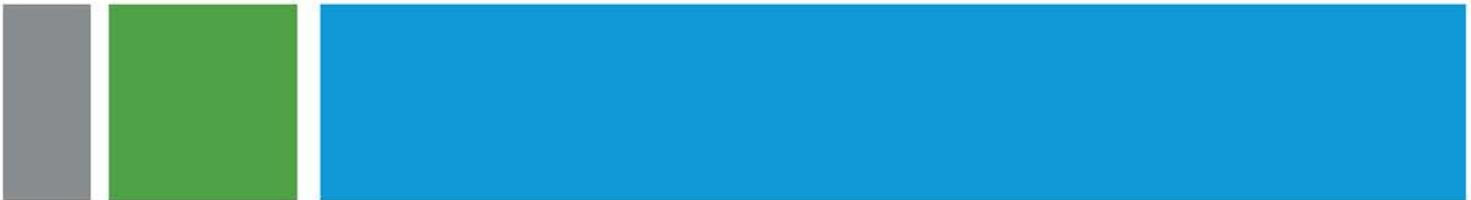


# State Employees' Retirement System of the State of Illinois

## Compliance Examination

For the Year Ended June 30, 2016  
Performed as Special Assistant Auditors for  
the Auditor General, State of Illinois



**State Employees' Retirement System of the State of Illinois  
Compliance Examination**

**Year Ended June 30, 2016**

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Financial Statement Report

The System's financial statement report for the year ended June 30, 2016, which includes the independent auditor's report, management's discussion and analysis, basic financial statements and notes, required supplementary information other than management's discussion and analysis, supplementary information, and the independent auditor's report on internal control over financial reporting and on compliance and other matters based on an audit of financial statements performed in accordance with *Government Auditing Standards* has been issued separately.

Supplementary Information for State Compliance Purposes

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**State Employees' Retirement System of the State of Illinois  
Compliance Examination**

**Year Ended June 30, 2016**

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**State Employees' Retirement System of the State of Illinois  
Compliance Examination**

**For the Year Ended June 30, 2016**

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***System Officials***

Executive Secretary  
Accounting Division Manager  
Internal Auditor

Timothy B. Blair  
Alan Fowler, CPA  
Casey Evans

***Office Locations***

2101 South Veterans Parkway  
P.O. Box 19255  
Springfield, Illinois 62794-9255

State of Illinois Building  
160 North LaSalle Street, Suite N725  
Chicago, Illinois 60601



April 24, 2017

RSM US LLP  
20 North Martingale Road, Suite 500  
Schaumburg, IL 60173

Ladies and Gentlemen:

We are responsible for the identification of, and compliance with, all aspects of laws, regulations, contracts, or grant agreements that could have a material effect on the operations of the State Employees' Retirement System of Illinois (System). 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 System's compliance with the following assertions during the year ended June 30, 2016. Based on this evaluation, we assert that during the year ended June 30, 2016, the System has materially complied with the assertions below.

- A. The System has obligated, expended, received and used public funds of the State in accordance with the purpose for which funds have been appropriated or otherwise authorized by law.
- B. The System 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 System has complied, in all material respects, with applicable laws and regulations, including the State uniform accounting system, in its financial and fiscal operations.
- D. State revenues and receipts collected by the System 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 System on behalf of the State or held in trust by the System have been properly and legally administered and the accounting and recordkeeping relating thereto is proper, accurate and in accordance with law.

Yours very truly,

State Employees' Retirement System

**SIGNED ORIGINAL ON FILE**

\_\_\_\_\_  
Timothy B. Blair, Executive Secretary

\_\_\_\_\_  
Alan Fowler, CPA, Accounting Division Manager

**State Employees' Retirement System of the State of Illinois  
Compliance Examination**

**Year Ended June 30, 2016**

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**Compliance Report**

**Summary**

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

**Accountant's Report**

The Independent Accountant's 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 non-standard language.

**Summary of Findings**

<b>Number of</b>	<b>Current Report</b>	<b>Prior Report</b>
Findings	3	3
Repeated findings	1	2
Prior recommendations implemented or not repeated	2	1

**Schedule of Findings**

<b>Item No.</b>	<b>Page</b>	<b>Description</b>	<b>Finding Type</b>
<b>FINDINGS (GOVERNMENT AUDITING STANDARDS)</b>			
2016-001	10	Noncompliance with the Fiscal Control and Internal Auditing Act	Significant Deficiency
<b>FINDINGS (STATE COMPLIANCE)</b>			
2016-002	11	Change Management Weaknesses	Noncompliance and Significant Deficiency
2016-003	12	Board of Trustees Vacancy	Noncompliance and Significant Deficiency

In addition, the following findings which are reported as current findings related to *Government Auditing Standards* also met the reporting requirements for State Compliance.

2016-001	10	Noncompliance with the Fiscal Control and Internal Auditing Act	Noncompliance and Significant Deficiency
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**State Employees' Retirement System of the State of Illinois  
Compliance Examination**

**Year Ended June 30, 2016**

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**Compliance Report (Continued)**

**Summary of Findings (Continued)**

PRIOR FINDINGS NOT REPEATED

A	13	Controls Over Census Data
B	13	Noncompliance with Ethics Training Requirements

**Exit Conference**

System officials elected to waive a formal exit conference in correspondence dated March 15, 2017. The responses to the recommendations were provided by Casey Evans, Internal Auditor, in correspondence dated April 3, 2017.

**Independent Accountant’s Report on State Compliance,  
on Internal Control Over Compliance, and on  
Supplementary Information for State Compliance Purposes**

Honorable Frank J. Mautino  
Auditor General, State of Illinois  
and  
Board of Trustees  
State Employees’ Retirement System of the State of Illinois

**Compliance**

As Special Assistant Auditors for the Auditor General, we have examined the State Employees’ Retirement System of the State of Illinois’ (System) 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, 2016. The management of the System is responsible for compliance with these requirements. Our responsibility is to express an opinion on the System’s compliance based on our examination.

- A. The System 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 System 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 System has complied, in all material respects, with applicable laws and regulations, including the State uniform accounting system, in its financial and fiscal operations.
- D. State revenues and receipts collected by the System 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 System on behalf of the State or held in trust by the System 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 System’s compliance with those requirements listed in the first paragraph of this report 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 System’s compliance with specified requirements.

In our opinion, the System complied, in all material respects, with the requirements listed in the first paragraph of this report during the year ended June 30, 2016. However, the results of our procedures disclosed instances of noncompliance with the 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 findings as items 2016-001, 2016-002, and 2016-003.

### **Internal Control**

Management of the System is responsible for establishing and maintaining effective internal control over compliance with the requirements listed in the first paragraph of this report. In planning and performing our examination, we considered the System's internal control over compliance with the requirements listed in the first paragraph of this report to determine the examination procedures that are appropriate in the circumstances 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, but not for the purpose of expressing an opinion on the effectiveness of the System's internal control over compliance. Accordingly, we do not express an opinion on the effectiveness of the System's internal control over compliance.

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

Our consideration of internal control over compliance was for the limited purpose described in the first paragraph of this section and was not designed to identify all deficiencies in internal control over compliance that might be material weaknesses or significant deficiencies and therefore, material weaknesses or significant deficiencies may exist that were not identified. We did not identify any deficiencies in internal control over compliance that we consider to be material weaknesses. However, we identified certain deficiencies in internal control over compliance, as described in the accompanying schedule of findings as items 2016-001, 2016-002 and 2016-003, that we consider to be significant deficiencies.

As required by the Audit guide, immaterial findings excluded from this report have been reported in a separate letter to your office.

The System's responses to the findings identified in our examination are described in the accompanying schedule of findings. We did not examine the System's responses and, accordingly, we express no opinion on the responses.

### **Supplementary Information for State Compliance Purposes**

As Special Assistant Auditors for the Auditor General, we have audited and issued under separate cover the Statement of Fiduciary Net Position of the State Employees' Retirement System of the State of Illinois (System) as of June 30, 2016, and the Statement of Changes in Fiduciary Net Position for the year then ended, and have issued our report thereon dated January 4, 2017, which contained an unmodified opinion on those financial statements. Our audit was conducted for the purpose of forming an opinion on the financial statements that collectively comprise the System's basic financial statements. We did not audit the 2016 financial statements of the Illinois State Board of Investment, an internal investment pool of the State of Illinois, which statements represent 97 percent, 98 percent and (6) percent respectively of total assets, net

position restricted for pension benefits, and total additions to the System. Those financial statements were audited by other auditors whose report thereon has been furnished to us, and our opinion, insofar as it relates to the amounts included for the Illinois State Board of Investment is based solely on the report of the other auditors. We have not performed any procedures with respect to the audited financial statements subsequent to January 4, 2017. The accompanying supplementary information for State compliance purposes, consisting of the Fiscal Schedules and Analysis Section (Schedules 1 through 11), for the year ended June 30, 2016 are presented for purposes of additional analysis and are not a required part of the basic financial statements of the System. Such information is the responsibility of management and was derived from and relates directly to the underlying accounting and other records used to prepare the basic financial statements. The accompanying Fiscal Schedules and Analysis Section (Schedules 1 through 11) for the year ended June 30, 2016 have been subjected to the auditing procedures applied in the audit of the basic financial statements and certain additional procedures, including comparing and reconciling such information directly to the underlying accounting and other records used to prepare the basic financial statements or to the basic financial statements themselves, and other additional procedures in accordance with auditing standards generally accepted in the United States of America. In our opinion, the accompanying Fiscal Schedules and Analysis Section (Schedules 1 through 11) for the year ended June 30, 2016 are fairly stated in all material respects in relation to the basic financial statements as a whole for the year ended June 30, 2016.

The System's basic financial statements as of and for the years ended June 30, 2015 and June 30, 2014 (not presented herein), were audited by other auditors whose reports thereon dated December 18, 2015 and December 22, 2014, respectively, expressed unmodified opinions on the basic financial statements. The reports of other auditors dated December 18, 2015 and December 22, 2014 stated that the accompanying supplementary information, for State compliance purposes, for the years ended June 30, 2015 and June 30, 2014, respectively, consisting of the Fiscal Schedules and Analysis section (Schedules 2, 4 through 7, and 9 through 11) was subjected to the auditing procedures applied in the audits of the June 30, 2015 and June 30, 2014 basic financial statements and certain additional auditing procedures, including comparing and reconciling such information directly to the underlying accounting and other records used to prepare those basic financial statements or to those basic financial statements themselves, and other additional procedures in accordance with auditing standards generally accepted in the United States of America and, in their opinion, was fairly stated, in all material respects, in relation to the basic financial statements as a whole for the years ended June 30, 2015 and June 30, 2014.

The accompanying supplementary information in the Analysis of Operations Section is presented for the purposes of additional analysis and is not a required part of the basic financial statements. Such information has not been subjected to the auditing procedures applied in the audit of the basic financial statements, and accordingly, we do not express an opinion or provide any assurance on it.

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

**SIGNED ORIGINAL ON FILE**

Schaumburg, Illinois  
April 24, 2017, except for the supplementary information  
for State compliance purposes, as to which the date  
is January 4, 2017

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

Honorable Frank J. Mautino  
Auditor General

Board of Trustees  
State Employees' Retirement System of the State of Illinois

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 financial statements of the State Employees' Retirement System of the State of Illinois (System), as of and for the year ended June 30, 2016, and the related notes to the financial statements as listed in the table of contents and have issued our report thereon dated January 4, 2017. Our report includes a reference to other auditors who audited the financial statements of the Illinois State Board of Investment, an internal investment pool of the State of Illinois, as described in our report on the System's financial statements. This report does not include the results of the other auditors' testing of internal control over financial reporting or compliance and other matters that are reported on separately by those auditors.

**Internal Control Over Financial Reporting**

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

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

Our consideration of internal control was for the limited purpose described in the first paragraph of this section and was not designed to identify all deficiencies in internal control that might be material weaknesses or significant deficiencies, and therefore, material weaknesses or significant deficiencies may exist that were not identified. Given these limitations, during our audit we did not identify any deficiencies in internal control that we consider to be material weaknesses. We did identify a deficiency in internal control, described in the accompanying schedule of findings as item 2016-001 that we consider to be a significant deficiency.

## **Compliance and Other Matters**

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

## **Response to Findings**

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

## **Purpose of this Report**

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

**SIGNED ORIGINAL ON FILE**

Schaumburg, Illinois  
January 4, 2017

**State Employees' Retirement System of the State of Illinois  
Compliance Examination**

**Schedule of Findings - *Government Auditing Standards***

**Year Ended June 30, 2016**

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**Finding No. 2016-001 Noncompliance with the Fiscal Control and Internal Auditing Act**

The State Employees' Retirement System (System) was not in compliance with the Fiscal Control and Internal Auditing Act (the Act).

The Act (30 ILCS 10/2003) requires the chief executive officer to ensure that internal audits of all major systems of internal control are conducted at least once every two years. The System was unable to complete internal audits of all major systems of internal control at least every two years as required by the Act.

System officials indicated the System was not able to provide additional resources to the internal audit function and therefore the current internal auditor did not have adequate time during the fiscal year to complete internal audits as required.

Failure to comply with the Act increases the risk that fraud, misuse of funds, or internal control weaknesses would not be detected on a timely basis. (Finding Code No. 2016-001, 2015-001, 2014-001).

**Recommendation:**

We recommend System management develop a plan to ensure the internal audit function has the resources necessary to comply with the Act.

**Response:**

The System accepts the finding. The SERS Board of Trustees has created and funded an additional internal auditor position in fiscal year 2017 to aid the Chief Internal Auditor in performing audit duties. The new position has been posted and candidates have been interviewed.

**State Employees' Retirement System of the State of Illinois  
Compliance Examination**

**Schedule of Findings – State Compliance**

**Year Ended June 30, 2016**

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**Finding No. 2016-002 Change Management Weaknesses**

The State Retirement System, which administers the State Employees' Retirement System (System), has weaknesses in their change management procedures.

The System develops and deploys custom software to manage pension accounts of Illinois members and collects, stores, and processes confidential and protected information related to this mission.

The System had established formal change management procedures; however, the procedures did not address migrating changes into the production environment. In addition, programmers developing and making changes to applications had access to the production environment and the capability to implement changes. Furthermore, monitoring tools were not in place to detect unauthorized code migrations.

Generally accepted information technology guidance endorses the implementation of change management procedures to reduce the risk of unauthorized, improper, or erroneous changes to computer systems. These procedures include restricting programmers from making a change and moving it into production.

Management stated that a plan was in place to restrict developer access to production for the central application but due to oversight the plan was not fully executed. The System is working on incorporating automated approval and deployment of changes into the production environment; however, it has not yet completed this process.

The lack of adequate change control procedures increases the risk that unauthorized changes are put into production that could compromise system integrity and data. (Finding Code No. 2016-002)

**Recommendation:**

We recommend the System update its change management procedures to address specific procedures for migrating changes into the production environment. The procedures should include a standard form for requesting a change be moved into production and include user and management approval. In addition, programmers should be prevented from migrating changes into the production environment. If the Office determines that programmer access is necessary in some situations, it should establish and enforce compensating controls to ensure appropriate and documented management oversight and approval.

**System Response:**

The System accepts the finding. A change control process has been implemented for all legacy computerized systems and the SRS IT Division is currently working towards implementing an automated approval and deployment process which it hopes to achieve in calendar year 2017.

**State Employees' Retirement System of the State of Illinois  
Compliance Examination**

**Schedule of Findings – State Compliance**

**Year Ended June 30, 2016**

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**Finding No. 2016-003 Board of Trustees Vacancy**

The State Employees' Retirement System of the State of Illinois (System) has had a vacancy in one of its thirteen required trustees of the Board for more than a year as of the end of fieldwork on February 24, 2017.

During the current fiscal year compliance examination, the auditors noted that a Board member resigned from the Board on October 15, 2015. The System's Executive Secretary informed the Board of the resignation on that same day. In addition, on November 4, 2015 the Executive Secretary communicated this vacancy to the Governor's Office via email requesting that the vacancy be filled. As of the end of fieldwork on February 24, 2017 the vacancy had not been filled and there has been no further follow-up communications with the Governor's Office by the System.

The Illinois Pension Code (40 ILCS 5/14-134) states "Beginning on the 90<sup>th</sup> day after the effective date of this amendatory Act of the 96<sup>th</sup> General Assembly, the Board shall consist of 13 trustees as follows:

- (1) the Comptroller, who shall be the Chairperson;
- (2) six persons appointed by the governor with the advice and consent of the Senate who may not be members of the system or hold an elective State office and who shall serve for a term of 5 years, except that the terms of the initial appointees under this amendatory Act of the 96<sup>th</sup> General Assembly shall be as follows: 3 for a term of 3 years and 3 for a term of 5 years;
- (3) four active participants of the system having at least 8 years of creditable service, to be elected from the contributing members of the system by the contribution members as provided in Section 14-134.1; and
- (4) two annuitants of the system who have been annuitants for at least one full year, to be elected from and by the annuitants of the system, as provided in section 14-134.1.

System officials stated the Executive Secretary communicated with the Governor's Office requesting appointment of a new member to fill the vacancy at the time the vacancy occurred and has not yet received an official response.

Failure to operate with the full thirteen members of the Board of Trustees could impact the Board's ability to establish a quorum and timely conduct the business of the System. (Finding Code No. 2016-003)

**Recommendation:**

We recommend that the System continue to communicate with the Governor's Office in order to fill the vacancy in its Board of Trustees.

**System Response:**

The System accepts the finding. Management continues to monitor Board vacancies and will communicate any appointed vacancies to the Governor's Office. The current Board vacancy has not resulted in the Board's inability to establish a quorum or conduct business.

**State Employees' Retirement System of the State of Illinois  
Compliance Examination**

**Schedule of Findings**

**Year Ended June 30, 2016**

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**Prior Findings Not Repeated**

**A. Finding - Controls over Census Data**

In the prior year, the State Employees' Retirement System of the State of Illinois (System) had weaknesses in controls over creditable earnings and member census data reported by its participating State agencies (Finding Code No. 2015-002, 2014-002).

During the current fiscal year, the System implemented a risk assessment and sampling plan to establish a schedule to perform audits of census data at the participating State agencies. In addition, the System performed audits at a sample of agencies to verify census data utilized by the System.

**B. Finding - Noncompliance with Ethics Training Requirements**

In the prior fiscal year compliance examination, the State Employees' Retirement System of the State of Illinois (System) did not comply with the ethics training provisions of the Illinois Pension Code. Auditors noted the System did not track the ethics training completed by its Board members and did not submit the required annual certification of compliance certifying ethics training completed by its Board members with the Department of Insurance. (Finding Code No. 2015-003).

During the current fiscal year compliance examination, the System's executive management conducted a training session for the Board of Trustees covering actuarial fundamentals, duties and responsibilities of the Board, key statutes and rules, the pension fund's plan design, member demographics and data, and risk management. A certification was completed and filed with the Illinois Department of Insurance.

## **State Employees' Retirement System of the State of Illinois Compliance Examination**

**Year Ended June 30, 2016**

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### **Supplementary Information for State Compliance Purposes**

#### **Summary**

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

- **Fiscal Schedules and Analysis:**
  - Schedule of Appropriations, Expenditures and Lapsed Balances
  - Comparative Schedule of Net Appropriations, Expenditures and Lapsed Balances
  - Schedule of Changes in State Property
  - Comparative Schedule of Cash Receipts
  - Reconciliation Schedule of Cash Receipts to Deposits Remitted to the State Comptroller
  - Analysis of Significant Variations in Expenditures
  - Analysis of Significant Variations in Cash Receipts
  - Analysis of Significant Lapse Period Spending
  - Comparative Schedule of Cash Balances
  - Comparative Schedule of Changes in Investment Balances
  - Analysis of Contributions Receivable
  
- **Analysis of Operations (Unaudited):**
  - System Functions and Planning Program (Unaudited)
  - Progress in Funding the System (Unaudited)
  - Budget Impasse Disclosures (Unaudited)
  - Alternative Financing in Lieu of Appropriations and Programs to Address  
    Untimely Payments to Vendors (Unaudited)
  - Interest Costs on Fiscal Year 2016 Invoices (Unaudited)
  - Money-Weighted Rate of Return (Unaudited)
  - Average Number of System Employees (Unaudited)
  - Comparison of Administrative Expenses to Total Expenses (Unaudited)
  - Schedule of Contributions/Deductions and Effect on Investments (Unaudited)
  - Service Efforts and Accomplishments (Unaudited)

The Independent Accountant's Report on State Compliance, on Internal Control Over Compliance, and on Supplementary Information for State Compliance Purposes covers the Supplementary Information for State Compliance Purposes presented in the Compliance Report Section and states that it has been subjected to the auditing procedures applied in the audit of the basic financial statements and, in the auditor's opinion, it is fairly stated, in all material respects, in relation to the basic financial statements as a whole from which it has been derived. The accountant's report also states the Analysis of Operations Section has not been subjected to the auditing procedures applied in the audit of the basic financial statements, and accordingly, they do not express an opinion or provide any assurance on it.

State Employees' Retirement System of the State of Illinois  
Compliance Examination

Schedule 1

Schedule of Appropriations, Expenditures and Lapsed Balances  
Expenditure Authority for Fiscal Year 2016  
Fourteen Months Ended August 31, 2016

Continuing Appropriations and Court Orders	Expenditure Authority (Net of Transfers)	Expenditures Through June 30	Lapse Period Expenditures July 1 to August 31	Total Expenditures 14 Months Ended August 31	Balances Lapsed August 31
<b>Appropriated Funds</b>					
General Revenue Fund - 001					
Personal services		\$ 38,509	\$ -	38,509	
Social security contributions		2,871	-	2,871	
Continuing appropriation for pension contributions	\$ 1,329,170,050	1,329,170,050	-	1,329,170,050	\$ -
Continuing appropriation for fiscal year shortfall	37,968,539	37,968,539	-	37,968,539	-
Total-All appropriated funds		<u>\$ 1,367,179,969</u>	<u>\$ -</u>	<u>\$ 1,367,179,969</u>	
<b>Nonappropriated Funds</b>					
State Employees' Retirement System Fund - 0479					
Personal services		\$ 5,364,479	\$ 1,441	\$ 5,365,920	
Employee retirement contributions paid by employer		32,838	-	32,838	
Retirement contributions		2,449,906	657	2,450,563	
Social security contributions		396,812	191	397,003	
Group insurance		1,573,530	-	1,573,530	
Contractual services		1,663,398	77,545	1,740,943	
Travel		10,633	1,577	12,210	
Commodities		10,230	2,150	12,380	
Printing		32,087	6,085	38,172	
Equipment		4,131	11,203	15,334	
Electronic data processing		5,502,005	496,046	5,998,051	
Telecommunications		50,315	9,411	59,726	
Automotive		5,455	798	6,253	

Schedule of Appropriations, Expenditures and Lapsed Balances (Continued)  
Expenditure Authority for Fiscal Year 2016  
Fourteen Months Ended August 31, 2016

	Expenditure Authority (Net of Transfers)	Expenditures Through June 30	Lapse Period Expenditures July 1 to August 31	Total Expenditures 14 Months Ended August 31	Balances Lapsed August 31
<b>Nonappropriated Funds (Continued)</b>					
State Employees' Retirement System					
Fund - 0479 (Continued)					
Nonrecurring refunds and distributions		\$ 19,573,818	\$ (167)	\$ 19,573,651	
Payments to general obligations bond retirement and interest fund		21,950,544	2,922,091	24,872,635	
Pensions, annuities and benefits		2,163,513,432	(518,395)	2,162,995,037	
Permanent improvements		64,494	121,257	185,751	
Refunds of prior calendar year retirement contributions		252,292	2,883	255,175	
Refunds, not classified elsewhere		26,843,047	(2,964)	26,840,083	
		<u>2,249,293,446</u>	<u>3,131,809</u>	<u>2,252,425,255</u>	
Subtotal - Fund 0479					
State Employees' Retirement System					
Excess Benefit Fund - 0788					
Pensions, annuities and benefits		468,046	-	468,046	
		<u>468,046</u>	<u>-</u>	<u>468,046</u>	
Total nonappropriated funds					
		<u>2,249,761,492</u>	<u>3,131,809</u>	<u>2,252,893,301</u>	
<b>Grand Total, All Funds</b>					
		<u>\$ 3,616,941,461</u>	<u>\$ 3,131,809</u>	<u>\$ 3,620,073,270</u>	

Note 1: Expenditure authority, appropriations, expenditures, and lapsed balances were obtained from the State Comptroller records as of September 30, 2016 and have been reconciled to System records.

Note 2: Expenditure amounts are vouchers approved for payment by the System and submitted to the State Comptroller for payment to the vendor.

Note 3: The State Pension Funds Continuing Appropriation Act (40 ILCS 15/1.2) provides a continuing annual appropriation for the State's Contributions to the System such that the State's total contributions are no less than the required State contributions lawfully submitted by the System under the Illinois Pension Code (40 ILCS 5/14-135.08) and the FY2015 Shortfall certified under Pension Code (40 ILCS 5/14-131(k)). The Circuit Court of Cook County in *People v. Munger* (15 CH 10243) ordered the State Comptroller, in the absence of enacted annual appropriations, to process and pay certified invoice vouchers from the System pursuant to this Statute. Therefore, the System's fiscal year 2016 appropriation for Fund 001 was established as the amount certified to the Governor and General Assembly as the State's required contribution on January 15, 2015.

Note 4: The Circuit Court of St. Clair County in *AFSCME Council 31 vs Munger* (15 CH 475) ordered the State Comptroller, in the absence of enacted annual appropriations, to "draw and issue warrants accomplishing payment of wages [for all State employees] at their normal rates of pay." As the System never received enacted personal services appropriations for Fund 001 the System was able to submit vouchers to pay its employees in full without a maximum expenditure limit for personal service costs during fiscal year 2016.

State Employees' Retirement System of the State of Illinois  
Compliance Examination

Schedule 2

Comparative Schedule of Net Appropriations,  
Expenditures and Lapsed Balances  
For the Years Ended June 30, 2016, 2015 and 2014

	Fiscal Year		
	2016	2015	2014
	Continuing		
	Appropriation and	P.A. 98-0679 and	P.A. 98-0017, 098-
	Court Orders	P.A. 98-0680	0064 and 098-0642
<b>Appropriated Funds</b>			
<b>General Revenue Fund - 0001</b>			
Appropriations	\$ -	\$ 1,148,701,430	\$ 1,097,457,120
Expenditures			
Continuing appropriation for pension contributions	1,329,170,050	1,136,479,500	1,097,360,220
Continuing appropriation for fiscal year shortfall	37,968,539	12,130,929	-
Personal services	38,509	40,188	70,574
Social Security contributions	2,871	2,904	5,260
Employee retirement contributions paid by employer	-	10,000	2,336
Contractual services	-	15,700	15,700
Travel	-	1,015	993
Commodities	-	100	-
Electronic data processing	-	500	500
Telecommunications	-	300	322
Total expenditures	1,367,179,969	1,148,681,136	1,097,455,905
Lapsed balances	\$ -	\$ 20,294	\$ 1,215
<b>Grand Total - Appropriated Funds</b>			
Appropriations (Net of transfers)	\$ -	\$ 1,148,701,430	\$ 1,097,457,120
Total expenditures	1,367,179,969	1,148,681,136	1,097,455,905
Lapsed balances	\$ -	\$ 20,294	\$ 1,215
<b>Nonappropriated Funds</b>			
<b>Kanerva vs State Trust Fund - 0234</b>			
Expenditures			
Annuitant disbursement	\$ -	\$ 34,749,730	\$ -
<b>State Employees' Retirement System Fund - 0479</b>			
Expenditures			
Personal services	5,365,920	5,737,994	5,693,842
Employee retirement contributions paid by employer	32,838	38,302	32,985
Retirement contributions	2,450,563	2,431,230	2,308,642
Social Security contributions	397,003	425,526	420,432
Group insurance	1,573,530	1,467,162	1,505,367
Contractual services	1,740,943	1,782,465	2,062,621
Travel	12,210	15,653	18,083
Purchase of investments	-	-	-
Commodities	12,380	18,629	25,165
Printing	38,172	48,463	48,694
Equipment	15,334	28,890	181,368
Electronic data processing	5,998,051	5,502,099	5,404,834
Telecommunications	59,726	170,576	98,717
Automotive	6,253	9,853	7,788

Comparative Schedule of Net Appropriations,  
Expenditures and Lapsed Balances (Continued)  
For the Years Ended June 30, 2016, 2015 and 2014

	Fiscal Year		
	2016	2015	2014
	Continuing		
	Appropriation and Court Orders	P.A. 98-0769 and P.A. 98-0680	P.A. 98-0017, 098- 0064 and 098-0642
<b>Nonappropriated Funds</b>			
<b>State Employees' Retirement System Fund - 0479</b>			
<b>(Continued)</b>			
Nonrecurring refunds and distributions	\$ 19,573,651	\$ 15,102,606	\$ 18,389,075
Payments to general obligation bond retirement and interest fund	24,872,635	28,977,468	29,456,449
Pensions, annuities and benefits	2,162,995,037	2,011,149,454	1,890,147,996
Permanent improvements	185,751	126,540	268,843
Refunds, prior calendar year contributions	255,175	296,199	248,203
Refunds, not elsewhere classified	26,840,083	23,523,103	23,314,091
FY 13 Overpayment General Revenue Fund employer contribution	-	-	58,607,580
Total expenditures - Fund 0479	2,252,425,255	2,096,852,212	2,038,240,775
<b>State Employees' Retirement Excess Benefit Fund - 0788</b>			
Expenditures			
Pensions, annuities and benefits	468,046	340,941	147,351
Total nonappropriated expenditures	2,252,893,301	2,131,942,883	2,038,388,126
Grand total expenditures, all Funds	\$ 3,620,073,270	\$ 3,280,624,019	\$ 3,135,844,031

Note 1: Expenditure authority, appropriations, expenditures, and lapsed balances were obtained from the State Comptroller records as of September 30, 2016 and have been reconciled to System records.

Note 2: Expenditure amounts are vouchers approved for payment by the System and submitted to the State Comptroller for payment to the vendor.

Note 3: The State Pension Funds Continuing Appropriation Act (40 ILCS 15/1.2) provides a continuing annual appropriation for the State's Contributions to the System such that the State's total contributions are no less than the required State contributions lawfully submitted by the System under the Illinois Pension Code (40 ILCS 5/14-135.08) and the FY2015 Shortfall certified under Pension Code (40 ILCS 5/14-131(k)). The Circuit Court of Cook County in *People v. Munger* (15 CH 10243) ordered the State Comptroller, in the absence of enacted annual appropriations, to process and pay certified invoice vouchers from the System pursuant to this Statute. Therefore, the System's fiscal year 2016 appropriation for Fund 001 was established as the amount certified to the Governor and General Assembly as the State's required contribution on January 15, 2015.

Note 4: The Circuit Court of St. Clair County in *AFSCME Council 31 vs Munger* (15 CH 475) ordered the State Comptroller, in the absence of enacted annual appropriations, to "draw and issue warrants accomplishing payment of wages [for all State employees] at their normal rates of pay." As the System never received enacted personal services appropriations for Fund 001 the System was able to submit vouchers to pay its employees in full without a maximum expenditure limit for personal service costs during fiscal year 2016.

**State Employees' Retirement System of the State of Illinois  
Compliance Examination**

**Schedule 3**

**Schedule of Changes in State Property  
For the Year Ended June 30, 2016**

	Beginning Balance	Additions	Deletions	Ending Balance
<b>State Employees' Retirement System Trust</b>				
<b>Fund</b>				
Land	\$ 655,241	\$ -	\$ -	\$ 655,241
Land improvements	315,779	-	-	315,779
Building	3,859,820	185,751	-	4,045,571
Furniture and equipment	2,398,907	464,105	(79,810)	2,783,202
Capitalized software costs	2,751,441	1,669,491	-	4,420,932
<b>Total</b>	<b>9,981,188</b>	<b>2,319,347</b>	<b>(79,810)</b>	<b>12,220,725</b>
Accumulated depreciation	(4,708,635)	(651,527)	78,386	(5,281,776)
Property and equipment - net	<u>\$ 5,272,553</u>	<u>\$ 1,667,820</u>	<u>\$ (1,424)</u>	<u>\$ 6,938,949</u>
<b>Social Security Contribution Fund</b>				
Furniture and equipment	<u>\$ 3,744</u>	<u>\$ -</u>	<u>\$ (452)</u>	<u>\$ 3,292</u>

This summary schedule was prepared using State property records required by the Illinois Administrative Code. The capitalization policy in the code is different than the capitalization policy established by the Office of the State Comptroller for financial reporting in accordance with generally accepted accounting principles.

**State Employees' Retirement System of the State of Illinois  
Compliance Examination**

**Schedule 4**

**Comparative Schedule of Cash Receipts  
For the Years Ended June 30, 2016 and 2015**

	2016	2015
Receipts:		
Participant contributions	\$ 247,670,465	\$ 257,823,268
Employer contributions (net of bond principle and interest)	645,258,707	599,464,616
General Revenue Fund / Pension Contribution Fund	1,359,109,815	1,174,448,039
Transfers from the Illinois State Board of Investment	100,000,000	-
Interest income on cash balances	703,936	620,455
Claims Receivable Payments	5,546,060	6,172,253
Installment Payments	3,120,620	3,258,283
Other	211,061	184,875
	<u>\$ 2,361,620,664</u>	<u>\$ 2,041,971,789</u>
Total cash receipts, per book		

**State Employees' Retirement System of the State of Illinois  
Compliance Examination**

**Schedule 5**

**Reconciliation Schedule of Cash Receipts  
to Deposits Remitted to the State Comptroller  
For the Years Ended June 30, 2016 and 2015**

	2016	2015
Total cash receipts, per books	\$ 2,361,620,664	\$ 2,041,971,789
Add (deduct)		
Bond principal and interest payments collected and remitted to the State of Illinois	25,624,320	28,880,832
Interest on cash balances	(703,936)	(620,455)
Cancelled warrants and adjustment deposits classified by the Comptroller as reductions of expenditures	(5,267,059)	(5,778,241)
Intergovernmental Transfers submitted to the Comptroller's Office but not yet released / deposited into Trust Fund (Fund 479) **	55,382,088	47,353,314
Prior year intergovernmental payment vouchers deposited into the Trust Fund (Fund 479) during the current fiscal year**	(47,353,314)	(45,723,343)
Cash in Transit		
Beginning of year	272,411	152,564
End of year	(275,026)	(272,411)
Deposits in transit		
Beginning of year	142,684	53,627
End of year	(126,548)	(142,684)
Deposits remitted to the State Comptroller for order into the State Treasury	<u>\$ 2,389,316,284</u>	<u>\$ 2,065,874,992</u>
Fund 788	\$ 558,271	\$ 450,169
Fund 479	<u>2,388,758,013</u>	<u>2,065,424,823</u>
	<u>\$ 2,389,316,284</u>	<u>\$ 2,065,874,992</u>

\*\* Intergovernmental transfer are GRF employer contributions that are deposited in Fund 479. The Comptroller posts them to the Revenue Report when the GRF payment vouchers posts. SERS does not post the deposit until the voucher has been released for payment.

**Analysis of Significant Variations in Expenditures  
For the Year Ended June 30, 2016**

The System's expenditures, obtained from Schedule 2, have been analyzed for fluctuations greater than \$1 million and 20 percent from the previous year.

	2016	2015	Increase (Decrease)
<b><u>Fund 0234:</u></b>			
Kanerva vs. State Trust Fund	\$ -	\$ 34,749,730	\$ (34,749,730) (1)
<b><u>Fund 0001:</u></b>			
Continuing appropriation for fiscal year shortfall	37,968,539	12,130,929	25,837,610 (2)
<b><u>Fund 0479:</u></b>			
Nonrecurring refunds and distributions	19,573,651	15,102,606	4,471,045 (3)

- (1) From July, 2013 through October, 2014, annuitants with more than 20 years of service started paying a portion of their health insurance as required by the pension reform law passed by the legislature in 2012. The Supreme Court later ruled that the 2012 pension reform law violated the state constitution's pension protection clause and, as a result, the premium payments were refunded to the annuitants. The amount shown for FY 2015 represents the amount of retiree health insurance premiums refunded to annuitants. All refunds took place in FY 2015 by court order.
- (2) In accordance with the Illinois Pension Code (40 ILCS 5/14-131(k)), "Contributions by the State," the Illinois Office of the Comptroller provides the System a certification of personal services expenditures from the General Revenue Fund (GRF) upon the completion of the fiscal year (including lapse period).

The System compares the amount due for employer contributions based on the rate certified by the Board of Trustees for the fiscal year.

If the funds amount due exceed the amount paid, the "FY Shortfall" is paid to the System under the State Pension Funds Continuing Appropriations Act.

If the amount due is less than the amount paid, the "FY Overpayment" will be repaid by the System to the General Revenue Fund.

The Shortfall for FY 2015 (payable in FY 2016) increased by \$25.8M over the shortfall for FY 2014 (payable in FY 2015) due the increase in the amount of GRF wages subject to retirement over those time periods.

- (3) There was an increase in nonrecurring death benefits paid out in FY 2016 over fiscal year 2015 due to an increase in the number of occurrences during the period.

**State Employees' Retirement System of the State of Illinois  
Compliance Examination**

**Schedule 7**

**Analysis of Significant Variations in Cash Receipts  
For the Year Ended June 30, 2016**

The System's expenditures, obtained from Schedule 4, have been analyzed for fluctuations greater than \$1 million and 20 percent from the previous year.

	2016	2015	Increase
Transfers from the Illinois State Board of Investment	\$ 100,000,000	\$ -	\$ 100,000,000 (1)

- (1) During FY 2016, \$100 million was drawn from the ISBI to cover the November 2015 benefit payments due to the GRF employer contribution for that month not being released until later in the fiscal year. No transfers from the ISBI were necessary during fiscal year 2015.

**Analysis of Significant Lapse Period Spending  
For the Year Ended June 30, 2016**

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The System's lapse period spending, obtained from Schedule 1, has been analyzed for spending greater than \$200,000 and 20 percent in any appropriate line item.

There was no significant lapse period spending during fiscal year 2016.

**State Employees' Retirement System of the State of Illinois  
Compliance Examination**

**Schedule 9**

**Comparative Schedule of Cash Balances  
For the Years Ended June 30, 2016 and 2015**

	2016	2015
State Treasury	\$ 300,189,652	\$ 170,349,835
Vouchers in transit	(2,223)	(14,185)
Deposits and cash in transit	141,201	310,739
	<u>300,328,630</u>	<u>170,646,389</u>
Petty cash fund	<u>200</u>	<u>200</u>
	<u>\$ 300,328,830</u>	<u>\$ 170,646,589</u>

The cash balance at the end of the fiscal year increased due to the timing of the release of the GRF employer contribution payment. The timing of receipts, as well as expenses, can fluctuate and variances in cash balance can occur from year to year.

**Comparative Schedule of Changes in Investment Balances  
For the Years Ended June 30, 2016 and 2015**

Pursuant to Article 22A of the Illinois Pension Code, investments of the State Employees' Retirement System of the State of Illinois are managed by the Illinois State Board of Investment (ISBI) and are held in the ISBI Commingled Fund. Units of the ISBI Commingled Fund are issued to the member systems on the last day of the month based on the unit net asset value calculated as of that date. Net investment income of the ISBI Commingled Fund is allocated to each of the member systems on the last day of the month on the basis of percentage of accumulated units owned by the respective systems.

Investment portfolio management and performance are the direct responsibility of ISBI which establishes investment policy and strategy.

Comparison of the changes in the System's investments held in the ISBI Commingled Fund for the years ended June 30, 2016 and 2015 is summarized as follows:

	<b>2016</b>	<b>2015</b>
Balance at beginning of year, at fair value	\$ 14,967,254,053	\$ 14,286,499,013
Net cash added (withdrawn) to/(from) investments, net	(100,000,000)	-
	<u>14,867,254,053</u>	<u>14,286,499,013</u>
Investment income		
Interest, dividends and other	449,189,664	482,642,760
Expenses	(38,394,629)	(42,184,943)
	<u>410,795,035</u>	<u>440,457,817</u>
Net appreciation (depreciation) in fair value of investments		
Net realized gain (loss) on sales of investments	127,975,145	490,289,530
Net unrealized gain (loss) on investment	(664,969,601)	(249,992,307)
	<u>(536,994,456)</u>	<u>240,297,223</u>
Total net investment income (loss)	<u>(126,199,421)</u>	<u>680,755,040</u>
Balance at end of year, at fair value	<u>\$ 14,741,054,632</u>	<u>\$ 14,967,254,053</u>

Securities lending collateral decreased by \$523.0 thousand in fiscal year 2016 compared to the fiscal year 2015 ending balance (\$64,256,000 from \$64,779,000). The State Treasurer lends securities to broker-dealers and other entities for collateral that will be returned for the same security in the future. Each year the Treasurer provides an allocation to the Comptroller to adjust each State Agency's financial statements to include their proportionate share of the securities lending transaction balances at year end. Securities lending activity can vary from year to year depending on market conditions and the availability of securities to lend.

**State Employees' Retirement System of the State of Illinois  
Compliance Examination**

**Schedule 11**

**Analysis of Contributions Receivable  
For the Years Ended June 30, 2016 and 2015**

	2016	2015
Participants' contributions	\$ 11,893,976	\$ 14,152,324
Employing State agencies	70,171,117	109,810,082 (a)
Other accounts	<u>4,477,002</u>	<u>4,784,680</u>
Total receivables	<u>\$ 86,542,095</u>	<u>\$ 128,747,086</u>

(a) In accordance with the Illinois Pension Code (40 ILCS 5/14-131(k)), "Contributions by the State," the Illinois Office of the Comptroller provides the System a certification of personal services expenditures from the General Revenue Fund (GRF) upon the completion of the fiscal year (including lapse period).

The System compares the amount due for employer contributions based on the rate certified by the Board of Trustees for the fiscal year.

If the funds amount due exceed the amount paid, the "FY Shortfall" is paid to the System under the State Pension Funds Continuing Appropriations Act.

If the amount due is less than the amount paid, the "FY Overpayment" will be repaid by the System to the General Revenue Fund.

In fiscal year 2015, there was an accrual for a shortfall (\$38.0 M) owed to SERS; in fiscal year 2016, an overpayment occurred causing the accrual of payable from the System back to GRF (there was no shortfall owed to the System).

Receivables included above represent amounts due from participants and the employers for contributions. Accounts are first analyzed by System personnel for collectability before being sent to the Attorney General's Office for a final determination.

## **State Employees' Retirement System of the State of Illinois Compliance Examination**

### **Analysis of Operations (Unaudited) For the Years Ended June 30, 2016 and 2015**

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#### ***System Functions and Planning Program (Unaudited)***

The State Employees' Retirement System of Illinois was established on January 1, 1944 for the purpose of providing an orderly means whereby aged or disabled employees may be retired from active service, without prejudice or hardship, and to enable the employees to accumulate reserves for themselves and their dependents for old age, disability, death and termination of employment, thus affecting economy and efficiency in the administration of the State government.

The System is governed by Article 14 of the Illinois Pension Code (Chapter 40 of the Illinois Compiled Statutes). As of June 30, 2016, the System had approximately 61,300 active members and 70,000 benefit recipients.

The State Employees' Retirement System of Illinois is administered by a Board of Trustees of thirteen persons, which includes: a. the Comptroller, who shall be the Chairperson; b. six persons appointed by the Governor with the advice and consent of the Senate who may not be members of the System or hold an elective State office and who shall serve a term of 5 years, except that the terms of the initial appointees under the amendatory act of the 96<sup>th</sup> General Assembly shall be as follows: 3 for a term of 3 years and 3 for a term of 5 years; c. four active participants of the System having at least 8 years of creditable service, to be elected from the contributing members of the System by the contribution members; and d. two annuitants of the System who have been annuitants for at least one full year, to be elected from and by the annuitants of the System. The administration of the detailed affairs of the System is vested in the Executive Secretary, under the direction of the Board. General policy relating to the administration of the System is stated in the minutes of the Board meetings.

The System also administers the Social Security Enabling Act, Article 21 of the Illinois Pension Code, which makes coverage under the Federal Social Security Program available to employees of the State and its political subdivisions. The purpose of the Social Security Division of the System was to collect FICA contributions from employees, employing State agencies and various political subdivisions and remitting these contributions to the Federal government for calendar years prior to 1987. The responsibility of collecting and remitting Social Security contributions to the Federal government was transferred from this office to the Office of the Comptroller effective January 1, 1987. All adjustments for wages paid prior to January 1, 1987 were processed through this office. The remaining function of the Social Security Division is largely to act as a liaison between the Social Security Administration and local governments throughout the State. All necessary documentation pertaining to Section 218 agreements are initiated by the Division. The administrative expenses of the Social Security Division are appropriated by the General Assembly on a line item basis through the General Revenue Fund.

The System is also responsible for the general administration of the State Employees Group Insurance Program as it applies to eligible annuitants. This includes enrollment, processing life insurance claims and other administrative details related to that program.

Program planning activities of the System are under the direct supervision of the Executive Secretary and involve coordination between the governing Board and other executive staff of the System. The current planning program identifies various operational projects for fiscal year 2016. The planning summary for each project includes the project scope and objectives, implementation phases and timing, resource application and expected benefits. Each project is assigned to a divisional level manager who acts as project leader during all implementation phases of the project. Implementation progress is reported to the Executive Secretary, who in turn reports such progress directly to the System's Board of Trustees.

## **State Employees' Retirement System of the State of Illinois Compliance Examination**

### **Analysis of Operations (Unaudited) (Continued) For the Years Ended June 30, 2016 and 2015**

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#### ***System Functions and Planning Program (Unaudited) (Continued)***

The operational plan for fiscal year 2016 involved numerous IT system modernization (re-engineering) projects and enhancements. These included the sync of retirement benefit data, the conversion of pattern letters, the new benefit setup process and pension calculations, new security functionality on the employer website, system performance tuning, and changes to the annual benefit statements. Additionally, the IT staff performed work to implement the new CMS benefit systems, completed the RFP for the new hyper-converged infrastructure, performed vulnerability and penetration testing remediation, completed full disaster recovery planning and testing, and upgraded 20 Windows Servers to 2012.

The operational plan for fiscal year 2017 includes several IT initiatives including: the complete conversion of IT infrastructure into the new hyper-converged system, the implementation of the new benefit setup and pension calculation, service purchase set up, cash receipts, and receivables. Additionally, the IT staff will upgrade to Office 2016, complete the upgrade of Windows Servers to 2012, and upgrade staff computers to Windows 10.

#### ***Progress in Funding the System (Unaudited)***

In August 1994, Senate Bill 533 was signed into law as Public Act 88-0593. This funding legislation, which became effective July 1, 1995, provides for a systematic 50-year funding plan with an ultimate goal to fund the cost of maintaining and administering the System at an actuarial funded ratio of 90 percent. In addition, the funding plan provides for a 15-year phase-in period to allow the State to adapt to the increased financial commitment. Once the 15-year phase-in is complete, the State's contribution will then remain at a level percentage of payroll for the next 35 years until the 90 percent funded level is achieved.

The funding legislation also provides for the establishment of a continuing appropriation of the required employer contributions to the System. This, in effect, removed the appropriation of those funds from the annual budgetary process.

Public Act 92-0566 became effective June 25, 2002, and provided an early retirement incentive (ERI) for those participants under the State Employees' Retirement System who terminated service before December 31, 2002 (or April 30, 2003, for certain cases). The increase in the unfunded actuarial accrued liability due to the ERI was originally to be amortized over ten years. The law, as modified, now requires that, in addition to any employer contributions required above, the State shall pay an amount equal to \$70,000,000 for fiscal years 2004 and 2005; and in each fiscal year 2006 through 2015, a level-dollar payment based upon the increase in the present value of future benefits provided by the early retirement incentives amortized at 8.5 percent interest.

Public Act 93-0002 became law on April 7, 2003, and authorized the State to issue \$10 billion in general obligation bonds for the purpose of making contributions to the retirement systems. On June 12, 2003, the State issued \$10 billion in General Obligation Bonds, Pension Funding Series of June 2003.

Commencing with fiscal year 2005, the maximum State contribution under Public Act 93-0002 equals the State contribution that would have been required if the general obligation bond contribution had not been made, reduced – but not below zero – by the State's debt service on each system's respective portion of the full \$10 billion of General Obligation Bond, Pension Funding Series of June 2003.

## State Employees' Retirement System of the State of Illinois Compliance Examination

### Analysis of Operations (Unaudited) (Continued) For the Years Ended June 30, 2016 and 2015

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#### ***Progress in Funding the System (Unaudited) (Continued)***

In June 2005, Public Act 94-0004 became law. This legislation further modified the funding plan by reducing the amount of required employer contributions for fiscal years 2006 and 2007 that would have otherwise been required under Public Act 88-0593, as modified by Public Act 93-0002. This act specified the appropriation amounts for fiscal years 2006 and 2007. The required State contributions for fiscal years 2008 through 2010 will then be increased incrementally as a percentage of the participant payroll so that by fiscal year 2011 the State is contributing at the required level contribution rate to achieve the financing objective of a 90% funded status by the end of fiscal year 2045.

Public Act 96-0043 became law on July 15, 2009. As required under PA 96-0043, the method for determining the actuarial value of assets used to determine the employer contribution rate was changed beginning with the June 30, 2009 valuation. The method was changed from the market/fair value to a smoothed value. The smoothed value recognizes actuarial investment gains or losses for each fiscal year, beginning with FY09, in equal amounts over the ensuing five-year period.

Public Act 96-0889 added a lower tier of benefits for members who first contribute to SERS on or after January 1, 2011. When Public Act 96-1511 was enacted in January 2011, it required the System to assume that the provisions of Public Act 96-0889 were in effect on June 30, 2009 and to recalculate and recertify the fiscal year 2011 state funding requirement. Under this recertification, the fiscal year 2011 state contribution requirement was reduced by \$95 million, from \$1,193.3 million to \$1,098.3 million.

Under the State's funding plan, the actuarial accrued liability of the System at June 30, 2016 amounted to approximately \$45.5 billion. The actuarial value of assets (at smoothed value) at June 30, 2016 amounted to approximately \$15.6 billion. The difference between the actuarial accrued liability and the actuarial value of assets of \$29.9 billion reflects the unfunded actuarial accrued liability of the System at June 30, 2016 under the State's funding plan. The System had a funded ratio (based on the State's funding plan) of 34.4% at June 30, 2016.

For financial reporting purposes, the System adopted GASB Statement No. 67, *Financial Reporting for Pension Plans* in the fiscal year ended June 30, 2014. GASB Statement No. 67 requires the use of the market value of assets rather than the actuarial value of assets (smoothed value) used under the State's funding plan in calculating the net pension liability. It also requires that the System use the entry age actuarial cost method rather than the projected unit costs method used under the State's funding plan for calculating the total pension liability. In addition it requires the System use a blended rate of return of 6.64% combining the assumed rate of return of 7.0% and a municipal bond rate of 2.85% based on an index of 20 year general obligation bonds with an average AA rating for investments in the event the System's assets are exhausted in the future.

On June 30, 2016, the System reported for financial reporting purposes under GASB Statement No. 67 that the market value of assets was \$15.0 billion. The difference between the total pension liability of \$49.2 billion and the market value of assets was the net pension liability of \$34.1 billion and the funded ratio was 30.6%. On June 30, 2015, the market value of assets was \$15.3 billion. The difference between the System's June 30, 2015 total pension liability of \$43.3 billion and the market value of assets was the June 30, 2015 net pension liability of \$28.0 billion and the funded ratio was 35.3%.

**State Employees' Retirement System of the State of Illinois  
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**Analysis of Operations (Unaudited) (Continued)  
For the Years Ended June 30, 2016 and 2015**

***Progress in Funding the System (Unaudited) (Continued)***

The market value of the assets of the fund, that were available for benefits, decreased from \$15.3 billion at June 30, 2015 to \$15.0 billion at June 30, 2016. This decrease is due to the decreased return on fund assets. The actuarial value of the assets of \$15.6 billion at June 30, 2016, is \$594.1 million higher than the market value of the assets due to recognition of 100% of the actuarial loss in fiscal year 2012, 80% of the actuarial gain in fiscal year 2013, 60% of the actuarial gain in fiscal year 2014, and 40% of the actuarial loss in fiscal year 2015 and 20% of the actuarial loss in 2016.

State required contributions to the System for the next five fiscal years are noted in the table below.

Year Ended June 30	Required State Contribution (in millions)
2017	\$ 2,014.5
2018	2,327.6
2019	2,377.9
2020	2,432.3
2021	2,504.5

The Schedule of the State's Net Pension Liability (in billions) for fiscal years ending June 30, 2016 and 2015 are noted in the table below.

	2016	2015
Total pension liability	\$ 49.184	\$ 43.267
Plan fiduciary net position	15.039	15.259
State's net pension liability (asset)	\$ 34.145	\$ 28.008
Plan fiduciary net position as a percentage of the total pension liability	30.58 %	35.27 %
Covered employee payroll	\$ 4.284	\$ 4.454
State's net pension liability (asset) as a percentage of Covered employee payroll	796.98 %	628.88 %

The Schedule of State Contributions (in millions) for the fiscal years ending June 30, 2016 and 2015 are noted in the table below.

Year Ended June 30,	Actuarially Determined Contribution	Contributions Received	Contribution (Deficiency) Excess	Covered Employee Payroll	Contributions Received as a Percentage of Covered Employee Payroll
2016	\$2,019.7	\$1,882.2	(137.5)	\$4,284.4	43.93%
2015	2,045.3	1,804.3	(241.0)	4,453.7	40.51%

**State Employees' Retirement System of the State of Illinois  
Compliance Examination**

**Analysis of Operations (Unaudited) (Continued)  
For the Years Ended June 30, 2016 and 2015**

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**Notes to the Schedule of State Contributions**

Valuation date: June 30, 2014

Notes: Actuarially determined contribution rates are calculated as of June 30, which is 12 months prior to the beginning of the fiscal year in which the contributions will be made.

**Methods and Assumptions Used to Determine Contribution Rates as of the Valuation Date**

Actuarial Cost Method: Projected Unit Credit

Amortization Method: Normal cost plus a level percentage of capped payroll amortization of the unfunded accrued liability.

Remaining Amortization Period: 30 years, open

Asset Valuation Method: 5 year smoothed market

Inflation: 3.00 percent

Salary Increases: Salary increase rates based on age-related productivity and merit rates plus inflation.

Post-Retirement Benefits: Post-retirement benefit increases of 3.00 percent, compounded, for Tier 1 and 3.00 percent or one-half of the annual increase in the Consumer Price Index whichever is less, simple, for Tier 2.

Investment Rate of Return: 7.25 percent

Retirement Age: Experience-based table of rates that are specific to the type of eligibility condition. Last updated for the June 30, 2014, valuation pursuant to an experience study of the period July 1, 2009 to June 30, 2013.

Mortality: 105 percent of the RP2014 Healthy Annuitant table, sex distinct

**State Employees' Retirement System of the State of Illinois  
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**Analysis of Operations (Unaudited) (Continued)  
For the Years Ended June 30, 2016 and 2015**

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***Budget Impasse Disclosures (Unaudited)***

All of the System's Fiscal Year 2016 costs were paid pursuant to continuing appropriations or court orders. The System did not have any outstanding invoices from Fiscal Year 2016 unpaid after the closure of the Fiscal Year 2016 Lapse Period on August 31, 2016.

***Alternative Financing in Lieu of Appropriations and Programs to Address Untimely Payments to Vendors (Unaudited)***

The System and its vendors did not participate in alternative financing in lieu of enacted appropriations involving the Illinois Finance Authority during Fiscal Year 2016.

None of the System's vendors participated in the Vendor Payment Program (VPP) or the Vendor Support Initiative Program (VSI) during Fiscal Year 2016.

***Interest Costs on Fiscal Year 2016 Invoices (Unaudited)***

The System did not incur any prompt payment interest due to vendors under the State Prompt Payment Act (Act) (30 ILCS 540). The System's vendors were paid from funds and accounts that are ineligible for prompt payment interest due to vendors under the Act.

***Money-Weighted Rate of Return (Unaudited)***

Pursuant to Article 22A of the Illinois Pension Code, investments of the State Employees' Retirement System of Illinois are managed by the Illinois State Board of Investment (ISBI) and are held in the ISBI Commingled Fund. ISBI 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 7.00% per year.
- At least equal to the return of a composite benchmark of market indices in the same proportions as the Board's asset allocation policy targets.

The time-weighted rate of return of the Illinois State Board of Investment (ISBI) Commingled Fund was (0.8)% for fiscal year 2016. The ISBI's total fund performance was less than the composite benchmark of 0.7% for the year ended June 30, 2016.

The annual money-weighted rate of return, net of investment expense, as of June 30, 2016 and 2015 was as follows:

	<u>2016</u>	<u>2015</u>
Money-weighted return*	(0.86)%	4.79%

\* The money-weighted rate of return expresses the investment performance, net of investment expense, adjusted for changing amounts actually invested.

**State Employees' Retirement System of the State of Illinois  
Compliance Examination**

**Analysis of Operations (Unaudited) (Continued)  
For the Years Ended June 30, 2016 and 2015**

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***Average Number of System Employees (Unaudited)***

**System Employees' Retirement System Trust Fund**

The average number of employees (not including the General Revenue Fund – Social Security Division) during the years ended June 30, 2016, 2015 and 2014 is summarized by functional classification as follows:

	<u>2016</u>	<u>2015</u>	<u>2014</u>
Executive and administrative	23	23	26
Accounting, bookkeeping and clerical	38	38	38
Other office employees	13	15	12
Electronic data processing	<u>23</u>	<u>23</u>	<u>22</u>
Total	<u>97</u>	<u>99</u>	<u>98</u>

**Social Security Contribution Fund**

The Social Security Contribution Fund had one employee for the years ended June 30, 2016, 2015 and 2014.

**State Employees' Retirement System of the State of Illinois  
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**Analysis of Operations (Unaudited)  
For the Years Ended June 30, 2016 and 2015**

**Comparison of Administrative Expenses to Total Expenses (Unaudited)**

	<u>2016</u>	<u>2015</u>	<u>2014</u>
Total expenses			
Benefits	\$ 2,190,501,203	\$ 2,034,858,435	\$ 1,917,062,639
Refunds of contributions, including transfers to reciprocating systems	26,708,730	23,128,975	23,082,814
Administrative expenses	<u>16,126,997</u>	<u>16,547,823</u>	<u>16,615,105</u>
	<u>\$ 2,233,336,930</u>	<u>\$ 2,074,535,233</u>	<u>\$ 1,956,760,558</u>
Administrative expenses as a percentage of total expenses	<u>0.7%</u>	<u>0.8%</u>	<u>0.8%</u>

**Schedule of Contributions/Deductions and Effect on Investments (Unaudited)**

Below is a schedule of contributions received by the System and expenditures of the System for benefits and operations and the effect of these transactions on the System's investments.

	<u>2016</u>	<u>2015</u>	<u>2014</u>
<b>Contributions</b>			
Participant Contributions	\$ 256,198,172	\$ 266,139,156	\$ 269,232,241
Employer Contributions	<u>1,882,243,268</u>	<u>1,804,319,356</u>	<u>1,699,447,826</u>
<b>Total Contributions</b>	<u>2,138,441,440</u>	<u>2,070,458,512</u>	<u>1,968,680,067</u>
<b>Deductions</b>			
Retirement Benefits	1,977,598,561	1,833,999,371	1,720,825,103
Survivor Benefits	128,689,627	121,930,337	114,177,228
Disability Benefits	64,057,780	63,929,747	64,782,236
Lump-Sum Death Benefits	20,155,235	14,998,980	17,278,072
Refunds (including transfers to reciprocating systems)	26,708,730	23,128,975	23,082,814
Administrative Expenses	<u>16,126,997</u>	<u>16,547,823</u>	<u>16,615,105</u>
<b>Total Deductions</b>	<u>2,233,336,930</u>	<u>2,074,535,233</u>	<u>1,956,760,558</u>
<b>Contributions in Excess of Deductions (Investments Used to Pay Benefits and Expenses)</b>	<u>\$ (94,895,490)</u>	<u>\$ (4,076,721)</u>	<u>\$ 11,919,509</u>

**State Employees' Retirement System of the State of Illinois  
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**Analysis of Operations (Unaudited) (Continued)  
For the Years Ended June 30, 2016 and 2015**

***Service Efforts and Accomplishments (Unaudited)***

	<b>2016</b>	<b>2015</b>	<b>2014</b>
Membership data			
Coordinated members	84,991	86,022	84,020
Noncoordinated members	2,446	2,559	3,003
Total members	<u>87,437</u>	<u>88,581</u>	<u>87,023</u>
Active members	<u>61,317</u>	<u>63,273</u>	<u>62,844</u>
Benefit payments processed			
Recurring			
Retirement annuities	56,825	54,802	53,478
Survivors' Annuities	11,043	10,889	10,819
Disability benefits	2,163	2,263	2,312
Total	<u>70,031</u>	<u>67,954</u>	<u>66,609</u>
Termination refunds processed	<u>2,792</u>	<u>2,293</u>	<u>2,467</u>
Retirement counseling			
Preretirement sessions <sup>(1)</sup>			
Number of sessions	102	86	69
Number of attendees	4,751	3,654	3,367
Postretirement seminars			
Number of sessions	28	28	31
Number of attendees	1,123	1,100	1,599
Regional and other meetings			
Number of sessions	20	4	24
Number of attendees	786	872	1,651
Retirement coordinator site visits <sup>(1)</sup>	51	18	20
One-on-one meetings	4,138	3,605	5,805

<sup>(1)</sup> During FY 2015, the regional meetings were reduced due to enhanced focus placed on individual counseling sessions at SERS facilities. This focus continued in FY 2016.