

# **ILLINOIS STATE BOARD OF INVESTMENT**

An Internal Investment Pool  
of the State of Illinois

Financial Statements

June 30, 2015

(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

1	Summary
2-3	Independent Auditors' Report
4-5	Management's Discussion and Analysis
	Financial Section
6	Statements of Net Position
7	Statements of Changes in Net Position
8-23	Notes to Financial Statements
24-25	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
26	Schedule of Finding

## **Financial Statement Report Summary**

The audits of the accompanying financial statements of the Illinois State Board of Investment (ISBI) were performed by RSM US LLP as of and for the years ended June 30, 2015 and 2014.

Based on their audits, the auditors expressed an unmodified opinion on the ISBI's basic financial statements.

### **Summary of Finding**

The auditors identified a matter involving ISBI's internal control over financial reporting that they considered to be a significant deficiency. The significant deficiency is described in the accompanying Schedule of Finding on page 26 of this report as item 2015-001, *Inadequate Controls Over Financial Close and Reporting*.

### **Exit Conference**

In correspondence received from Alise White, on November 5, 2015, ISBI elected to waive a formal exit conference. The response to the recommendation was provided by Alise White, Deputy Executive Director, in correspondence dated November 6, 2015.

Honorable William G. Holland  
Auditor General  
State of Illinois

Board of Trustees  
Illinois State Board of Investment

## Report on the Financial Statements

As Special Assistant Auditors for the Auditor General, we have audited the accompanying Statements of Net Position of the Illinois State Board of Investment Member Systems (ISBI Member Systems), an internal investment pool of the State of Illinois, as of and for the years ended June 30, 2015 and 2014, and the accompanying Statements of Net Position of its investment trust fund, the Illinois Power Agency Trust Fund (Trust Fund) as of June 30, 2015 and June 30, 2014, and the related Statements of Changes in Net Position and the related notes to the financial statements for the years then ended, which collectively comprise the Illinois State Board of Investment's (ISBI) basic financial statements as listed in the table of contents.

## Management's Responsibility for the Financial Statements

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

## Auditors' Responsibility

Our responsibility is to express opinions 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 the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States. Those standards require that we plan and perform the audits to obtain reasonable assurance about whether the financial statements are free from material misstatement.

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

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

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## Opinions

In our opinion, the financial statements referred to above present fairly, in all material respects, the net position of ISBI Member Systems, as of June 30, 2015 and 2014, and the changes in net position for the years then ended, and its investment trust fund, the Illinois Power Agency Trust Fund, as of June 30, 2015 and 2014, in accordance with accounting principles generally accepted in the United States of America.

## Other Matters

### *Required Supplementary Information*

Accounting principles generally accepted in the United States of America require that the management's discussion and analysis on pages 4-5 be presented to supplement the basic financial statements. Such information, although not a part of the basic financial statements, is required by the Governmental Accounting Standards Board who considers it to be an essential part of financial reporting for placing the basic financial statements in an appropriate operational, economic, or historical context. We have applied certain limited procedures to the required supplementary information in accordance with auditing standards generally accepted in the United States of America, which consisted of inquiries of management about the methods of preparing the information and comparing the information for consistency with management's responses to our inquiries, the basic financial statements, and other knowledge we obtained during our audit of the basic financial statements. We do not express an opinion or provide any assurance on the information because the limited procedures do not provide us with sufficient evidence to express an opinion or provide any assurance.

## Other Reporting Required by Government Auditing Standards

In accordance with *Government Auditing Standards*, we have also issued our report dated December 9, 2015, on our consideration of the ISBI Member Systems and Trust Fund's internal control over financial reporting and on our tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements and other matters. The purpose of that report is to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing, and not to provide an opinion on internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* in considering the ISBI Member Systems and Trust Fund's internal control over financial reporting and compliance.



Schaumburg, Illinois  
December 9, 2015

# Management's Discussion and Analysis

In October 1969, the Illinois State Board of Investment (ISBI) was created by enactment of Article 22A of the Illinois Pension Code by the 76th General Assembly of Illinois. By statute, ISBI was given the responsibility for management of the assets of the General Assembly Retirement System, the Judges' Retirement System of Illinois and the State Employees' Retirement System of Illinois (Member Systems). Also, in August 2007, by enactment of 30 ILCS 105/6z-75 of the Illinois Compiled Statutes, ISBI was given responsibility for the management of the Illinois Power Agency Trust Fund. Board membership consists of five members appointed by the Governor and four ex officio members consisting of the State Treasurer and the Chairman of the Board of Trustees of each of the retirement systems. ISBI maintains its office in Chicago, Illinois.

The following Management's Discussion and Analysis (MD&A) provides an introduction and overview of the Illinois State Board of Investment (ISBI) financial activities for the fiscal years ended June 30, 2015 and 2014.

## Financial Highlights

The net position of ISBI totaled approximately \$15.8 billion at fiscal year end June 30, 2015, compared to approximately \$15.1 billion at June 30, 2014. The increase from the previous year is primarily the result of investment gains.

## General Market Risk

ISBI is exposed to general market risk. This general market risk is reflected in asset valuations fluctuating with market volatility. Any impact from market volatility on ISBI's investment portfolio depends in large measure on how deep the market downturn is, how long it lasts, and how it fits within fiscal year reporting periods. The resulting market risk and associated realized and unrealized gains and losses could significantly impact ISBI's financial condition. The readers of these financial statements are advised that financial markets continue to be volatile and are experiencing significant changes on almost a daily basis.

## Overview of the Financial Statements

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

The Statements of Net Position presents information on ISBI's assets and liabilities and the resulting net position. This statement also reflects ISBI's investments along with the cash and short-term investments, receivables, and other assets and liabilities.

The gain in investments at June 30, 2015 is a result of an investment gain of 4.7% for the fiscal year, net of expenses which are shown in the Statements of Changes in Net Position. The increase in liabilities for fiscal 2015 compared with 2014 is consistent with a large amount of investment purchases at year-end to rebalance the portfolio. The decrease in liabilities for fiscal 2014 compared with 2013 consisted mainly of an increase in payables for investment purchases. This increase in investment payables was a result of the rebalancing of the portfolio and updates to the asset allocation due to approval of Marquette Associates to be retained as a result of an RFP for General and/or Real Estate Investment Consulting services. As consistent with the Investment Policy of ISBI, the conclusion of that process automatically triggers a new asset allocation study. Marquette Associates put forth Asset Allocation recommendations that were approved at the ISBI June 2013 Board meeting.

## Condensed Summary of Net Position

	June 30			2015/2014 Change	2014/2013 Change
	2015	2014	2013		
	\$	\$	\$	\$	\$
Cash	14,210,878	9,397,247	21,388,387	4,813,631	(11,991,140)
Receivables	632,521,317	401,298,113	418,929,069	231,223,204	(17,630,956)
Investments	15,831,411,636	15,116,104,672	12,849,984,270	715,306,964	2,266,120,402
Securities lending collateral	31,096,392	60,129,299	59,175,835	(29,032,907)	953,464
Prepaid expenses	11,588	14,565	27,946	(2,977)	(13,381)
Capital assets	41,223	42,514	44,076	(1,291)	(1,562)
Total assets	16,509,293,034	15,586,986,410	13,349,549,583	922,306,624	2,237,436,827
Liabilities	663,399,484	477,611,035	483,092,347	185,788,449	(5,481,312)
Total net position	15,845,893,550	15,109,375,375	12,866,457,236	736,518,175	2,242,918,139

# Management's Discussion and Analysis

The Statements of Changes in Net Position present information regarding changes during the fiscal year ended June 30, 2015. These statements reflect additions and deductions, which include the investment income and losses derived from realized and unrealized gains/losses, member system contributions, and income received from securities lending activities. Also reflected in the statements are deductions, which include withdrawals from the Member Systems and operating expenses of ISBI.

The net investment gains for the year ended June 30, 2015 were the result of upward movement in the securities markets. There was a decrease in withdrawals by the member systems. Fiscal year 2015 withdrawals were \$5.4 million compared with \$65.1 million in fiscal year 2014. Withdrawals are determined by the member retirement systems based on the State of Illinois' funding and the Member Systems' benefit payment needs. The increase in administrative expenses for fiscal year 2015 compared to 2014 is due to an upward movement in the value of the portfolio which is the base for calculation of investment management fees.

The net investment gains for the year ended June 30, 2014 were the result of upward movement in the securities markets. There was an increase in withdrawals by the member systems. Fiscal year 2014 withdrawals were \$65.1 million compared with \$29.8 million in fiscal year 2013. Withdrawals are determined by the member retirement systems based on the State of Illinois' funding and the Member Systems' benefit payment needs. As a result of a one-time transfer to the State Employees' Retirement System to pay for the FY2013 overpayment per ILCS 5/14-131(f) withdrawals increased for the year. The increase in administrative expenses for fiscal year 2014 compared to 2013 is due to an upward movement in the value of the portfolio which is the base for calculation of investment management fees.

## Condensed Statements of Changes in Net Position

	Fiscal Years Ended June 30			2015/2014 Change	2014/2013 Change
	2015	2014	2013		
	\$	\$	\$	\$	\$
<b>Additions:</b>					
Net investment income	765,107,482	2,334,760,880	1,625,321,501	(1,569,653,398)	709,439,379
Contributions from the State of Illinois	21,400,460	16,000,000	24,900,254	5,400,460	(8,900,254)
Total additions	786,507,942	2,350,760,880	1,650,221,755	(1,564,252,938)	700,539,125
<b>Deductions:</b>					
Member Systems' withdrawals	5,350,000	65,062,913	29,792,192	(59,712,913)	35,270,721
Administrative expenses	44,639,767	42,779,828	37,909,012	1,859,939	4,870,816
Total deductions	49,989,767	107,842,741	67,701,204	(57,852,974)	40,141,537
Net increase (decrease) in net position	736,518,175	2,242,918,139	1,582,520,551	(1,506,399,964)	660,397,588

### Future Outlook

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

At the June 18, 2015 Board Meeting the allocation of the Board's real estate portfolio target was temporarily adjusted to 10.4% of total plan assets. Money will be taken from the Fixed Income portfolio to fund this increase in Real Estate. The additional monies will be targeted towards International Real Estate.

# Statements of Net Position

JUNE 30, 2015 and 2014

	Illinois State Board of Investment Member Systems		Illinois Power Agency Trust Fund		Total Illinois State Board of Investment	
	2015	2014	2015	2014	2015	2014
	\$	\$	\$	\$	\$	\$
<b>ASSETS</b>						
Cash	12,983,801	9,376,958	1,227,077	20,289	14,210,878	9,397,247
Receivables:						
Foreign taxes	4,679,308	2,735,624	9,759	5,919	4,689,067	2,741,543
Accounts receivable	307,208	1,519,374	641	3,288	307,849	1,522,662
Investments sold	584,600,148	356,879,941	1,219,162	772,192	585,819,310	357,652,133
Interest and dividends	41,618,298	39,296,747	86,793	85,028	41,705,091	39,381,775
Total receivables	631,204,962	400,431,686	1,316,355	866,427	632,521,317	401,298,113
Prepaid expenses	11,565	14,534	23	31	11,588	14,565
Capital assets	41,137	42,422	86	92	41,223	42,514
Investments at fair value:						
Government and agency Obligations	905,946,508	782,781,918	1,889,318	1,693,730	907,835,826	784,475,648
Foreign obligations	890,996,127	830,485,454	1,858,139	1,796,948	892,854,266	832,282,402
Corporate obligations	812,745,287	797,788,043	1,694,950	1,726,199	814,440,237	799,514,242
Common stock and equity funds	4,738,608,305	4,543,452,501	9,884,435	9,830,815	4,748,492,740	4,553,283,316
Commingled funds	769,200,906	731,428,365	1,604,140	1,582,615	770,805,046	733,010,980
Foreign equity securities	2,375,046,028	2,341,436,888	4,953,070	5,066,241	2,379,999,098	2,346,503,129
Foreign preferred stock	177,269	72,750	370	157	177,639	72,907
Hedge funds	1,572,969,759	1,481,938,543	3,280,370	3,206,517	1,576,250,129	1,485,145,060
Real estate funds	1,607,473,903	1,480,243,122	3,352,327	3,202,849	1,610,826,230	1,483,445,971
Private equity	665,692,385	666,288,596	1,388,277	1,441,670	667,080,662	667,730,266
Money market instruments	230,634,419	217,266,893	480,979	470,107	231,115,398	217,737,000
Real assets	531,609,455	523,152,831	1,108,652	1,131,962	532,718,107	524,284,793
Bank loans	696,384,329	687,768,412	1,452,284	1,488,146	697,836,613	689,256,558
Foreign currency forward contracts	977,606	(636,223)	2,039	(1,377)	979,645	(637,600)
Total investments	15,798,462,286	15,083,468,093	32,949,350	32,636,579	15,831,411,636	15,116,104,672
Securities lending collateral	31,031,677	59,999,476	64,715	129,823	31,096,392	60,129,299
Total assets	16,473,735,428	15,553,333,169	35,557,606	33,653,241	16,509,293,034	15,586,986,410
<b>LIABILITIES</b>						
Payables:						
Investments purchased	621,851,424	406,924,166	1,296,848	880,475	623,148,272	407,804,641
Administrative expenses	8,227,266	8,378,940	17,158	18,130	8,244,424	8,397,070
Securities lending cash collateral obligation	31,940,178	61,276,738	66,610	132,586	32,006,788	61,409,324
Total liabilities	662,018,868	476,579,844	1,380,616	1,031,191	663,399,484	477,611,035
Net position	15,811,716,560	15,076,753,325	34,176,990	32,622,050	15,845,893,550	15,109,375,375

\*The assets of the Illinois Power Agency Trust Fund came under management of the Illinois State Board of Investment in fiscal year 2012.

See notes to financial statements, pages 8-23

# Statements of Changes In Net Position

JUNE 30, 2015 and 2014

	Illinois State Board of Investment Member Systems		Illinois Power Agency Trust Fund		Total Illinois State Board of Investment	
	2015	2014	2015	2014	2015	2014
	\$	\$	\$	\$	\$	\$
<b>ADDITIONS</b>						
Investment income:						
Net increase in fair value						
of investments	253,829,554	1,908,636,433	548,718	4,202,702	254,378,272	1,912,839,135
Interest and other	353,516,656	263,808,067	764,494	580,167	354,281,150	264,388,234
Dividends	152,962,203	153,952,707	330,787	338,572	153,292,990	154,291,279
Securities lending income	161,232	182,900	349	402	161,581	183,302
Securities lending rebates	3,317,554	3,392,284	7,174	7,437	3,324,728	3,399,721
Securities lending expense	(330,524)	(340,045)	(715)	(746)	(331,239)	(340,791)
Total investment income	763,456,675	2,329,632,346	1,650,807	5,128,534	765,107,482	2,334,760,880
Contributions from the State of Illinois	21,400,000	16,000,000	460	-	21,400,460	16,000,000
Total additions	784,856,675	2,345,632,346	1,651,267	5,128,534	786,507,942	2,350,760,880
<b>DEDUCTIONS</b>						
Administrative expenses:						
Salaries and benefits:						
Salaries	1,224,606	1,144,901	2,648	2,516	1,227,254	1,147,417
Benefits	845,698	748,626	1,829	1,646	847,527	750,272
Operating expenses:						
Rent and utilities	172,347	187,702	372	413	172,719	188,115
Audit	196,397	176,542	425	388	196,822	176,930
Other	232,892	239,586	504	527	233,396	240,113
External support:						
Custody	234,493	219,517	507	483	235,000	220,000
Consulting and professional	1,332,084	1,209,191	2,881	2,659	1,334,965	1,211,850
Investment advisors/managers	40,062,708	38,474,339	86,636	84,589	40,149,344	38,558,928
Investment services and research	242,215	285,575	525	628	242,740	286,203
Total administrative expenses	44,543,440	42,685,979	96,327	93,849	44,639,767	42,779,828
Member Systems' withdrawals	5,350,000	64,407,580	-	655,333	5,350,000	65,062,913
Total deductions	49,893,440	107,093,559	96,327	749,182	49,989,767	107,842,741
Increase in net position	734,963,235	2,238,538,787	1,554,940	4,379,352	736,518,175	2,242,918,139
Net position at beginning of year	15,076,753,325	12,838,214,538	32,622,050	28,242,698	15,109,375,375	12,866,457,236
Net position at end of year	15,811,716,560	15,076,753,325	34,176,990	32,622,050	15,845,893,550	15,109,375,375

See notes to financial statements, pages 8-23

# Notes to Financial Statements

JUNE 30, 2015 and 2014

## Note 1

### Summary of Significant Accounting Policies

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#### Reporting Entity

The Illinois State Board of Investment (ISBI) is considered to be an internal investment pool of the State of Illinois, operating from investment income and contributions from the State of Illinois. ISBI manages and invests the pension assets of three separate public employee retirement systems (Member Systems): General Assembly Retirement System, the Judges' Retirement System of Illinois, and State Employees' Retirement System of Illinois. ISBI also manages the assets of the Illinois Power Agency Trust Fund (Trust Fund). The Trust Fund is reported as an investment trust fund of ISBI.

The assets of the Member Systems and the Trust Fund are accounted for in a single commingled fund. Separate information on each System's participation is presented in Note 3. The assets of the Trust Fund came under management of ISBI in fiscal year 2012. The assets and liabilities of the Trust Fund are reported on the Statements of Net Position. The revenues and expenses for the Trust Fund for fiscal years 2015 and 2014 are reported on the Statements of Changes in Net Position.

#### Basis of Accounting

Accounting records are maintained on an accrual basis. Units are allocated monthly to each Member System and the Illinois Power Agency Trust Fund based upon percentage of ownership. Administrative expenses are deducted monthly from income before allocation.

#### 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, Foreign 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 Investments – fair values based on audited financial statements of the funds and then adjusted by ISBI and its investment managers for activity from audit date to fiscal year end; (5) Alternative Investments (Private Equity, Hedge funds, Bank Loans and Real Assets) – fair values based on audited financial statements of the funds and then adjusted by ISBI and its investment managers for activity from audit date to fiscal year end; (6) Commingled funds – fair values based on audited financial statements of the funds and then adjusted by ISBI and its investment managers for activity from audit date to fiscal year end.

#### Investment Transactions and Investment Income

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

#### Custody and Investment Management Fees

ISBI has contracted with investment managers approved by the Board of Trustees to make investment decisions based on investment guidelines provided to them by ISBI staff and consultants. The investment managers serve as investment advisors to ISBI. ISBI pays an investment management fee to each investment manager for these services on a quarterly basis. The investment management fee is based upon contractual agreement provisions and is computed as a percentage of each manager's portfolio market value.

Management fees paid to Real Estate funds and Private Equity funds are calculated based upon the terms of each individual fund agreement and are reported in Investment Income on the Statements of Changes in Net Position. Management fees paid to Hedge funds, certain Real Assets, Commingled funds and Bank Loan funds are calculated based on each manager's portfolio market value or ISBI's capital commitment and are reported as Investment Advisor/Managers Expense on the Statements of Changes in Net Position. Certain other infrastructure fund fees are reported net of investment income on the Statements of Changes in Net Position.

ISBI has contracted with State Street Bank and Trust Company (State Street) to provide custody services for the pension systems assets. These services include safekeeping and transaction processing services for all pension assets of the Member Systems. State Street also provides cash management services and all necessary reporting for pension assets including performance reporting and accounting reports. There are no base charges for custody fees. Custody fees paid to State Street are paid based on set quarterly amounts per the Custodian Contract for performance and analytics services and various accounting data interface feeds.

#### Risk Management

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, which handles processing of all claims. ISBI obtains commercial insurance for fidelity and surety and property. There have been no commercial insurance claims in the past five years.

**Note 1 (continued)**  
**Summary of Significant Accounting Policies**

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**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 Statements of Net Position.

**Use of Estimates**

In preparing financial statements in conformity with U.S. generally accepted accounting principles, ISBI 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 additions and deductions during the reporting period. Actual results could differ from those estimates and assumptions and the differences may be material.

The determination of fair value for illiquid/alternative investments, such as investments in Real Estate and Private Equity funds, takes into account consideration of a range of factors, including but not limited to the price at which the underlying investments were acquired, the nature of the underlying investments, local market conditions, trading values on public exchanges for comparable underlying investments, current and projected operating performance of the underlying investments, and financing transactions subsequent to the acquisition of the investment. Determining fair value of such investments involves a significant degree of judgment by ISBI and its investment managers.

Because of the inherent uncertainty of the above referenced fair values, the estimated values may differ significantly from the values that would have been used had a ready market for the securities existed, and the differences could be material.

**Compensated Absences**

The liability for compensated absences consists of unpaid, accumulated vacation and sick leave balances for ISBI employees. The liability has been calculated using the vesting method,

in which leave amounts for both employees who are currently eligible to receive termination payments, and other employees who are expected to become eligible in the future to receive such payments upon termination are included. The liability has been calculated based on the employees' current salary and includes salary related costs (e.g., social security and Medicare tax). The liability is included in Administrative Expenses on the Statements of Net Position and the annual increase or decrease in the liability is reflected in the Salaries Expense on the Statements of Changes in Net Position.

Legislation that became effective January 1, 1998 capped the paid sick leave for all State Employees' Retirement System members at December 31, 1997. Employees continue to accrue twelve sick days per year, but will not receive monetary compensation for any additional time earned after December 31, 1997. Sick days earned between 1984 and December 31, 1997 (with a 50% cash value) would only be used after all days with no cash value are depleted. Any sick days earned and unused after December 31, 1997 will be converted to service time for purposes of calculating employee pension benefits.

**Reclassification**

Certain amounts in the 2014 financial statements have been reclassified to conform to the current year presentation, without any impact on net position or the change in net position as previously reported.

**Subsequent Events**

ISBI has evaluated subsequent events for potential recognition and/or disclosure through December 9, 2015, the date the financial statements were available to be issued.

# Notes to Financial Statements

JUNE 30, 2015 and 2014 (continued)

## Note 2

### Deposits, Investments, and Investment Risk

#### 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. As of June 30, 2015 and 2014, ISBI had non-investment related bank balances of \$1,433,111 and \$474,083, respectively. During fiscal year 2007, a Credit Risk Policy was implemented by ISBI staff and formally adopted by ISBI in July of 2007. The Policy outlines the control procedures used to monitor custodial credit risk. These assets are under the custody of State Street Bank and Trust Company and Deutsche Bank AG, NY Branch. State Street Bank and Trust Company has an AA- Long-term Deposit/Debt rating by Standard & Poor's and an Aa2 rating by Moody. Deutsche Bank AG has a BBB+ Long-Term rating by Standard & Poor's and an A3 rating by Moody's. Certain investments of ISBI with maturities of 90 days or less would be considered cash equivalents; these consist of short-term investment funds and U.S. Treasury bills with maturities of 90 days or less, which are not subject to the custodial credit risk. For financial statement presentation and investment purposes, ISBI reports these types of cash equivalents as Money Market Instruments in the Statements of Net Position. As of June 30, 2015 and 2014, ISBI had investment related bank balances of \$13,575,431 and \$8,923,164, respectively. These balances include USD and foreign cash balances. As of January 1, 2013, cash held in the investment related bank account is neither insured nor collateralized for amounts in excess of \$250,000. At any given point and time the foreign cash balances may be exposed to custodial credit risk.

#### 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 1, ISBI currently manages and invests the assets of the General Assembly Retirement System, Judges' Retirement System, and State Employees' Retirement System and the Illinois Power Agency Trust Fund. 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 ISBI 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 Commitments

ISBI had total investment commitments of \$613 million and \$458 million at the end of fiscal years 2015 and 2014, respectively. Real Estate and Private Equity investment portfolios consist of passive interests in limited partnerships. ISBI had outstanding commitments to these limited partnerships of approximately \$460 million and \$426 million as of June 30, 2015 and 2014, respectively. At the end of fiscal year 2015 and 2014, ISBI had outstanding commitments of \$4 million and \$61 million to separate real estate accounts within the Real Estate and Private Equity investment portfolios, respectively. Also at the end of fiscal year 2015 and 2014, ISBI had outstanding amounts of \$153 million and \$32 million to real assets, respectively. ISBI would fund outstanding commitments by utilizing available cash and then selling liquid securities in the portfolio as necessary.

#### Investment Liquidity

ISBI holds investments in hedge funds, real estate funds, private equity funds and real assets that are considered illiquid by the very nature of the investment. Market risk exists with respect to these investments as ISBI may not be able to exit from the investments during periods of significant market value declines.

#### Rate of Return

For the year ended June 30, 2015 and 2014, the annual money-weighted rate of return on pension plan investments, net of

**Note 2 (continued)**

**Deposits, Investments, and Investment Risk**

pension plan investment expense, was 4.74 percent and 17.86 percent, respectively. The money-weighted rate of return expresses investment performance, net of investment expense, adjusted for the changing amounts actually invested. The money-weighted rate of return (MWRR) information was presented to assist the Member Systems to prospectively implement GASB 67 during fiscal year 2014.

**Alternative Investments**

Investments in hedge funds are structured to achieve a diversified hedged equity fund-of-funds portfolio. Capital is allocated to a select group of Hedge Fund managers that invest predominately in equity securities, both long and short. The investments shall be managed with the intent of preserving capital in a declining market and in a rising market they will generate a smaller return than the overall equity market. These investments are redeemable once the underlying assets are liquidated.

ISBI's investments in Private Equity and Real Estate funds represent investment vehicles used for making investments in various equity and debt securities according to the investment strategies as determined by the fund managers at the commencement of the fund.

Investment strategies of Private Equity funds include, but are not limited to, leveraged buyouts, venture capital, growth capital and mezzanine capital.

Investment strategies of Real Estate investments include, but are not limited to, the purchase, development, ownership, management, rental and/or sale of real estate for profit.

Certain real estate investments are leveraged whereby partnerships have been established to purchase properties through a combination of contributions from ISBI and through acquisition of debt. At June 30, 2015, real estate equities of approximately \$1,611 million are reported at estimated fair value. Of this amount, \$1,415 million is equity and \$196 million is long-term debt. At June 30, 2014 real estate equities of approximately \$1,483 million were reported at estimated market value. Of this amount, \$1,288 million was equity and \$195 million was long-term debt.

Required repayment of real estate debt, which is non-recourse debt, is as follows as of June 30, 2015 and 2014:

Debt Maturities Year Ending June 30	2015 \$	2014 \$
2015	-	-
2016	27,418,790	28,240,488
2017	56,584,691	57,416,040
2018	22,500,000	-
2019	44,355,719	-
2020-2024	45,057,515	88,046,051
2025-2026	-	21,321,503
	<u>195,916,715</u>	<u>195,024,082</u>

ISBI's investments in Real Assets represent pooled investment vehicles used to seek capital appreciation and current income by acquiring, holding, financing, refinancing and disposing of infrastructure investments and farmland assets. Real Assets include various public works (e.g. bridges, tunnels, toll roads, airports, public transportation and other public works) that are made typically as a part of a privatization initiative on the part of a government entity.

A Commingled fund is a kind of mutual fund or common trust fund which consists of multiple kinds of assets from several accounts combined together. 'Commingling' these separate assets mitigates risk for the trader through investment diversification and reduces the cost of managing each account separately. Commingled funds are also called "pooled funds" and "master trusts."

**Concentration of Credit Risk and Credit Risk for Investments**

ISBI's portfolio of investments 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. ISBI did not have any single issuer investment that exceeded 5% of the total net assets of ISBI as of June 30, 2015

# Notes to Financial Statements

JUNE 30, 2015 and 2014 (continued)

## Note 2 (continued)

### Deposits, Investments, and Investment Risk

and 2014. The following table presents the quality ratings of debt securities held by ISBI as of June 30, 2015 and 2014:

	Moody's Quality Rating	2015 \$	2014 \$
U.S. Government obligations and agency obligations	AAA	378,200,000	425,527,082
	AA	9,517,822	7,344,587
	A	-	12,943,001
	Not rated	520,118,004	338,660,978
Total Government and agency obligations		<u>907,835,826</u>	<u>784,475,648</u>
Foreign obligations	AAA	132,272,871	141,563,493
	AA	192,601,201	186,950,502
	A	107,666,050	81,171,275
	BAA	228,447,204	204,409,825
	BA	44,533,922	36,645,027
	B	51,489,197	41,169,215
	Not rated	135,843,821	140,373,065
Total foreign obligations		<u>892,854,266</u>	<u>832,282,402</u>
Corporate Obligations			
Bank and Finance	AA	3,829,086	2,957,585
	A	42,709,447	50,029,728
	BAA	73,781,060	82,453,817
	BA	43,936,037	34,830,061
	B	38,781,176	35,544,808
	Not rated	1,183	2,340,263
Total Bank and Finance		<u>203,037,989</u>	<u>208,156,262</u>
Industrial	AAA	1,112,464	-
	AA	14,086,661	10,224,115
	A	19,011,440	21,987,306
	BAA	36,578,192	44,506,699
	BA	150,284,966	159,584,773
	B	220,705,212	209,039,592
	CAA	6,437,020	6,992,615
	Not rated	19,036,249	13,073,374
Total Industrial		<u>467,252,204</u>	<u>465,408,474</u>
Other	AAA	1,520,669	1,521,596
	A	7,734,927	7,995,874
	BAA	15,470,896	19,568,129
	BA	47,098,831	48,791,454
	B	72,324,721	48,352,453
	Not rated	-	(280,000)
Total Other		<u>144,150,044</u>	<u>125,949,506</u>
Total Corporate Obligations		<u>814,440,237</u>	<u>799,514,242</u>
Money Market	Not rated	231,115,398	217,737,000
Total Money Market		<u>231,115,398</u>	<u>217,737,000</u>

**Note 2 (continued)**

**Deposits, Investments, and Investment Risk**

**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 a counterparty. As of June 30, 2015 and 2014, there were no investments that were uninsured and unregistered, securities held by the counterparty or by its trust department or agent but not in ISBI's name.

**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 duration between 80% and 120% of the benchmark index.

Duration is the 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 fair value. The effective duration measures the sensitivity of market price to parallel shifts in the yield curve. As of June 30, 2015 and 2014, ISBI benchmarked its debt security portfolio to Barclay's Capital Intermediate U.S. Government/Credit Bond Index. At June 30, 2015 and 2014, the effective duration of the Barclay's Capital Intermediate U.S. Government/Credit Bond Index was 5.6 years and 5.6 years, respectively. At the same point in time, the effective duration of the ISBI debt security portfolio at June 30, 2015 and 2014 was 5.7 and 5.3 years, respectively. Below is the detail of the duration by investment type as of June 30, 2015 and 2014:

Investment Type	2015		2014	
	Fair Value	Effective Weighted Duration	Fair Value	Effective Weighted Duration
	\$	Years	\$	Years
Government and Agency				
U.S. Government	450,342,908	7.7	380,521,606	6.7
Federal Agency	457,492,918	3.3	403,954,042	3.5
Foreign Obligations	892,854,266	6.3	832,282,402	5.8
Corporate Obligations				
Bank and Finance	203,037,989	5.5	208,156,262	5.8
Industrial	467,252,204	5.1	465,408,474	4.7
Other	144,150,044	4.6	125,949,506	4.6
	<u>2,615,130,329</u>		<u>2,416,272,292</u>	

# Notes to Financial Statements

JUNE 30, 2015 and 2014 (continued)

## Note 2 (continued)

### Deposits, Investments, and Investment Risk

#### 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 discre-

tion. Certain investments held in infrastructure funds trade in a reported currency of Euro-based dollars valued at \$52,895,123 and \$61,343,167 as of June 30, 2015 and 2014, respectively. The following table presents the foreign currency risk by type of investment as of June 30, 2015 and 2014:

	2015		2014	
	Foreign Equity Securities and Preferred Stock	Foreign Obligations	Foreign Equity Securities and Preferred Stock	Foreign Obligations
	\$	\$	\$	\$
Argentine Peso	-	564,401	-	-
Australian Dollar	101,071,595	26,524,849	90,774,346	23,031,004
Brazilian Real	19,506,199	22,032,221	20,078,894	29,522,411
Canadian Dollar	116,709,419	26,779,874	141,782,577	36,442,872
Chilean Peso	-	4,168,867	-	3,713,553
Colombian Peso	377,334	15,312,245	-	15,223,691
Czech Koruna	779,797	6,990,145	804,780	3,560,005
Danish Krone	56,479,696	4,766,276	44,415,985	5,392,244
Egyptian Pound	498,599	-	627,634	-
English Pound Sterling	407,189,285	61,148,582	410,712,209	46,015,531
Euro Currency	614,538,415	132,800,775	614,324,960	144,113,041
Hong Kong Dollar	147,171,701	2,586,762	129,948,463	2,550,498
Hungarian Forint	650,782	3,367,039	642,189	329,052
Indonesian Rupiah	2,672,277	14,066,740	2,609,187	12,085,949
Israeli Shekel	2,693,371	4,780,588	2,886,339	4,040,894
Japanese Yen	315,281,746	71,139,096	302,710,537	66,876,957
Malaysian Ringgit	3,841,562	22,209,736	453,753	20,518,690
Mexican Peso	7,344,176	48,063,655	11,149,254	41,011,377
New Israeli Sheqel	1,226,963	-	-	-
New Russian Ruble	-	28,747,709	-	41,669,459
New Zealand Dollar	4,165,766	2,597,322	3,297,560	2,365,325
Nigerian Naira	-	-	-	10,909,408
Norwegian Krone	19,984,988	7,187,208	30,066,361	5,799,023
Peruvian Nouveau Sol	-	751,184	-	1,817,219
Philippine Peso	1,551,135	724,551	-	755,069
Polish Zloty	64,211	28,095,503	-	25,311,976
Qatari Rial	458,487	-	-	-
Singapore Dollar	26,658,642	5,534,326	34,481,140	5,121,850
South African Rand	19,045,501	25,092,609	14,851,595	23,599,596
South Korean Won	73,721,461	24,800,431	72,778,832	21,003,245
Swedish Krona	40,012,576	5,823,010	41,872,359	2,241,325
Swiss Franc	241,987,995	13,799,902	219,282,841	12,141,173
Thailand Baht	2,087,372	12,954,145	-	8,619,111
Turkish Lira	101,877	30,121,571	-	18,968,168
UAE Dirham	693,879	-	-	-
Uruguayan Peso	-	1,760,087	-	4,198,906
Foreign Investments denominated in U.S. Dollars	151,609,930	237,562,857	156,024,241	193,333,780
	<u>2,380,176,737</u>	<u>892,854,266</u>	<u>2,346,576,036</u>	<u>832,282,402</u>

## **Note 2 (continued)**

### **Deposits, Investments, and Investment Risk**

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#### **Securities Lending**

ISBI participates in a securities lending program with Deutsche Bank AG, New York Branch as of June 30, 2015 who acts as securities lending agent. Prior to June 22, 2015 ISBI participated in a securities lending program with Credit Suisse AG, New York Branch who acted as securities lending agent. Securities are loaned to brokers and, in return, ISBI receives cash and non-cash collateral. All of the securities are eligible for the securities lending program. Collateral consists solely of cash and government securities having a fair 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, Deutsche Bank AG, New York Branch provides ISBI with counterparty default indemnification. Investments in the cash collateral account represent securities that were distributed to ISBI in connection with the in-kind redemption of ISBI's ownership in the State Street Bank and Trust Company Quality Funds for Short-Term Investment (Quality D). Deutsche Bank is not responsible for any losses with regards to these legacy investments. This arrangement subjects ISBI to credit risk as the credit quality of these investments may decline over time. The credit risk on the legacy investments is the risk of a possible loss arising from the inability of a counterparty to meet its obligations. This loss could include the loss of principal, interest and/or decreased expected cash flows in any of the investments held in ISBI's cash collateral account. In the event a counterparty defaults on its obligations, ISBI would need to credit the cash collateral account with the amount of the default to make the account whole so that once loaned securities are returned, the cash pledged by borrowers can be returned to them. As of June 30, 2015 and 2014, the collateral received exceeded the fair value of the securities loaned. As of June 30, 2015 and 2014, there were

outstanding loaned securities having fair values of \$107,922,255 and \$168,534,354, respectively; against which collateral was received with a fair value of \$110,826,173 and \$182,644,281, respectively. Collateral received at June 30, 2015 and 2014 consisted of \$32,006,788 and \$61,409,324, respectively, in cash and \$78,819,385 and \$121,234,957, respectively, in government securities for which ISBI does not have the ability to pledge or sell.

The cash collateral received is invested in a short-term instrument having a fair value of \$30,394,702 and \$60,114,354 as of June 30, 2015 and 2014, respectively. This investment pool had an average duration of 32.19 days and 23.86 days as of June 30, 2015 and 2014, respectively. Any decrease in the fair value of invested cash collateral is recorded as unrealized losses and reported as a component of the investment income/loss on the Statements of Changes in Net Position.

#### **Derivative Securities**

In fiscal year 2010, ISBI implemented GASB Statement No. 53, Accounting and Financial Reporting for Derivative Instruments, with respect to investments held in derivative securities. A derivative security is an investment whose payoff depends upon the value of other assets such as commodity prices, bond and stock prices, or a market index. ISBI invests in derivative instruments including forward foreign currency contracts, futures, rights and warrants. ISBI's derivatives are considered investment derivatives.

Foreign currency forward contracts (FX forwards) are used to protect against the currency risk in ISBI's foreign equity portfolio. A foreign currency forward contract is an agreement to buy or sell a specific amount of a foreign currency at a specified delivery or maturity date for an agreed-upon price. Fluctuations in the market value of foreign currency forward contracts are marked to market on a daily basis. These investments are reported at fair value in the investment section of the Statements of Changes in Net Position. The gain or loss arising from the difference between the

# Notes to Financial Statements

JUNE 30, 2015 and 2014 (continued)

## **Note 2 (continued)**

### **Deposits, Investments, and Investment Risk**

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original contracts and the closing of such contracts is recognized in the net increase/decrease in the fair value of investments in the Statements of Changes in Net Position. In May 2011, ISBI removed language from the investment management agreements allowing managers to hedge foreign currencies and/or to hedge equity positions.

ISBI investment managers use financial futures to replicate an underlying security they wish to hold (sell) in the portfolio. In certain instances, it may be beneficial to own a futures contract rather than the underlying security (arbitrage). Additionally, financial futures are used in the ISBI fixed income portfolio to adjust portfolio strategy and overall portfolio duration. A financial futures contract is an agreement to buy or sell a specific amount at a specified delivery or maturity date for an agreed-upon price. The fair values of the futures contract vary from the original contract price, a gain or loss is recognized and paid to or received from the clearinghouse. The gain or loss is recognized in the net increase/decrease in the fair value of investments in the Statements of Change in Net Position. 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.

ISBI investment managers use options in an attempt to add value to the portfolio (collect premiums) or protect (hedge) a position in the portfolio. Financial options are an agreement that gives one party the right, but not the obligation, to buy or sell a specific amount of an asset for a specified price, called the strike price, on or before a specified expiration date. As a writer of financial options, ISBI receives a premium at the outset of the agreement and bears the risk of an unfavorable change in the price of the finan-

cial instrument underlying the option. All written financial options are recognized as a liability on ISBI's financial statements. As a purchaser of financial options, 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 gain or loss associated with options is recognized in the net increase/decrease in the fair value of investments in the Statements of Changes in Net Position.

Rights and warrants allow ISBI investment managers to replicate an underlying security they wish to hold (sell) in the portfolio. Rights and warrants provide the holder with the right, but not the obligation, to buy or sell a company's stock at a predetermined price. Rights usually expire after a few weeks and warrants can expire from one to several years. Under certain circumstances, a type of warrant called Participatory Notes (P-Notes) are used in the portfolio by ISBI investment managers that are not registered to trade in domestic Indian Capital Markets. P-Notes are issued by Indian based brokerage firms against an underlying Indian security permitting holders to get a share in the income from the security. These investments are reported at fair value in the investment section of the Statements of Net Position within the common stock and foreign equity classifications. The gain or loss associated with rights and warrants is recognized in the net increase/decrease in the fair value of investments in the Statements of Changes in Net Position.

**Note 2 (continued)**  
**Deposits, Investments, and Investment Risk**

The fair values of the forward contracts are estimated based on the present value of their estimated future cash flows. Futures contracts are exchange traded instruments where the fair value is determined by the equilibrium between the forces of supply and demand. The fair value of a right or warrant closely tracks the intrinsic value of the underlying stock and can be determined either by formulaic methodology (most commonly Black-Scholes) or intrinsic value methodology.

The following table presents the investment derivative instruments aggregated by type that were held by ISBI as of June 30, 2015 and 2014:

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. Derivatives which are exchange traded are not subject to credit risk. No derivatives held are subject to custodial credit risk. Market risk is the possibility that a change in interest (interest rate risk) or currency rates (foreign currency risk) 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

	Changes in Fair Value		Fair Value at Year End		Notional Amount	
	2015	2014	2015	2014	2015	2014
	\$	\$	\$	\$	Number of Shares	Number of Shares
FX Forwards	(1,677,653)	(4,557,072)	979,645	(637,600)	N/A	N/A
Futures	N/A	N/A	N/A	N/A	9,942,012	(19,492,453)
Options	(5,588)	(9,152,466)	-	(2,635,570)	-	3,450,575
Rights	(303,610)	687,576	36,595	21,258	1,943,891	32,233
Warrants	154,914	43,476	300,696	145,805	74,061	77,375
	<u>(1,831,937)</u>	<u>(12,978,486)</u>	<u>1,316,936</u>	<u>(3,106,107)</u>	<u>11,959,964</u>	<u>(15,932,270)</u>

The table below shows the futures positions held by ISBI as of June 30, 2015 and 2014.

	2015		2014	
	Number of Contracts	Contract Principal*	Number of Contracts	Contract Principal*
Equity futures purchased	753	78,343,610	984	94,707,150
Fixed income futures purchased	360	57,338,435	500	58,038,549
Fixed income futures sold	366	49,307,563	519	90,728,863

\*Contract principal amounts shown represent the market value of the underlying assets the contracts control. Contract principal is shown to present the volume of the transactions but does 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 actual values reported in the Statement of Net Position.

# Notes to Financial Statements

JUNE 30, 2015 and 2014 (continued)

## Note 2 (continued)

### Deposits, Investments, and Investment Risk

managers may undertake. These limits are approved by the Board of Trustees and management of ISBI and the risk positions of the investment managers are reviewed on a periodic basis to monitor compliance with the limits. As of June 30, 2015 and June 30, 2014, respectively, ISBI held futures contracts whose underlying instruments were exposed to interest risk but there were no GASB 53 reportable elements. The ISBI has not adopted a formal policy specific to master netting arrangements.

ISBI's derivative investments in foreign currency forward contracts are held with counterparties. The credit ratings and net exposure as of June 30, 2015 and 2014 for the counterparties are as follows:

Moody's Rating	2015			2014		
	Fair Value	Net Exposure	Percentage of Net Exposure	Fair Value	Net Exposure	Percentage of Net Exposure
	\$	\$	%	\$	\$	%
Aa3	1,017,321	1,017,321	52.82	31,958	31,958	5.47
Aa2	290,223	290,223	15.07	135,731	135,731	23.22
Aa1	3,316	3,316	0.17	-	-	-
A3	288,895	288,895	15.00	-	-	-
A2	71,901	71,901	3.73	291,685	291,685	49.89
A1	251,850	251,850	13.08	2,450	2,450	0.42
Baa1	2,507	2,507	0.13	16,943	16,943	2.90
Baa2	-	-	-	105,781	105,781	18.10
	<u>1,926,013</u>	<u>1,926,013</u>	<u>100.00</u>	<u>584,548</u>	<u>584,548</u>	<u>100.00</u>

**Note 2 (continued)****Deposits, Investments, and Investment Risk**

The following table presents the fair value of derivative investments exposed to foreign currency risk as of June 30, 2015 and 2014:

Currency	2015				2014			
	FX Forwards	Rights	Warrants	Options	FX Forwards	Rights	Warrants	Options
	\$	\$	\$	\$	\$	\$	\$	\$
Australian Dollar	1,906	-	-	-	(10,223)	-	-	-
Brazilian Real	254,077	-	-	-	(468,235)	-	-	-
Canadian Dollar	(22,077)	140	-	-	18,701	-	-	-
Chilean Peso	(200,371)	-	-	-	(2,651)	-	-	-
Columbian Peso	372,529	-	-	-	(65,342)	-	-	-
Czech Koruna	14,308	-	-	-	(3,596)	-	-	-
Danish Krone	(1,024)	-	-	-	(2,479)	-	-	-
English Pound Sterling	(8,411)	-	-	-	(15,658)	-	-	-
Euro Currency	(6,986)	28,398	300,524	-	(109,012)	8,011	140,436	-
Hong Kong Dollar	(61)	-	-	-	(455)	-	4,326	-
Hungarian Forint	71,267	-	-	-	3,661	-	-	-
Indian Ruppe	51,803	-	-	-	(40,098)	-	-	-
Indonesian Rupiah	11,571	-	-	-	6,912	-	-	-
Israeli Shekel	1,008	-	-	-	(1,833)	-	-	-
Japanese Yen	322,452	-	-	-	125,773	-	-	-
Malaysian Ringgit	215,479	-	-	-	(7,300)	11,665	-	-
Mexican Peso	(48,321)	-	-	-	4,770	-	-	-
New Zealand Dollar	-	-	-	-	1,912	-	-	-
Norwegian Krone	(63)	-	-	-	(2,286)	-	-	-
Peruvian Noveau Sol	7,789	-	-	-	3,634	-	-	-
Polish Zloty	(12,107)	-	-	-	13,381	-	-	-
Russian Ruble	(402,898)	-	-	-	72,949	-	-	-
Singapore Dollar	15,482	-	-	-	(3,924)	-	-	-
South African Rand	135,668	-	-	-	(44,578)	-	-	-
South Korean Won	89,547	6,125	-	-	(20,558)	-	-	-
Swedish Krona	(68,590)	-	-	-	7,769	-	-	-
Swiss Franc	16,063	-	-	-	(65,602)	-	-	-
Taiwan Dollar	-	-	-	-	6,992	-	-	-
Thailand Baht	(4,634)	-	-	-	(944)	-	-	-
Turkish Lira	174,239	-	-	-	(8,039)	-	-	-
Yuan Renminbi	-	-	-	-	(31,241)	-	-	-
Investments denominated in U.S Dollars	-	1,932	172	-	-	1,582	1,043	(2,635,570)
	<u>979,645</u>	<u>36,595</u>	<u>300,696</u>	<u>-</u>	<u>(637,600)</u>	<u>21,258</u>	<u>145,805</u>	<u>(2,635,570)</u>

# Notes to Financial Statements

JUNE 30, 2015 and 2014 (continued)

## Note 3 Member Systems' and Trust Fund Participation

	General Assembly	Judges'	State Employees'	Illinois State Board of Investment Member Systems	Illinois Power Agency Trust Fund	Total Illinois State Board of Investment*
<b>Member Systems' Income and Expenses</b>	\$	\$	\$	\$	\$	\$
<b>Fiscal Year Ended June 30, 2015</b>						
Interest and dividends	1,630,364	25,187,109	479,661,386	506,478,859	1,095,281	507,574,140
Net securities lending income	10,096	156,792	2,981,374	3,148,262	6,808	3,155,070
Net increase in fair value of investments	769,133	12,763,198	240,297,223	253,829,554	548,718	254,378,272
Total investment income	2,409,593	38,107,099	722,939,983	763,456,675	1,650,807	765,107,482
Administrative expenses	(143,291)	(2,215,206)	(42,184,943)	(44,543,440)	(96,327)	(44,639,767)
Net investment income	<u>2,266,302</u>	<u>35,891,893</u>	<u>680,755,040</u>	<u>718,913,235</u>	<u>1,554,480</u>	<u>720,467,715</u>
<b>Member Systems' Changes in Net Position</b>						
<b>Fiscal Year Ended June 30, 2015</b>						
Net position at beginning of year	51,549,374	738,704,938	14,286,499,013	15,076,753,325	32,622,050	15,109,375,375
Member Systems' net withdrawals	(4,650,000)	20,700,000	-	16,050,000	460	16,050,460
Net investment income	2,266,302	35,891,893	680,755,040	718,913,235	1,554,480	720,467,715
Net position at end of year	<u>49,165,676</u>	<u>795,296,831</u>	<u>14,967,254,053</u>	<u>15,811,716,560</u>	<u>34,176,990</u>	<u>15,845,893,550</u>
The source of net position of the member systems since inception at June 30, 2015, is as follows:						
Member Systems' net contributions (withdrawals)	(85,300,878)	(111,185,969)	(1,862,826,847)	(2,059,313,694)	24,153,189	(2,035,160,505)
Accumulated net investment income	134,466,554	906,482,800	16,830,080,900	17,871,030,254	10,023,801	17,881,054,055
Net position at fair value	<u>49,165,676</u>	<u>795,296,831</u>	<u>14,967,254,053</u>	<u>15,811,716,560</u>	<u>34,176,990</u>	<u>15,845,893,550</u>
<b>Member Systems' Money Weighted Position</b>						
<b>Fiscal Year Ended June 30, 2015</b>	3.24	5.08	4.79		4.79	

\* Combined column for the Member Systems and Trust fund is presented for information purposes only and does not indicate that the assets of one system or trust fund may be used for another system or trust fund.

**Note 3 (continued)**  
**Member Systems' and Trust Fund Participation**

	General Assembly	Judges'	State Employees'	Illinois State Board of Investment Member Systems	Illinois Power Agency Trust Fund	Total Illinois State Board of Investment*
<b>Member Systems' Income and Expenses</b>	\$	\$	\$	\$	\$	\$
<b>Fiscal Year Ended June 30, 2014</b>						
Interest and dividends	1,499,303	20,166,571	396,094,900	417,760,774	918,739	418,679,513
Net securities lending income	11,489	156,652	3,066,998	3,235,139	7,093	3,242,232
Net increase in fair value of investments	<u>6,988,375</u>	<u>91,689,469</u>	<u>1,809,958,589</u>	<u>1,908,636,433</u>	<u>4,202,702</u>	<u>1,912,839,135</u>
Total investment income	8,499,167	112,012,692	2,209,120,487	2,329,632,346	5,128,534	2,334,760,880
Administrative expenses	<u>(153,577)</u>	<u>(2,059,317)</u>	<u>(40,473,085)</u>	<u>(42,685,979)</u>	<u>(93,849)</u>	<u>(42,779,828)</u>
Net investment income	<u>8,345,590</u>	<u>109,953,375</u>	<u>2,168,647,402</u>	<u>2,286,946,367</u>	<u>5,034,685</u>	<u>2,291,981,052</u>
<b>Member Systems' Changes in Net Position</b>						
<b>Fiscal Year Ended June 30, 2014</b>						
Net position at beginning of year	49,003,784	612,751,563	12,176,459,191	12,838,214,538	28,242,698	12,866,457,236
Member Systems' net withdrawals	(5,800,000)	16,000,000	(58,607,580)	(48,407,580)	(655,333)	(49,062,913)
Net investment income	8,345,590	109,953,375	2,168,647,402	2,286,946,367	5,034,685	2,291,981,052
Net position at end of year	<u>51,549,374</u>	<u>738,704,938</u>	<u>14,286,499,013</u>	<u>15,076,753,325</u>	<u>32,622,050</u>	<u>15,109,375,375</u>
The source of net position of the member systems since inception at June 30, 2014, is as follows:						
Member Systems' net contributions (withdrawals)	(80,650,878)	(131,885,969)	(1,862,826,847)	(2,075,363,694)	24,152,729	(2,051,210,965)
Accumulated net investment income	<u>132,200,252</u>	<u>870,590,907</u>	<u>16,149,325,860</u>	<u>17,152,117,019</u>	<u>8,469,321</u>	<u>17,160,586,340</u>
Net position at fair value	<u>51,549,374</u>	<u>738,704,938</u>	<u>14,286,499,013</u>	<u>15,076,753,325</u>	<u>32,622,050</u>	<u>15,109,375,375</u>
<b>Member Systems' Money Weighted Position</b>						
<b>Fiscal Year Ended June 30, 2014</b>	18.12	17.45	17.90		17.89	

\* Combined column for the Member Systems and Trust fund is presented for information purposes only and does not indicate that the assets of one system or trust fund may be used for another system or trust fund.

# Notes to Financial Statements

JUNE 30, 2015 and 2014 (continued)

## Note 4 Pensions

### Plan Description

All of 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 2015 and 2014 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 South Veterans Parkway, P.O. Box 19255, Springfield, IL 62794-9255 or by calling 217/785-7444. 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 217/782-6000.

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 2015 and 2014, the employer contribution rates were 42.339% and 40.312%, respectively. ISBI contributions to SERS for fiscal years 2015 and 2014 were \$535,055 and \$461,173, respectively, and were equal to the required contributions for each fiscal year.

Effective for pay periods beginning after December 31, 1991, the Board opted to pay the employee portion of retirement for ISBI employees covered by the State Employees' Retirement Sys-

tems. Generally, this pickup of employee retirement was part of the budget process and was, in part, a substitute for salary increases. In November 2010 the Board amended the policy to pay the employee portion of retirement to only apply to current employees as of the date of the policy change. New employees from that date forward must pay their own employee portion of retirement contributions. ISBI contributions to SERS for the employee portion for fiscal years 2015 and 2014 were \$39,055 and \$40,575, respectively.

### Member System Contributions and Withdrawals

Member systems' contributions are comprised solely of proceeds from bonds issued by the State of Illinois. As required by Public Act 96-1497, the State of Illinois issued \$3.7 billion of General Obligation Bonds, Taxable Bond Series February 2011 on March 10, 2011 at an interest rate of 5.56%. 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 \$745,546,496 on March 14, 2011. The monies were deposited into the Master Trust Account with the Illinois State Board of Investment the same day. The monies were combined with ISBI's other investments and invested in accordance with the asset allocation policy of ISBI during the year ended June 30, 2011. The Judges' Retirement System made contributions of \$21,400,000 and \$16,000,000 in fiscal years 2015 and 2014, respectively. Member systems' withdrawals are determined by the member retirement systems based on the State's funding, the systems' benefit payment needs and the ability for ISBI to liquidate available assets. The total withdrawals for fiscal years 2015 and 2014 were \$5,350,000 and \$65,062,913, respectively.

### Post-retirement Benefits

The State provides health, dental, and life insurance benefits for retirees and their dependents in a program administered by the Department of Central Management Services. Substantially all State employees become eligible for post-employment benefits if they eventually become annuitants of one of the State sponsored pension plans. Health, dental and vision benefits include basic

**Note 4 (continued)**  
**Pensions**

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benefits for annuitants under the State's self-insurance plan and insurance contracts currently in force. Annuitants may be required to contribute towards health, dental and vision benefits with the amount based on factors such as date of retirement, years of credited service with the State, whether the annuitant is covered by Medicare, and whether the annuitant has chosen a managed health care plan. Annuitants who retired prior to January 1, 1998, and who are vested in the State Employees' Retirement System, do not contribute toward health, dental and vision benefits. For annuitants who retired on or after January 1, 1998, the annuitant's contribution amount is reduced five percent for each year of credited service with the State allowing those annuitants with twenty or more years of credited service to not have to contribute towards health, dental and vision benefits. Annuitants also receive life insurance coverage equal to the annual salary of the last day of employment until age 60, at which time the benefits become \$5,000.

The total cost of the State's portion of health, dental, vision and life insurance benefits of all members including post-employment health, dental, vision and life insurance benefits, is recognized as an expenditure by the State in the Illinois Comprehensive Annual Financial Report. The State finances the cost on a pay-as-you-go basis. The total costs incurred for health, dental, vision and life insurance benefits are not separated by department or component unit for annuitants and their dependents nor active employees and their dependents.

A summary of post-employment benefit provisions, changes in benefit provisions, employee eligibility requirements including eligibility for vesting, and the authority under which benefit provisions are established are included as an integral part of the financial statements of the Department of Central Management Services. A copy of the financial statements of the Department of Central Management Services may be obtained by writing to the Department of Central Management Services, 715 Stratton Building, 401 South Spring Street, Springfield, Illinois 62706-4100.

**Note 5**  
**New Governmental Accounting Standards**

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GASB Statement No. 72, Fair Value Measurement and Application, will be effective for ISBI with its year ended June 30, 2016. This Statement addresses accounting and financial reporting issues related to fair value measurements. The definition of fair value is the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date. This Statement provides guidance for determining a fair value measurement for financial reporting purposes. This Statement also provides guidance for applying fair value to certain investments and disclosures related to all fair value measurements.

Management has not yet completed its assessment of this Statement; however, it is not expected to have a material effect on the overall financial statement presentation.

**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

Board of Trustees  
Illinois State Board of Investment

As Special Assistant Auditors for the Auditor General, we have audited, in accordance with the auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards* issued by the Comptroller General of the United States, the Statements of Net Position and Statements of Changes in Net Position of the Illinois State Board of Investment Member Systems (ISBI Member Systems), as of and for the years ended June 30, 2015 and June 30, 2014, and the Statements of Net Position of its investment trust fund, the Illinois Power Agency Trust Fund (Trust Fund), as of June 30, 2015 and June 30, 2014, and the Statements of Changes in Net Position for the years ended June 30, 2015 and June 30, 2014 which collectively comprise the Illinois State Board of Investment's (ISBI) basic financial statements, and have issued our report thereon dated December 9, 2015.

### **Internal Control Over Financial Reporting**

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

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

Our consideration of internal control was for the limited purpose described in the first paragraph of this section and was not designed to identify all deficiencies in internal control that might be material weaknesses or significant deficiencies and therefore, material weaknesses or significant deficiencies may exist that were not identified. Given these limitations, during our audit we did not identify any deficiencies in internal control that we consider to be material weaknesses. However, material weaknesses may exist that have not been identified. We did identify a certain deficiency in internal control, described in the accompanying schedule of finding as item 2015-001 that we consider to be a significant deficiency.

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### **Compliance and Other Matters**

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

### **Illinois State Board of Investments' Response to Finding**

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

### **Purpose of this Report**

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

A rectangular box containing a handwritten signature in black ink that reads "RSM US LLP".

Schaumburg, Illinois  
December 9, 2015

STATE OF ILLINOIS  
ILLINOIS STATE BOARD OF INVESTMENT

**Schedule of Finding  
For the Year Ended June 30, 2015**

**Current Finding - Government Auditing Standards**

**2015-001 Inadequate Controls Over Financial Close and Reporting**

The Illinois State Board of Investment (ISBI) recorded a fiscal year 2016 distribution of \$1,200,000 in fiscal year 2015.

During our testing over distributions, we noted that a distribution to the Illinois Power Agency in the amount of \$1,200,000 was recorded in fiscal year 2015 in error. The funds were not distributed to the Illinois Power Agency until fiscal year 2016. An audit adjustment of \$1,200,000 was recorded by ISBI to correct the error.

Generally Accepted Accounting Practices (GAAP) requires transactions to be reported in the year that they occur. Additionally, the Fiscal Control and Internal Auditing Act (30 ILCS 10/3001) requires ISBI to establish and maintain a system, or systems, of internal fiscal and administrative controls which shall provide assurance that distributions are recorded in the proper fiscal year.

According to ISBI Management, the cause of the deficiency occurred during the June 30, 2015 cash reconciliation. The \$1,200,000 was inadvertently coded to the wrong account which caused the cash balance to be reduced by the \$1,200,000. To compound that error, the \$1,200,000 voucher disbursement was inadvertently coded to fiscal year 2015 instead of fiscal year 2016. During the review of the State Treasurer's Bank Statements, the coding errors were not detected when reconciling the bank statements.

Failure to record transaction in the proper period could result in inaccurate financial statements. (Finding Code No. 2015-001)

**Recommendation**

We recommend that ISBI review their procedures for monitoring significant transactions occurring near the end of their fiscal year in order to help identify and record transactions in the proper fiscal year.

**Agency Response**

The Board agrees the procedures for monitoring significant transactions occurring near the end of the fiscal year should be enhanced.

The Chief Fiscal Officer has received additional training on how to detect errors of this nature by conducting a more thorough review of the SAMS monthly reports provided by the Comptroller's Office. Accounting sub-ledger records have been reformatted to make it easier to detect errors of this nature moving forward.

Also the Deputy Executive Director will perform a detailed review of all transaction activity to derive the sub-ledger balance for each reporting period that will include a comparison to the monthly SAMS transaction reports.