005
Blaylock Partners		—	69,617
Bloomberg Tradebook		23,193	—
BMO Nesbitt Burns		—	28,930
BNY Brokerage		27,371	—
BNY ESI & Co.		15,149	—
BOE Securities		6,923	—
Boston Institutional Services		—	8,746
Cabrera Asset Management		105,779	—
Canadian Imperial Bank		—	86,209
Cantor Fitzgerald & Co.		41,521	—
Capital Institutional Services Inc.		8,037	70,548
Capital Management Group		12,830	31,452
Cazenove & Co.		—	39,335
Cheevers & Company		40,793	—
Cheuvreus De Virieu		—	79,514
CIBC World Markets Corp.		13,526	—
CISTSOF		—	37,180
Citigroup Smith Barney Inc.		39,678	9,244
CJS Securities		13,530	88,469
Cowan & Company		6,455	—
Credit Suisse First Boston Corp.		50,964	17,358
Cromwell Weeden & Co.		—	24,787
D. A. Davidson & Co.		—	6,123
Dain Raucher		8,991	—
Deutsche Banc Securities Inc.		15,719	15,748
Direct Trading		—	29,496
Doherty & Co.		—	15,299
Dusable Partners		—	20,944
E. J. Securities		—	6,408
F McDonald & Co.		—	9,017
Fidelity		—	5,820
First Albany		11,744	—

(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, 2006 and 2005

	2006	2005
First Analysis Securities Corp.	$ —	6,975
First Boston	—	8,175
First Honolulu	83,901	31,443
Flagstone	9,656	—
Fox Pitt Kelton	9,949	34,696
Friedman Billings and Ramsey & Co. Inc.	9,800	—
Garban International	5,872	—
Gardner Rich & Co.	81,672	54,345
Gerard Klaider Mattison & Co.	—	121,870
Goldman Sachs & Company	25,165	9,487
Greentree Brokerage	—	38,072
Guzman & Co.	18,853	6,158
Harris Nesbitt Corp.	—	5,709
HSBC Securities Inc.	—	10,290
Instinet	12,262	10,812
Institutional Direct Inc.	—	28,006
Investment Technology Group	92,797	—
ITG Posit	—	13,643
Ivy Securities	—	45,094
J.P. Morgan Securities, Inc.	20,064	9,749
Jackson Partners	—	69,575
Janney Montgomery Scott, Inc.	6,250	—
Jefferies & Company	33,692	9,224
JNK Securities	—	60,136
Johnson Rice & Co.	—	6,024
Jones & Associates	38,150	7,872
KBC Financial Products	—	25,269
Keefe Bruynette and Woods Inc.	11,565	—
Knight Securities	—	12,992
Lava Trading	—	5,768
Legg Mason & Co.	15,984	8,850
Lehman Brothers Inc.	90,077	39,574
Liquidnet Inc.	142,311	91,935
LJRY	—	52,634
Loop Capital Markets	139,807	268,526
Lynch Jones & Ryan	20,939	12,740
M. Ramsey King Securities	14,382	37,696
Macquarie Securities	—	29,514
Magna Securities	20,910	59,210
Mainfirst Bank	—	5,158
McDonald and Company	5,554	—
MDB Capital	—	29,524
Melvin Securities Corp	161,026	22,033
Merrill Lynch Pierce Fenner & Smith	43,833	40,215

(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, 2006 and 2005

	2006	2005
Midwest Research Securities	$ 11,605	95,010
Morgan Keegan and Company	—	8,774
Morgan Stanley & Co.	78,763	12,173
MR Beal	62,769	—
Muriel Siebert	5,009	43,795
National Financial Services	—	12,452
Nutmeg Securities	40,006	13,420
NYFIX	—	78,822
Oppenheimer	14,882	8,392
Ormes Capital Msrkets, Inc.	—	6,713
Pacific American	13,190	—
Petrie Parkman	—	57,785
Prudential Equity Group	—	14,631
Prudential Securities	14,896	—
Pulse Trading LLC	—	18,933
Ramirez	12,296	—
Raymond James & Assoc.	10,764	6,847
Redi Plus	—	10,257
Robert W. Baird & Co.	51,009	17,652
Robinson Humphery	5,897	22,680
Rock Island Securites	—	12,292
Roth Capital	—	15,017
Royal Bank of Canada	—	7,302
Ryan Beck	—	7,828
Salomon Smith Barney	12,523	—
Sanford C. Bernstein	42,907	22,881
Saxony	7,426	—
SBK Brooks	17,759	44,508
Schwab, Charles	—	8,232
SG Cowen and Company	9,799	—
Sidoti	—	7,794
Smith Barney	5,012	—
Soleil Securites	—	7,307
State Street Bank	7,583	—
Stephen Inc.	7,133	—
Stuart Frankel & Co.	—	6,572
Susquehanna Capital	12,579	—
Svenska Handlebank	—	5,420
Thomas Weisel Partners LLC	8,613	—
Thompson Davis	7,553	17,410
U.S. Bancorp Piper Jaffray Inc.	13,677	12,572
UBS Warburg Dillon Read	37,153	42,293
USIG-bea	—	53,130

(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, 2006 and 2005

		2006	**2005**
Wachovia Securities	$	8,919	—
Waterhouse		—	6,620
Wedbush Morgan Securities, Inc.		13,925	5,514
Weeden & Co.		21,840	9,921
Wheat First		5,476	37,053
Williams Capital Group		101,521	72,055
Various (Under $5,000)		157,980	137,461
	$	2,777,611	3,316,588

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

Schedule of Property and Equipment

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

		Beginning balance	Additions	Deletions	Ending balance
Cost	$	99,335	21,442	—	120,777
Less accumulated depreciation		(57,563)	(17,866)	—	(75,429)
Net property and equipment	$	41,772	3,576	—	45,348

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, 2006	$	58,234
Vouchers in transit		(80,611)
Balance per Board at June 30, 2006	$	(22,377)

Analysis of Accounts Receivable

The Board's receivable balance at June 30, 2006 amounted to $184,529,093, which consisted of $38,355,081 of dividends, interest, foreign taxes, and accounts receivable on investments held and receivables of $146,174,012 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.

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, 2006 include:

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

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, 2006.

Number of Employees

The Board had 11 full-time employees at June 30, 2006 and 10 full-time employees at June 30, 2005.

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.

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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, 2006 and 2005 were as follows:

	Cost	Fair value	Gain (loss)
June 30, 2006:			
Forward currency purchases	$ 3,956,106	4,008,201	52,095
Forward currency sales	7,860,622	7,886,572	(25,950)
Total gain			$ 26,145
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 loss			$ (497,874)

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, 2006 and 2005, the fair value of the Board's CMO holdings totaled $211,686,803 and $97,392,369, 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, 2006 and 2005:

	2006		2005	
	Number of contracts	**Contract principal***	**Number of contracts**	**Contract principal***
Domestic:				
Equity futures purchased	2,667	$ 190,210,548	847	$ 141,009,225
Fixed income futures purchased	1,605	269,684,894	689	131,827,288
Fixed income futures sold	355	37,149,313	630	74,051,321
Fixed income written put options	71	7,100,000	158	15,800,000
Fixed income written call options	320	122,900,000	18,150,179	36,050,000
Eurocurrency purchased call options	23,550,000	23,550,000	—	—
Fixed income purchased put options	58	58,000,000	278	138,500,000
Fixed income purchased call options	—	—	131	77,000,000

* 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 (State Street). 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, 2006 and 2005, there were outstanding loaned investment securities having market values of $1,568,683,721 and $1,442,715,435, respectively, against which collateral was received with a value of $1,597,656,445 and $1,476,263,962, respectively. Collateral received at June 30, 2006 and 2005 consisted of $1,530,783,382 and $1,444,871,284, respectively, in cash and $66,873,063 and $31,392,678, respectively, in securities for which the Board does not have the ability to pledge or sell.

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

Public Act 93-0002 (the 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 11.0% during the year ended June 30, 2006, which is the same as the overall return for the Board's investment portfolio.

Legislative Changes

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 resulted in an increase in member systems' withdrawals of $211.3 million in fiscal year 2006 to meet their respective funding requirements for benefit obligations.

Third-Party Marketing Fees Paid (Unaudited)

The Board disclosed that investment managers hired marketing groups to assist with promoting their investment product to the Board. Marketing fees paid by investment managers were as follows:

Investment manager	Third-party marketer	Type of fund		Year ended June 30 2006	2005
Harris Bank	Michael Dudek	Fixed Income	$	56,578	79,033
Howland & Associates	Carol Mackoff	Equity		7,923	5,015
Ironbridge Capital	Frontier Partners-Frontegra Asset Mgmt.	Equity		177,259	150,887
Ivy Asset Management	The Marwood Group	Hedge Fund		183,954	—
Jordan Resolute Fund	Atlantic Pacific Capital	Private Equity		—	120,357
William Blair	Orlando Jones	Equity		211,408	260,155
Windpoint Partners	C.P. Eaton & Associates	Private Equity		—	17,608
Total			$	637,122	633,055

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

	2006	2005	2004	2003	2002
Annual total return	11.0%	10.1%	16.4%	0.3%	(6.9)%
Compound annual rate of return since July 1, 1982	10.7	10.7	10.8	10.5	11.1

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

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

Analysis of Operations

Year ended June 30, 2006

The Board earned a total rate of return of 11.0% for the year ended June 30, 2006, 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, 2006 was 11.5%.

						(Annualized)	
	2006	**2005**	**2004**	**2003**	**2002**	**3 years**	**5 years**
Total fund	11.0%	10.1%	16.4%	0.3%	(6.9)%	12.4%	5.8%
*Composite bench mark**	*11.5*	*10.9*	*16.3*	*3.5*	*(7.3)*	*12.9*	*6.7*
Consumer price index	*4.2*	*2.5*	*3.3*	*2.1*	*1.1*	*3.3*	*2.6*
U.S. equities	10.7	9.3	21.7	0.9	(14.6)	13.7	4.4
Wilshire 500 Index	*10.0*	*8.4*	*21.2*	*1.3*	*(16.6)*	*13.1*	*4.1*
International equities	28.9	14.8	29.8	(7.5)	(6.3)	24.2	10.7
MSCI-EAFE Index	*27.1*	*14.1*	*32.9*	*(6.1)*	*(9.2)*	*24.4*	*10.4*
Fixed income	0.8	6.9	0.7	8.3	5.5	2.8	4.4
Lehman U.S. Universal Bond Index	*(0.3)*	*7.4*	*1.0*	*11.5*	*7.7*	*2.7*	*5.4*
Real estate	19.5	14.8	9.1	2.2	11.5	14.4	11.3
NCRIEF Real Estate Index	*18.7*	*15.6*	*9.7*	*5.2*	*5.9*	*15.8*	*12.0*
Private equity	21.3	29.6	16.9	(4.9)	(18.4)	20.8	6.5

* 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%.

(Continued)

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

Analysis of Operations

Year ended June 30, 2006

Asset Allocations by Fund Type as of June 30, 2006

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	$ 5,370.2	47%	45%
U.S. equity hedge funds	416.5	4	5
International equity	1,113.2	10	10
Fixed income[1]	2,597.9	23	25
Real estate	1,134.0	10	10
Private Equity[2]	482.3	4	5
Cash[3]	202.4	2	—
Total	$ 11,316.5	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 money market instruments and other assets, less liabilities.