STATE EMPLOYEES' RETIREMENT SYSTEM OF ILLINOIS

A Pension Trust Fund of the State of Illinois

COMPREHENSIVE ANNUAL FINANCIAL REPORT FOR THE FISCAL YEAR ENDED JUNE 30, 2006

STATE EMPLOYEES' RETIREMENT
SYSTEM OF ILLINOIS

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

Prepared by the Accounting Division

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2101 South Veterans Parkway, P.O. Box 19255, Springfield, IL 62794-9255 217-785-7444

February 22, 2007

The Board of Trustees and Members
State Employees' Retirement System of Illinois
Springfield, IL 62794

Dear Board and Members:

The comprehensive annual financial report of the State Employees' Retirement System of Illinois (System) as of and for the fiscal year ended June 30, 2006 is hereby submitted. Responsibility for both the accuracy of the data and the completeness and fairness of the presentation, including all disclosures, rests with the System.

To the best of our knowledge and belief, the enclosed data are accurate in all material respects and are reported in a manner designed to present fairly the financial position and results of operations of the various funds of the System. All disclosures necessary to enable the reader to gain an understanding of the System's financial activities have been included.

Generally accepted accounting principles require that management provide a narrative introduction, overview, and analysis to accompany the basic financial statements in the form of Management's Discussion and Analysis (MD&A). This letter of transmittal is designed to complement MD&A and should be read in conjunction with it. The System's MD&A can be found immediately following the report of the independent auditors.

The report consists of six sections:

1. The Introductory Section contains this letter of transmittal and the identification of the administrative organization and the Certificate of Achievement for Excellence in Financial Reporting;

2. The Financial Section contains the report of the Independent Auditors, the financial statements of the System, and certain required and other supplementary financial information;

3. The Investment Section contains a summary of the System's investment management approach and selected summary tables, including investment performance;

4. The Actuarial Section contains an Actuary's Certification Letter and the results of the annual actuarial valuation;

5. The Statistical Section contains significant statistical data;

6. The Plan Summary and Legislative Section contains a summary of the System's plan provisions and current legislative changes.

Generally accepted accounting principles require that the financial reporting entity include:

1. the primary government;
2. organizations for which the primary government is financially accountable;
3. other organizations for which the nature and significance of their relationship with the primary government are such that exclusion would cause the reporting entity's financial statements to be misleading or incomplete.

Based on the criteria of the Governmental Accounting Standards Board Statement No. 14, there are no other state agencies, boards or commissions, or other organizations required to be combined with the System. The System is considered to be part of the State of Illinois financial reporting entity, and is to be combined and included in the State of Illinois' comprehensive annual financial report.

Although the State Employees' Retirement System, Judges' Retirement System and General Assembly Retirement System share a common administration, they are separate entities for legal and financial reporting purposes. Therefore, the financial statements of the State Employees' Retirement System do not include plan net asset information nor the changes in plan net assets of the General Assembly Retirement System or Judges' Retirement System.

PLAN HISTORY & SERVICES PROVIDED

The System is the administrator of a single-employer public employee retirement system established to provide pension benefits for State of Illinois employees. The System also administers widows and survivors benefits as well as the state's occupational and nonoccupational disability programs.

The System was established January 1, 1944 and 17,237 state employees became members on that date. As of June 30, 1944, net assets of the System amounted to $1,255,778. The fair value of plan net assets at the end of the fiscal year June 30, 2006 are slightly under $10.9 billion, and there are 68,075 active members.

INVESTMENTS

The System's investments are managed by the Illinois State Board of Investment (ISBI) pursuant to Chapter 40, Article 5/22A of the Illinois Compiled Statues, using the "prudent person rule".

This rule states that fiduciaries shall discharge their duties solely in the interest of the fund participants and beneficiaries and with the degree of diligence, care and skill which prudent men and women would ordinarily exercise under similar circumstances in a like position.

The ISBI maintains a wide diversification of investments within this fund which is intended to reduce overall risk and increase returns. As further detailed in the Investment Section, the ISBI Commingled Fund earned 11.0%, net of expenses, for the fiscal year ended June 30, 2006.

FUNDING

Funding is the process of specifically allocating monies for current and future use. Proper funding includes an actuarial review of the fund balances to ensure that funds will be available for current and future benefit payments. The greater the level of funding, the larger the ratio of accumulated assets to the actuarial accrued liability and the greater the level of investment potential.

The funding plan for the System, enacted in 1994 with subsequent modifications, requires that state contributions be paid to the System so that by the end of fiscal year 2045, the ratio of accumulated assets to the actuarial accrued liability will be 90%. For fiscal years 2011 through 2045, the required state contributions are to be computed as a level percentage of participant payroll.

For fiscal years up through 2010, the required state contributions, except for fiscal years 2006 and 2007, are to 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 by the end of fiscal year 2045. For fiscal years 2006 and 2007, the state contributed $203,783,900 and will contribute $344,164,400, respectively, as required by Public Act 94-0004.

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

The actuarial determined liability of the System using the projected unit credit actuarial method at June 30, 2006, amounted to $20.875 billion. The actuarial value of assets (at fair value) amounted to $10.900 billion resulting in an unfunded accrued actuarial liability of $9.975 billion as of the same date. A detailed discussion of funding is provided in the Actuarial Section of this report.

MAJOR EVENTS/ INITIATIVES

The operational plan for FY06 included: an election of two (2) trustees, one contributing member with at least eight years of creditable service and one annuitant who has been an annuitant for at least one full year; a review of all position descriptions; the feasibility to electronically process first payment of benefits and refunds of contributions; a review of agency publications for style consistency; and a study of Internet usage.

New projects for FY07 include: a review of the tax information brochure; a toll-free telephone service study; and a new attendance system. Other administrative projects will also be performed.

ACCOUNTING SYSTEM & INTERNAL CONTROL

This report has been prepared to conform with the principles of governmental accounting and reporting pronounced by the Governmental Accounting Standards Board and the American Institute of Certified Public Accountants.

The accrual basis of accounting is used to record the financial transactions and activities of the System. Revenues are recognized in the accounting period in which they are earned, without regard to the date of collection, and expenses are recognized when the corresponding liabilities are incurred, regardless of when payment is made.

The System also uses the State of Illinois, Statewide Accounting Management System (SAMS) as a basis for the preparation of the financial statements. In developing the System's accounting system, consideration is given to the adequacy of internal accounting controls.These controls are designed to provide reasonable assurance regarding the safekeeping of assets and the reliability of financial records. Constant effort is directed by the System at improving this level to assure the participants of a financially sound retirement system.

PROFESSIONAL SERVICES

Independent consultants are retained by the Board of Trustees to perform professional services that are essential to the effective and efficient operation of the System. Actuarial services are provided by Gabriel, Roeder, Smith & Co., Chicago, Illinois.

The annual financial audit of the System was conducted by the accounting firm of McGladrey & Pullen, LLP, under the direction of the Auditor General of the State of Illinois. In addition to the annual financial audit, a compliance attestation examination was also performed by the auditors.

The purpose of the compliance attestation examination was to determine whether the System obligated, expended, received and used public funds of the state in accordance with the purpose for which such funds have been authorized by law. The System's investment function is managed by the Illinois State Board of Investment.

CERTIFICATE OF ACHIEVEMENT

The Government Finance Officers Association of the United States and Canada (GFOA) awarded a Certificate of Achievement for Excellence in Financial Reporting to the State Employees' Retirement System of Illinois for its comprehensive annual financial report for the fiscal year ended June 30, 2005.

The Certificate of Achievement is a prestigious national award recognizing excellence in the preparation of state and local government financial reports.

To be awarded a Certificate of Achievement, a governmental unit must publish an easily readable and efficiently organized CAFR, whose contents meet or exceed program standards. This report must satisfy both generally accepted accounting principles and applicable legal requirements.

A Certificate of Achievement is valid for a period of one year only. The State Employees' Retirement System of Illinois has received a Certificate of Achievement for the past twenty consecutive years (fiscal years ended June 30, 1986 through June 30, 2005).

We believe our current report continues to conform to the Certificate of Achievement program requirements, and we are submitting it to the GFOA to determine its eligibility for another certificate.

ACKNOWLEDGMENTS & COMMENTS

After 31 years of service with the State Retirement Systems, Executive Secretary Robert V. Knox retired effective May 31, 2006. In May, 2006, Timothy B. Blair was named acting Executive Secretary by the Board of Trustees to succeed Mr. Knox.

The preparation of this report reflects the combined efforts of the System's staff under the direction of the Board of Trustees. It is intended to provide complete and reliable information as a basis for making management decisions, as a means of determining compliance with legal provisions, and for determining responsible stewardship for the assets contributed by the members in the State of Illinois.

On behalf of the Board of Trustees, we would like to express our appreciation to the staff and professional consultants who worked so effectively to ensure the successful operation of the System.

Respectfully submitted,

Timothy B. Blair

Timothy B. Blair
Acting Executive Secretary

Nicholas C. Merrill, Jr.

Nicholas C. Merrill, Jr., CPA
Chief Fiscal Officer

BOARD OF TRUSTEES

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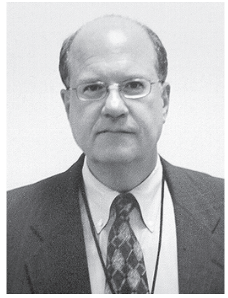
Chairman



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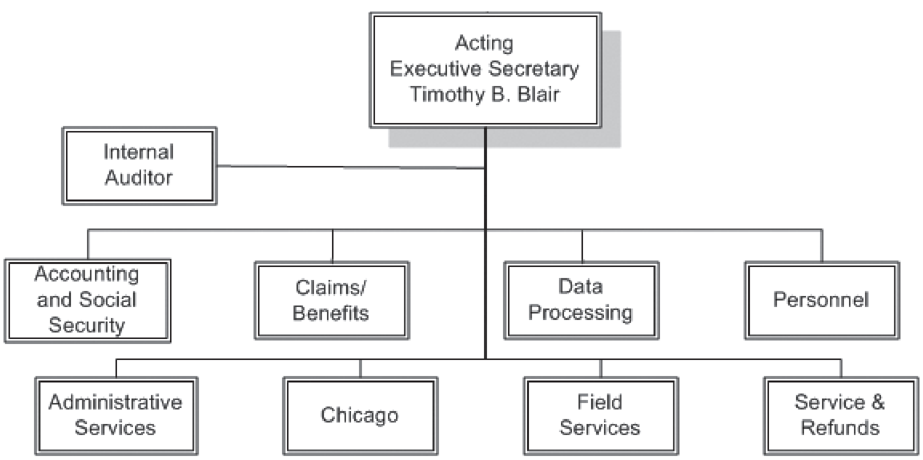

Management Group

Accounting & Social Security	Nicholas C. Merrill, Jr.
Administrative Services	David L. O'Brien
Claims	Patrick P. Cummings
Chicago Office	Barbara J.C. Baird
Data Processing	James J. Spears
Field Services	David F. Thompson
Human Resources	Marty Nantkes
Service & Refunds	Joseph S. Maggio
Internal Auditor	Larry L. Stone

Advisors, Auditors & Administrators

Consulting Actuary	Gabriel, Roeder, Smith & Company Chicago Illinois
External Auditor	McGladrey & Pullen, LLP Schaumburg, Illinois
Investments	Illinois State Board of Investment Chicago, Illinois

Certificate of Achievement for Excellence in Financial Reporting

Presented to

State Employees' Retirement System of Illinois

For its Comprehensive Annual
Financial Report
for the Fiscal Year Ended
June 30, 2005

A Certificate of Achievement for Excellence in Financial Reporting is presented by the Government Finance Officers Association of the United States and Canada to government units and public employee retirement systems whose comprehensive annual financial reports (CAFRs) achieve the highest standards in government accounting and financial reporting.

GOVERNMENT FINANCE OFFICERS ASSOCIATION OF THE UNITED STATES AND CANADA CORPORATION SEAL CHICAGO

President

Executive Director

FINANCIAL SECTION

This financial report is designed to provide a general overview of the State Employees' Retirement System's finances for all those with an interest in the System's finances.

This section presents management's discussion and analysis of the financial position and performance of the State Employees' Retirement Systems of Illinois (System) for the years ended June 30, 2006 and 2005. It is presented as a narrative overview and analysis. Readers are encouraged to consider the information presented here in conjunction with the Letter of Transmittal included in the Introductory Section, of the Comprehensive Annual Financial Report.

The System is a defined benefit, single-employer public employee retirement system. It provides services to over 68,000 active state employees and approximately 54,900 benefit recipients. Throughout this discussion and analysis units of measure (i.e. billions, millions, thousands) are approximate, being rounded up or down to the nearest tenth of the respective unit value.

OVERVIEW OF THE FINANCIAL STATEMENTS

This discussion and analysis is intended to serve as an introduction to the System's financial reporting which is comprised of the following components:

1. Basic Financial Statements. For the fiscal years ended June 30, 2006 and 2005, basic financial statements are presented for the System. This information presents the net assets held in trust for pension benefits for the System as of June 30, 2006 and 2005. This financial information also summarizes the changes in net assets held in trust for pension benefits for the years then ended.

2. Notes to the Financial Statements. The notes to the Financial Statements provide additional information that is essential to achieve a full understanding of the data provided in the basic financial statements.

3. Required Supplementary Information. The required supplementary information consists of two schedules and related notes concerning actuarial information, funded status and required contributions for the System.

4. Other Supplementary Schedules. Other schedules include more detailed information pertaining to the System, including schedules of revenues by source, cash receipts and disbursements, and payments to consultants.

FINANCIAL HIGHLIGHTS

- The Systems' net assets increased by $405 million and $504 million during fiscal years 2006 and 2005 respectively. The increase was primarily due to a $383 million and 431 million increase in the System's investments, at fair value, for fiscal years 2006 and 2005 respectively.
- The System was actuarially funded at 52.2% as of June 30, 2006, compared to 54.4% as of June 30, 2005.
- The overall rate of return for the Illinois State Board of Investment (ISBI) Commingled Fund was 11.0% for fiscal year 2006 compared to 10.1% for fiscal year 2005.

ADDITIONS TO PLAN NET ASSETS

Additions to Plan Net Assets include employer and participant contributions and net income from investment activities. Participant contributions were approximately $214.1 million and $209.3 million for the years ended June 30, 2006 and 2005, respectively. Participant contribution rates are set by statute as a percentage of gross salary. Employer contributions decreased to approximately $210.5 million in 2006 from approximately $427.4 million in 2005. This decrease was due to Public Act 94-0004 which was enacted into law on June 1, 2005. This legislation contained a two-year funding reduction by stipulating that state contributions for fiscal year 2006 and 2007 be based on specific dollar amounts rather than actuarial calculations.

PLAN NET ASSETS

The condensed Statements of Plan Net Assets reflect the resources available to pay benefits to members, including retirees and beneficiaries, at the end of the years reported. A summary of the System's Plan Net Assets is presented below.

Condensed Statements of Plan Net Assets
(in millions)

	As of June 30			Increase/(Decrease) from	
	2006	2005	2004	2006 to 2005	2004 to 2005
Cash	$ 226.7	$ 204.5	$ 66.6	$ 22.2	$ 137.9
Receivables	29.5	36.9	85.0	(7.4)	(48.1)
Investments, at fair value	10,654.9	10,271.4	9,840.1	383.5	431.3
Propery & equipment, net	2.9	3.1	3.2	(.2)	(0.1)
Total assets	10,914.0	10,515.9	9,994.9	398.1	521.0
Liabilities	14.1	21.7	4.7	(7.6)	17.0
Total plan net assets	$ 10,899.9	$ 10,494.2	$ 9,990.2	$ 405.7	$504.0

DEDUCTIONS FROM PLAN NET ASSETS

Deductions from Plan Net Assets are primarily benefit payments. During 2006 and 2005, the System paid out approximately $1,124.0 million and $1,078.0 million, respectively, in benefits and refunds, an increase of approximately 4.4%. Those higher payments were mainly due to a scheduled 3% increase in retirement and other benefit payments and the Alternative Retirement Cancellation Payment (ARCP) program. The administrative costs of the System represented approximately 1% of total deductions in both 2006 and 2005.

FUNDED RATIO

The funded ratio of the plan measures the ratio of net assets against actuarially determined liabilities and is one indicator of the fiscal strength of a pension fund's ability to meet obligations to its members. An annual actuarial valuation is required by statute. The most recent available valuation showed the funded status of the System on June 30, 2006 decreased to 52.2% from 54.4% at June 30, 2005. Major reasons for the decrease were reduced employer contributions and changes in plan assumptions, partially offset by investment gains. The amount by which actuarially determined liabilities exceeded net assets was $10.0 billion at June 30, 2006 compared to $8.8 billion at June 30, 2005.

INVESTMENTS

Investments of the System are combined in a commingled investment pool with the Judges' Retirement System and the General Assembly Retirement System. Each system owns an equity position in the pool and receives proportionate investment income from the pool in accordance with respective ownership percentage. Investment gains or losses are reported in the Statement of Changes in Net Assets of each retirement system.

Net investment income less expenses for the System totaled approximately $1,113.2 million during fiscal year 2006, versus $953.6 million during fiscal year 2005, resulting in returns of 11.0% and a 10.1%, respectively. For the three, five, and ten year period ended June 30, 2006, the ISBI Commingled Fund earned a compounded rate of return of 12.4%, 5.8%, and 8.3%, respectively.

LEGISLATION

On June 1,2005, Public Act 94-0004 was enacted into law. This legislation contains employer contribution funding reductions of approximately $486.3 million and $419.0 million for fiscal years 2006 and 2007, respectively. This resulted in increased transfers from the ISBI Commingled Fund in fiscal year 2006. In addition, it will result in increased transfers in fiscal year 2007 to meet future funding requirements for benefit obligations.

Questions concerning any of the information provided in this report or requests for additional financial information should be addressed to the State Employees' Retirement System of Illinois, Accounting Division, 2101 S. Veterans Parkway, P. O. Box 19255, Springfield, Illinois 62794

CHANGES IN PLAN NET ASSETS

The condensed Statements of Changes in Plan Net Assets reflect the changes in the resources available to pay benefits to members, including retirees and beneficiaries.

Condensed Statements of Changes in Plan Net Assets
(In millions)

	For the Year Ended June 30,			Increase/(Decrease) from	
	2006	2005	2004	2005 to 2006	2004 to 2005
Additions					
Participant contributions	$ 214.1	$ 209.3	$ 199.8	$ 4.8	$ 9.5
Employer contributions	210.5	427.4	1,864.7	(216.9)	(1,437.3)
Net investment income	1,113.2	953.6	1,421.9	159.6	(468.3)
Total additions	1,537.8	1,590.3	3,486.4	(52.5)	(1,896.1)
Deductions					
Benefits	1,110.6	1,063.9	978.2	46.7	85.7
Refunds	13.4	14.1	12.4	(0.7)	1.7
Administrative expenses	8.1	8.3	7.7	(0.2)	.6
Total deductions	1,132.1	1,086.3	998.3	45.8	88.0
Net increase/(decrease) in plan net assets	$ 405.7	$ 504.0	$2,488.1	$ (98.3)	$ (1,984.1)

STATE EMPLOYEES' RETIREMENT SYSTEM OF ILLINOIS

Statements of Plan Net Assets
June 30, 2006 and 2005

	2006	2005
Assets		
Cash	$ 226,751,078	$ 204,525,471
Receivables:		
Contributions:		
Participants	13,154,690	13,921,578
Employing state agencies	11,284,318	18,827,922
Other accounts	5,066,573	4,188,506
Total Receivables	29,505,581	36,938,006
Investments - held in the Illinois State Board of Investment Commingled Fund at fair value	10,654,863,723	10,271,356,795
Property and equipment, net of accumulated depreciation	2,886,428	3,071,449
Total Assets	10,914,006,810	10,515,891,721
Liabilities		
Benefits payable	3,611,783	3,511,282
Refunds payable	232,462	358,589
Administrative expenses payable	990,923	958,248
Participants' deferred service credit accounts	275,865	223,927
Due to the State of Illinois	9,042,712	16,691,722
Total Liabilities	14,153,745	21,743,768
Net assets held in trust for pension benefits	$ 10,899,853,065	$ 10,494,147,953

(A schedule of funding progress is presented on page 27.)

See accompanying notes to financial statements.

STATE EMPLOYEES' RETIREMENT SYSTEM OF ILLINOIS

Statements of Changes in Plan Net Assets
Years Ended June 30, 2006 and 2005

	2006	2005
Additions:		
Contributions:		
Participants	$ 214,108,896	$ 209,334,207
Employing State agencies and appropriations	210,499,791	427,434,612
Total Contributions	424,608,687	636,768,819
Investment income:		
Net investment income	264,013,416	227,422,797
Interest earned on cash balances	8,724,784	4,300,338
Net appreciation in fair value of investments	840,493,512	721,856,118
Total net investment income	1,113,231,712	953,579,253
Total Additions	1,537,840,399	1,590,348,072
Deductions:		
Benefits:		
Retirement annuities	985,503,023	935,677,837
Survivors' annuities	61,100,647	57,542,913
Disability benefits	40,271,558	36,828,758
Lump-sum benefits	23,710,733	33,920,915
Total Benefits	1,110,585,961	1,063,970,423
Refunds (including transfers to reciprocating systems)	13,410,048	14,105,301
Administrative	8,139,278	8,311,269
Total Deductions	1,132,135,287	1,086,386,993
Net Increase	405,705,112	503,961,079
Net assets held in trust for pension benefits:		
Beginning of year	10,494,147,953	9,990,186,874
End of year	$ 10,899,853,065	$ 10,494,147,953

See accompanying notes to financial statements.

STATE EMPLOYEES' RETIREMENT SYSTEM OF ILLINOIS

Notes to Financial Statements June 30, 2006 and 2005

1. Reporting Entity

Generally accepted accounting principles require that the financial reporting entity include: 1) the primary government; 2) organizations for which the primary government is financially accountable; and 3) other organizations for which the nature and significance of their relationship with the primary government are such that exclusion would cause the reporting entity's financial statement to be misleading or incomplete.

The State Employees' Retirement System of Illinois (System) is administered by a Board of Trustees consisting of seven persons, which includes: a. the Director of the Governor's Office of Management and Budget; b. the Comptroller; c. one trustee, not a state employee, who shall be chairman, to be appointed by the Governor for a 5 year term; d. two members of the system, one of whom shall be an annuitant age 60 or over, having at least 8 years of creditable service, to be appointed by the Governor for terms of 5 years; e. one member of the System having at least 8 years of creditable service, to be elected from the contributing membership of the System by the contributing members; and f. one annuitant of the System who has been an annuitant for at least one full year, to be elected from and by the annuitants of the System.

At June 30, 2006 and 2005, the number of participating state agencies, boards and commissions totaled:

	2006	2005
State agencies	37	34
State boards and commissions	40	42
TOTAL	77	76

At June 30, 2006 and 2005, SERS membership consisted of:

	2006	2005
Retirees and beneficiaries currently receiving benefits:		
Retirement annuities	42,676	42,649
Survivors' annuities	10,036	10,041
Disability benefits	2,156	2,138
TOTAL	54,868	54,828
Inactive employees entitled to benefits, but not yet receiving them	4,605	4,672
TOTAL	59,473	59,500
Current Employees:		
Vested: Coordinated with Social Security	42,453	41,697
Noncoordinated	1,976	2,053
Nonvested: Coordinated with Social Security	22,726	24,612
Noncoordinated	920	801
TOTAL	68,075	69,163

Operation of the System and the direction of its policies are the responsibility of the Board of Trustees of the System.

Based on the criteria of the Governmental Accounting Standards Board Statement No. 14, there are no other state agencies, boards or commissions, or other organizations required to be combined with the System. However, the System is considered to be part of the State of Illinois financial reporting entity, and is to be combined and included in the State of Illinois' comprehensive annual financial report.

Pursuant to federal tax laws and regulations governing the administration of public employee pension plans, the System has established a separate fund for the sole purpose of disbursing benefits in accordance with Section 415 of the Internal Revenue Code. Receipts of the fund for fiscal year 2006 were approximately $60,000, disbersments were approximately $54,000. For fiscal year 2005, receipt and disbursement amounts were approximately $57,000.

Due to the immaterial nature of the separate fund, these receipts and disbursements have been included in the financial statements of the System.

2. Plan Description

The System is the administrator of a single-employer, defined benefit public employee retirement system (PERS) established and administered by the State of Illinois to provide pension benefits for its employees.

a. Eligibility and Membership

Membership is automatic for most state employees who are not eligible for another state-sponsored retirement plan.

Generally, anyone entering state service, except those in positions subject to membership in certain other state sponsored retirement systems, persons employed after June 30, 1979 as public service employment program participants under the Federal

CETA program, and other exceptions as indicated in state law, become members of the System upon completion of six months of service.

Employees appointed by the Governor and requiring confirmation by the State of Illinois Senate may elect to become members of the System.

b. Contributions

Participating members contribute specified percentages of their salaries for retirement annuities and survivors' annuities in accordance with Chapter 40, Section 5/14-133 of the Illinois Compiled Statutes (ILCS).

Contributions are excluded from gross income for Federal and State income tax purposes. The total contribution rate is 4% if the member is covered by Social Security and 8% if the member is not covered. Certain employment categories which are eligible for benefits under alternative formulas contribute at the rate of 8 1/2% or 12 1/2 % depending upon whether or not the employee is covered by Social Security. Participants' contributions are fully refundable, without interest, upon withdrawal from state employment.

The State of Illinois is obligated to make payment for the required departmental employer contributions, all allowances, annuities, any benefits granted under Chapter 40, Article 5/14 of the ILCS and all administrative expenses of the System to the extent specified in the ILCS. State law provides that the employer contribution rate be determined based upon the results of each annual actuarial valuation.

c. Benefits

The System is governed by Chapter 40, Article 5/14 of the ILCS. Vesting and benefit provisions of the System are defined in the ILCS. Employees who retire at or after age 60 with 8 years of credited service, at age 55 with at least 25 years of credited service with reduced benefits, or when an employee's age and service equal 85 years, are entitled to an annual retirement benefit, payable monthly for life, in an amount based upon final average compensation and credited service.

Final average compensation for retirement and survivors' annuities, is the employee's average salary, during a 48 consecutive month period within the last 120 months of service in which the total compensation was the highest, to a maximum of 75%. Alternative formula positions use their final rate of pay for the final average compensation, to a maximum of 80%.

The retirement benefit formula available to general state employees is 1.67% for each year of covered service and 2.2% for each year of noncovered service. Alternative formula employees have a formula of 2.5% for covered service and 3.0% for noncovered service.

Occupational and nonoccupational (including temporary) disability benefits are available through the System. To be eligible for nonoccupational (including temporary) disability benefits, an employee must have at least eighteen months of credited service with the System.

The nonoccupational (including temporary) disability benefit is equal to 50% of the monthly rate of compensation of the employee on the date of removal from the payroll. Occupational disability benefits are provided when the member becomes disabled as a direct result of injuries or diseases arising out of and in the course of state employment. The monthly benefit is equal to 75% of the monthly rate of compensation on the date of removal from the payroll. This benefit amount is reduced by Workers' Compensation or payments under the Occupational Diseases Act.

Occupational and nonoccupational death benefits are also available through the System. Certain nonoccupational death benefits vest after eighteen months of credited service. Occupational death benefits are provided from the date of employment.

3. Summary of Significant Accounting Policies & Plan Asset Matters

a. Basis of Accounting

The financial transactions of the System are maintained and these financial statements have been prepared using the accrual basis of accounting in conformity with generally accepted accounting principles. Employee and employer contributions are recognized as revenues when due pursuant to statutory requirements.

Benefits and refunds are recognized as expenses when due and payable in accordance with the terms of the plan.

b. Cash

The System retains all of its available cash in a commingled investment pool managed by the Treasurer of the State of Illinois (Treasurer). All deposits are fully collateralized by the Treasurer.

"Available cash" is determined to be that amount which is required for the current operating expenditures of the System. The excess of available cash is transferred to the Illinois State Board of Investment (ISBI) for purposes of long-term investment for the System.

c. Implementation of New Accounting Standard

In May, 2004, the Governmental Accounting Standards Board (GASB) issued Statement No. 44 (GASB 44), Economic Condition Reporting: The Statistical Section, an amendment of NCGA Statement No. 1. This statement establishes and modifies requirements related to the supplementary information presented in the statistical section. The requirements of this statement were effective for statistical sections prepared for periods beginning after June 15, 2005. The System implemented GASB 44 for the fiscal year ended June 30, 2006.

d. Investments

The System transfers money to the ISBI for investment in the ISBI Commingled Fund. This money is then allocated among various investment managers to pursue a specific investment strategy. All investment transactions are initiated by the investment managers. The transaction settlement information is then forwarded to the agent bank's trust department under a master custodial agreement.

Custody of a majority of the actual physical securities is maintained at an agent of the agent bank's trust department using a book-entry system. The ISBI's master custodian is The State Street Bank & Trust Company. The agent of the master custodian is the Depository Trust Company.

Investments are managed by the ISBI pursuant to Chapter 40, Article 5/22A of the Illinois Compiled Statutes (ILCS) and are maintained in the ISBI Commingled Fund.

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

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. Management expenses are deducted monthly from income before distribution.

The investment authority of the ISBI is provided in Chapter 40, Section 5/22A-112 of the ILCS. The ISBI investment authority includes investments in obligations of the U.S. Treasury and other agencies, notes secured by mortgages which are insured by the Federal Housing Commission, real estate, common and preferred stocks, convertible debt securities, deposits or certificates of deposit of federally insured institutions and options.

Such investment authority requires that all opportunities be undertaken with care, skill, prudence and diligence given prevailing circumstances that a prudent person acting in like capacity and experience would undertake.

Summary of the ISBI Fund's investments at fair value by type

	June 30, 2006	June 30, 2005
Government and agency obligations	$ 1,110,919,988	$ 1,130,079,107
Foreign obligations	104,455,671	88,970,486
Corporate obligations	1,382,574,163	1,643,935,794
Convertible bonds	0	1,404,244
Common stock & equity funds	5,369,124,032	5,529,033,328
Preferred stock	1,057,334	1,593,391
Foreign equity securities	1,113,268,102	1,035,874,373
Hedge Funds	416,462,183	0
Real estate investments	1,134,025,154	778,951,123
Private Equity	482,264,036	466,871,030
Money market instruments	320,641,552	283,461,008
Forward foreign exchange contracts	26,145	(497,874)
Total investments	$ 11,434,818,360	$10,959,676,010

Deposits

Custodial credit risk for deposits is the risk that, in the event of a financial institution failure, the System's and the ISBI's deposits may not be returned. All non-investment related bank balances at year end are insured or collateralized with securities held by the Illinois State Treasurer or agents in the name of the State Treasurer. Cash held in the investment related bank account by the ISBI is neither insured nor collateralized for amounts in excess of $100,000. There is no related deposit policy for custodial risk. These assets are under the custody of State Street Bank and Trust. State Street Bank and Trust has a AA Long-term Deposit/Debt rating by Standards & Poor and an Aa2 rating by Moody. Certain investments of the 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. For financial statement presentation and investment purposes, the ISBI reports its cash equivalents as Money Market Instruments within their investments. The table at the top of the next column discloses the deposits held by the ISBI at June 30, 2006 and 2005, and the portion of those deposits exposed to custodial credit risk.

	June 30, 2006	June 30, 2005
Carrying amount of Cash	$ 80,644,137	$ 13,722,061
Bank balance total	$ 80,724,748	$ 13,729,252
Amount exposed to custodial credit risk	$ 80,566,513	$ 13,501,974

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, the ISBI will not be able to recover the value of investments or collateral securities that are in the possession of an outside party. As of June 30, 2006 and 2005 , the following investments were uninsured and unregistered, with securities held by the counterparty or by its trust department or agent but not in the ISBI's name:

	2006	2005
Common stock	$ 7,540,275	$ 2,283,261
Government and agency obligations	43,932,397	16,885,000
Corporate obligations	4,649,641	4,725,000
Total	$ 56,122,313	$ 23,893,261

Interest Rate Risk

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

Duration is a measure of a debt investment's exposure to fair value changes arising from changing interest rates. It uses the present value of cash flows, weighted for those cash flows as a percentage of the investment's full price. The effective duration measures the sensitivity of market price to parallel shifts in the yield curve. The ISBI benchmarks its debt security portfolio to Lehman Brothers Aggregate. At June 30, 2006 the effective duration of the Lehman Brothers Aggregate was 3.6 years. At the same point in time, the effective duration of the ISBI debt security portfolio was 3.8 years . The effective duration of the ISBI portfolio at June 30, 2005 was 3.9 years.

	2006		2005	
	Fair Value	Effective Weighted Duration Years	Fair Value	Effective Weighted Duration Years
Investment Type				
Government & agency obligations				
U.S. Government	$ 457,091,471	4.4	$ 556,169,172	4.5
Federal agency	651,140,066	3.3	570,050,982	2.8
Municipal	2,688,451	4.8	3,858,953	3.5
Foreign obligations	104,455,671	5.1	88,970,486	6.1
Corporate obligations				
Bank and finance	306,124,824	3.4	309,725,184	2.5
Collateralized mortgage obligations	211,686,803	2.1	97,392,369 3.0	
Industrials	580,581,651	4.7	655,888,086	4.8
Commingled	40,713,286	N/A	341,540,499	N/A
Other	243,467,599	5.5	239,389,656	3.97
Convertible bonds	0	N/A	1,404,244	N/A
	$ 2,597,949,822		$2,864,389,631	

	Moody's Quality Rating	2006	2005
Government and agency obligations			
U.S. Government obligations	AAA	$ 457,091,471	$ 556,169,172
Federal agency obligations	AAA	651,140,066	570,050,982
Municipal	AAA	2,688,451	3,858,953
Total Government and agency obligations		$ 1,110,919,988	$ 1,130,079,107
Foreign obligations	AAA	$ 16,124,526	$ 15,399,251
	AA	4,040,041	3,307,170
	A	16,276,367	3,845,152
	BAA	27,419,722	18,565,417
	BA	12,024,660	9,027,386
	B	19,290,811	4,172,675
	CAA	1,274,200	0
	Not rated	8,005,344	34,653,435
Total foreign obligations		$ 104,455,671	$ 88,970,486
Corporate obligations	AAA	$ 324,130,117	$ 196,072,210
	AA	144,481,958	137,477,375
	A	148,904,618	165,820,135
	BAA	115,363,940	165,909,475
	BA	238,778,065	161,802,497
	B	274,358,266	269,923,855
	CAA	14,129,168	6,874,324
	CA	682,031	660,671
	C	461,236	0
	Not rated	121,284,764	539,395,252
Total corporate obligations		$ 1,382,574,163	$ 1,643,935,794
Convertible bonds	AAA	$ 0	$ 1,111,744
	BAA	0	292,500
Total convertible bonds		$ 0	$ 1,404,244

Concentration of Credit Risk and Credit Risk for Investments

The ISBI's portfolio is managed by professional investment management firms. These investment management firms are required to maintain diversified portfolios. Each investment manager must comply with risk management guidelines individually assigned to them as part of their Investment Management Agreement. The ISBI did not have any single issuer investment that exceeded 5% of the total net assets of the fund as of June 30, 2006 and 2005. The table at left presents the quality ratings of debt securities held by the ISBI as of June 30, 2006 and 2005.

Securities Lending

The ISBI participates in a securities lending program with State Street who acts as securities lending agent. Securities are loaned to brokers and, in return, the ISBI has rights to a portion of a collateral pool. All of the securities are eligible for the securities lending program.

Collateral consists solely of cash, letters of credit, commercial paper and government securities having a 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, State Street provides the ISBI with counterparty default indemnification.

The ISBI had no credit risk as a result of its securities lending program as the collateral held exceeded the fair value of the securities lent. As of June 30, 2006 and 2005, there were outstanding loaned investment securities having fair values of $1,568,683,721 and $1,442,715,435, respectively; against which collateral was received with a fair value of $1,597,656,445 and $1,476,263,962, respectively. Collateral received at June 30, 2006 and 2005 consisted of $1,530,783,382 and $1,444,871,284, respectively, in cash and $66,873,063 and $31,392,678, respectively, in securities for which the ISBI does not have the ability to pledge or sell.

Derivative Securities

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

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

Forward foreign currency contracts are used to hedge against the currency risk in the ISBI's foreign stock and fixed income portfolios. Forward foreign currency contracts are agreements to buy or sell specific amounts of a foreign currency at a specified delivery or maturity date for an agreed upon price. As the fair value of the forward contracts varies, the ISBI records an unrealized gain or loss. Forward foreign currency contracts represent an off-balance sheet obligation, as there are no balance sheet assets or liabilities associated with those contracts. The fair value of forward foreign currency contracts outstanding at June 30, 2006 and 2005, was as follows:

	Cost	Fair Value	Gain/(Loss)
As of June 30, 2006			
Forward currency purchases	$3,956,106	$4,008,201	$ 52,095
Forward currency sales	7,860,622	7,886,572	(25,950)
Total gain/(loss)			$ 26,145

	Cost	Fair Value	Gain/(Loss)
As of June 30, 2005			
Forward currency purchases	$41,391,551	$40,355,914	$ (1,035,637)
Forward currency sales	47,581,929	47,044,166	537,763
Total gain/(loss)			$ (497,874)

The ISBI also invests in mortgage-backed securities to maximize yields and to hedge against a rise in interest rates. These securities are based on cash flows from principal and interest payments on underlying mortgages. Therefore, they are sensitive to prepayments by mortgagees, which may result from a decline in interest rates. As of June 30, 2006 and 2005, the fair value of the ISBI's CMO holdings totaled $211,686,803 and $97,392,369, respectively.

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

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

Futures and options positions held by the ISBI as of June 30, 2006 and 2005

	2006		2005	
	Number of Contracts	Contract Principal*	Number of Contracts	Contract Principal*
Equity futures purchased	2,667	$ 190,210,548	847	$ 141,009,225
Fixed income futures purchased	1,605	269,684,894	689	131,827,288
Fixed income futures sold	355	37,149,313	630	74,051,321
Fixed income written put options	71	7,100,000	158	15,800,000
Fixed income written call options	320	122,900,000	18,150,179	36,050,000
Eurocurrency purchased call options	23,550,000	23,550,000	0	0
Fixed income purchased call options	58	58,000,000	278	138,500,000
Fixed income purchased put options	0	0	131	77,000,000

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

Investment Commitments

The ISBI real estate and private equity investment portfolios consist of passive interests in limited partnerships. The ISBI had outstanding commitments to these limited partnerships of approximately $400 million and $524 million, as of June 30, 2006 and 2005, respectively. Also, at the end of fiscal year 2006, the ISBI had an outstanding commitment of $567 million to separate real estate accounts.

Foreign Currency Risk

The ISBI's international portfolio is constructed on the principles of diversification, quality growth and value. Risk of loss arises from changes in currency exchange rates. International managers may also engage in transactions to hedge currency at their discretion. The table below presents the foreign currency risk by type of investment as of June 30, 2006 and 2005.

	2006		2005	
	Foreign Equity Securities	Foreign Obligations	Foreign Equity Securities	Foreign Obligations
Australian Dollar	$ 45,031,863	$ 0	$ 47,593,913	$ 0
Canadian Dollar	27,309,690	0	32,554,284	0
Danish Krone	11,811,080	0	11,599,786	0
English Pound Sterling	208,671,160	0	202,953,950	0
Euro Currency	298,835,278	2,773,684	281,227,718	4,417,066
Hong Kong Dollar	48,639,162	0	44,843,103	0
Japanese Yen	272,057,458	0	228,925,686	4,569,663
Mexican Peso	0	147,648	0	2,573,969
New Zealand Dollar	767,645	2,205,864	519,315	2,741,363
Norwegian Krone	9,864,745	0	5,641,688	0
Singapore Dollar	9,200,224	0	9,859,570	0
South Korean Won	22,537,972	0	21,372,559	0
Swedish Krona	29,340,607	0	29,822,230	0
Swiss Franc	54,417,316	0	52,437,404	0
Foreign investments denominated in U.S. Dollars	74,783,902	99,328,475	66,523,167	74,668,425
Total	$ 1,113,268,102	$ 104,455,671	$ 1,035,874,373	$ 88,970,486

Other Information

The System owns approximately 94% of the net investment assets of the ISBI Commingled Fund as of June 30, 2006. A schedule of investment expenses is included in the ISBI's annual report.

For additional information on ISBI's investments, please refer to their Annual Report as of June 30, 2006. A copy of the report can be obtained from the ISBI at 180 North LaSalle Street, Suite 2015, Chicago, Illinois 60601.

e. Actuarial Experience Review

In accordance with Illinois Compiled Statutes, an actuarial experience review is to be performed at least once every five years to determine the adequacy of actuarial assumptions regarding the mortality, retirement, disability, employment, turnover, interest and earnable compensation of the members and beneficiaries of the System.

The System's actuarial consultant preformed an experience review for the four-year period ending June 30, 2005. Based upon the results of the review, several changes were made to the actuarial assumptions which were used in the actuarial valuation for the fiscal year ended June 30, 2006. These changes had the effect of increasing the actuarial liability and the related unfunded accrued liability by $710,975,535.

f. Administrative Expenses

Expenses related to the administration of the System are financed through investment earnings and employer retirement contributions. These expenses are budgeted and approved by the System's Board of Trustees.

g. Risk Management

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

h. Use of Estimates

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

i. Reclassifications

Certain fiscal year 2005 amounts have been reclassified to conform to the fiscal year 2006 presentation. These reclassifications have not changed the fiscal year 2005 results.

4. Funding - Statutory Contributions Required & Contributions Made

On an annual basis, a valuation of the liabilities and reserves of the System is performed by the System's actuarial consultants in order to determine the amount of contributions statutorily required from the State of Illinois. For fiscal years 2006 and 2005 the actuary used the projected unit credit actuarial method for determining the proper employer contribution rate and amount.

For fiscal year 2005 the required employer contributions was computed in accordance with Public Act 88-0593 as modified by Public Act 93-0002. This funding legislation 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%.

For fiscal years 2006 and 2007, state contributions were and will be based on dollar amounts specified by Public Act 94-0004, rather than actuarial calculations. The legislation contains a two-year funding reduction of approximately 62% or $905.3 million for the System. State contributions will be higher in future years to make up for the two-year funding reduction, as the overall goal of 90% funding in fiscal year 2045 in unchanged.

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 period is complete, the state's contribution will then remain at a level percentage of payroll for the next 35 years until the 90% funded level is achieved.

5. Accrued Compensated Absences

Employees of the System are entitled to receive compensation for all accrued but unused vacation time and one-half of all unused sick leave earned on and after January 1, 1984 and before January 1, 1998 upon termination of employment. These accrued compensated absences as of June 30, 2006 and 2005 totaled $831,345 and $799,836, respectively are included in Administrative Expenses Payable.

6. Property & Equipment

Capital assets are capitalized at their cost at the time of acquisition. Depreciation is computed using the straight-line method over the estimated useful life of the asset. The estimated useful lives are as follows: (1) office furniture - 10 years, (2) equipment - 6 years, (3) automobiles and certain electronic data processing equipment - 3 years, and (4) building - 30 years. Land is carried at its original cost, including applicable legal fees, surveying costs, etc.

This is a summary of changes in property and equipment assets for 2006 and 2005:

2006	Beginning Balance	Additions	Deletions	Ending Balance
Assets				
Land	$ 655,241	$ –	$ –	$ 655,241
Land improvements	250,316	-	–	250,316
Building	3,352,428	-	–	3,352,428
Equipment	2,209,825	84,843	(74,435)	2,220,233
TOTAL	6,467,810	84,843	(74,435)	6,478,218
Accumulated depreciation				
Land Improvements	(292)	(71)	-	(363)
Building	(1,611,984)	(113,382)	-	(1,725,366)
Fixed Assets	(1,784,085)	(156,388)	74,412	(1,866,061)
TOTAL	(3,396,361)	(269,841)	74,412	(3,591,790)
Net property and equipment	$3,071,449	$ (184,998)	$ (23)	$2,886,428

2005	Beginning Balance	Additions	Deletions	Ending Balance
Assets				
Land	$ 655,241	$ –	$ –	$ 655,241
Land improvements	245,351	4,965	–	250,316
Building	3,352,428	-	–	3,352,428
Equipment	2,214,084	157,565	(161,824)	2,209,825
TOTAL	6,467,104	162,530	(161,824)	6,467,810
Accumulated depreciation				
Land Improvements	(220)	(71)	-	(292)
Building	(1,496,576)	(115,409)	-	(1,611,984)
Fixed Assets	(1,818,227)	(127,091)	161,233	(1,784,085)
TOTAL	(3,315,023)	(242,571)	161,233	(3,396,361)
Net property and equipment	$ 3,152,081	$ (80,041)	$ (591)	$3,071,449

7. Collection and Remittance of Bond and Interest Payments

On April 7, 2003 House Bill 2660 was signed into law as Public Act 93-0002. This legislation authorized the State to issue $10 billion in general obligation bonds for the purpose of making required contributions to the five state-funded retirement systems, including the State Employees' Retirement System. On July 1, 2003, the net bond proceeds were allocated and distributed to each of the five state-funded retirement systems based on each system's relative percentage of the total unfunded liability at June 30, 2002. The State Employees' Retirement System received an allocation of bond proceeds totaling $1,385,895,278 and deposited all of the proceeds into the Illinois State Board of Investment Commingled Fund on July 2, 2003.

Public Act 93-0839, effective July 30, 2004, requires that employer contributions to the System shall include an additional amount to be paid over to the General Obligation Bond Retirement and Interest Fund to pay principal of and interest on those general obligation bonds due that fiscal year. This debt service payment is to be made on the first day of each month, or as soon thereafter as practical.

The total debt service payments received for all fiscal year 2006 and 2005 payrolls, amounted to $70.6 million and $134.1 million, respectively. The total amount remitted to the State of Illinois as of June 30, 2006 and 2005 was $61.7 million and $117.5 million, respectively.

As of June 30, 2006, the following amounts are included in the System's Statement of Plan Net Assets regarding the collection of bond principal and interest payments:

	2006	2005
Cash - payments collected but not yet remitted to the State of Illinois	$ 6,183,979	$ 12,180,829
Accounts receivable - for June payrolls received in July and August	$ 2,858,733	$ 4,510,893
Due to the State of Illinois	$ (9,042,712)	$ (16,691,722)

8. Administrative Expenses & Other Post-Employment Benefits

Expenses related to the administration of the System are financed through investment earnings and employer retirement contributions. These expenses are budgeted and approved by the System's Board of Trustees.

The System pays employer retirement contributions based upon an actuarially determined percentage of its payrolls. For fiscal years 2006, 2005, and 2004 the employer contribution rates were 7.792%, 16.107%, and 13.439%, respectively. The System's contributions to SERS for fiscal years 2006, 2005, and 2004 were $252,355, $500,477, and $401,155 respectively, for the general staff. The System's contributions for the electronic data processing staff for fiscal years 2006, 2005, and 2004 were $70,438, $142,816, and $107,998, respectively. These amounts were equal to the required contributions for each fiscal year.

In addition to providing pension benefits, the State Employees Group Insurance Act of 1971, as amended, requires that certain health, dental and life insurance benefits shall be provided by the state to annuitants who are former state employees. This includes annuitants of the System. Substantially all state employees including the System's employees may become eligible for post-employment benefits if they eventually become annuitants.

Health and dental benefits include basic benefits for annuitants under the state's self-insurance plan and insurance contracts currently in force. Life insurance benefits are limited to five thousand dollars per annuitant age 60 and older.

Costs incurred for health, dental and life insurance for annuitants and their dependents were not separated from benefits provided to active employees and their dependents for the year ended June 30, 2006. However, post-employment costs for the State as a whole for all State agencies/departments for health, dental and life insurance for annuitants and their dependents are disclosed in the State of Illinois Comprehensive Annual Financial Report.

Cost information for retirees by individual State agency is not available. Payments are made on a "pay-as-you-go" basis. The System is not the administrator of any of the other post-employment benefits described previously.

A summary of the administrative expenses of the System for fiscal years 2006 and 2005 are as follows:

	2006	2005
Personal Services	$ 3,235,537	$ 3,119,207
Employee Retirement Pickup	108,812	119,180
Retirement Contributions	252,355	500,477
Social Security Contributions	241,079	232,929
Group Insurance	868,983	803,980
Contractual Services	1,352,042	1,352,284
Travel	45,970	49,509
Commodities	21,844	25,081
Printing	55,944	65,592
Electronic data processing	1,570,156	1,724,842
Telecommunications	61,765	63,012
Automotive	20,535	20,615
Depreciation	269,841	242,571
Other (net)	34,415	(8,010)
Total	$ 8,139,278	$ 8,311,269

9. Social Security Division - Administrative Expenses

The Social Security Division of the State Employees' Retirement System was created by 40 ILCS 5/21, to administer the state's responsibilities under Title II Section 218 of the Federal Social Security Act and the master federal-state agreement.

The state's responsibilities include extending Social Security coverage by agreement to any of the state's retirement systems or units of local government requesting social security or medicare only coverage for their members or employees.

In addition, the Social Security Division was responsible for collecting wage information and contribution payments from covered retirement systems and units of local government on wages paid prior to January 1, 1987. Administrative expenses for the Social Security Division are appropriated annually by the State Legislature.

Administrative expenses for the Social Security Division are appropriated annually by the State Legislature

	2006	2005
Personal services	$43,809	$ 42,228
Retirement contributions	3,413	6,802
Social Security contributions	3,238	3,120
Contractual services	17,750	19,350
Travel	1,167	494
Commodities	188	182
Telecommunications	354	341
Total	$ 69,919	$ 72,517

10. Analysis of Changes in Reserve Balances

The System maintains three reserve accounts. The reserves are defined as follows:

a. Participants' contributions: Accounts for assets contributed by each participant,

b. Interest accumulations: Accounts for interest credited to each participant's account,

c. Other future benefits: Accounts for all assets not otherwise specifically provided for in items (a) and (b) above.

State Employees' Retirement System
Statements of Changes in Reserve Balances Years Ended June 30, 2006 and 2005

	Participants' Contributions	Interest Accumulations	Other Future Benefits	Total Reserve Balances
Balance at June 30, 2004	1,570,508,130	$ 1,005,580,314	$ 7,414,098,430	$ 9,990,186,874
Add (deduct):				
Excess revenue over expenses	177,273,796	–	326,687,283	503,961,079
Reserve transfers:				
Accumulated contributions of members who retired during the year, less contributions of annuitants returning to active status	(64,399,611)	–	64,399,611	–
Interest credited to members' accounts	–	92,569,784	(92,569,784)	–
Balance at June 30, 2005	$ 1,683,382,315	$ 1,098,150,098	$ 7,712,615,540	$10,494,147,953
Add (deduct):				
Excess revenue over expenses	186,684,209	–	219,020,903	405,705,112
Reserve transfers:				
Accumulated contributions of members who retired during the year, less contributions of annuitants returning to active status	(50,167,965)	–	50,167,965	–
Interest credited to members' accounts	–	115,074,193	(115,074,193)	–
Balance at June 30, 2006	$ 1,819,898,559	$ 1,213,224,291	$ 7,866,730,215	$10,899,853,065

SCHEDULE OF FUNDING PROGRESS

Actuarial Valuation Date	Actuarial Value of Assets (a)	Actuarial Accrued Liability (AAL) -Projected Unit Credit (b)	Unfunded AAL (UAAL) (b-a)	Funded Ratio (a/b)	Covered Payroll (c)	UAAL as a Percentage Covered Payroll ([b-a]/c)
6/30/01	$ 8,276,661,352	$ 12,572,240,145	$ 4,295,578,793	65.8	$ 3,564,441,000	120.5%
6/30/02	7,673,892,691	14,291,044,457	6,617,151,766	53.7	3,713,020,000	178.2
6/30/03	7,502,111,416	17,593,980,039	10,091,868,623	42.6	3,639,334,000	277.3
6/30/04	9,990,186,874	18,442,664,834	8,452,477,960	54.2	3,439,251,000	245.8
6/30/05	10,494,147,953	19,304,646,648	8,810,498,695	54.4	3,475,528,000	253.5
6/30/06	10,899,853,065	20,874,541,910	9,974,688,845	52.2	3,572,541,000	279.2

SCHEDULE OF EMPLOYER CONTRIBUTIONS

Year Ended June 30	Annual Required Contribution per GASB Statement No. 25 (1)	Percentage Contributed	(A) Annual Required Payroll Contribution per State Statute(3)	(B) State Pension Fund Contribution	(A) + (B) Total Required State Contribution	Percentage Contributed
2001	$ 294,351,538	124.3%	$ 354,448,013	10,490,000	$ 364,938,013	100%
2002	306,509,801	126.0	372,787,208	10,290,000	383,077,208	100
2003	449,348,569	88.1	375,615,662	17,195,000	392,810,662	100
2004	576,219,951	83.1 (2)	462,200,942	15,150,000 (4)	477,350,942	100 (2)
2005	727,428,010	58.8	425,682,669	-	425,682,669	100
2006	672,555,569	31.3	207,814,710	-	207,814,710	100

Notes to Required Supplementary Information

Valuation date: June 30, 2006
Actuarial cost method: Projected Unit Credit
Amortization method:

a. For GASB Statement No. 25 reporting purposes – Level percent of payroll
b. Per state statute – 15-year phase-in to a level percent of payroll until a 90% funding level is achieved

Remaining amortization period:

a. For GASB Statement No. 25 reporting purposes – 40 years, open
b. Per state statute – 39 years, closed

Asset valuation method – Fair Value
Actuarial assumptions:

Investment rate of return – 8.5 percent
Projected salary increases – 1.0 to 6.1 percent, based upon member's age
Assumed inflation rate – 3.0 percent
Group size growth rate – 0.0 percent
Post-retirement increase – 3.0 percent, compounded
Mortality table – 1994 Group Annuity Mortality Table for males and females. Five percent of deaths amongst active employees are assumed to be in the performance of their duty.

(1) This amount includes both payroll and non-payroll employer required contributions.

(2) This percentage excludes the additional employer contributions received from the State of General Obligation bonds by the State of Illinois. These proceeds were not part of the current fiscal year required contributions.

(3) Employer required contribution determined in accordance with SB533 (P.A. 88-0593). These amounts reflect only payroll required contributions.

(4) The actual distribution from the State Pension Fund was $5,970,645, the additional amount of $9,179,355 was received in accordance with HB585 (P.A.93-0665), as a distribution from the Pension Contribution Fund.

SUMMARY OF REVENUES BY SOURCE

	2006	2005
Contributions:		
Participants	$ 207,667,143	$ 201,764,897
ERI payments	-	538
Repayments of contributions refunded	1,345,085	1,413,352
Interest received from participants	5,096,668	6,155,420
Total participants contributions	214,108,896	209,334,207
Employing state agencies	210,499,791	427,434,612
Investments:		
Net investments income	264,013,416	227,422,797
Interest earned on cash balances	8,724,784	4,300,338
Net appreciation in fair value of investments	840,493,512	721,856,118
Total investment revenue	1,113,231,712	953,579,253
TOTAL REVENUE	$ 1,537,840,399	$ 1,590,348,072

SUMMARY SCHEDULE OF CASH RECEIPTS & DISBURSEMENTS

	2006	2005
Cash balance, beginning of year	$ 204,525,471	$ 66,642,027
Receipts:		
Participant contributions	205,265,817	200,680,710
Employer contributions		
(net of bond principal and interest transfers)	209,677,099	490,689,715
Transfers from Illinois State Board of Investment	721,000,000	518,000,000
Interest income on cash balance	8,324,160	3,851,374
Claims receivable payments	4,687,995	5,331,207
Installment payments	5,068,650	5,860,986
Other	114,964	317,324
Total cash receipts	1,154,138,685	1,224,731,316
Disbursements:		
Annuity payments:		
Retirement annuities	985,960,464	936,358,756
Widow's and Survivor's annuities	61,366,786	57,606,256
Disability benefits	38,155,674	34,554,392
Lump Sum benefits	12,022,378	10,295,772
Refunds	26,466,430	39,443,480
Administrative expenses	7,941,346	8,559,571
Transfers to reciprocal systems	-	29,645
Total cash disbursements	1,131,913,078	1,086,847,872
Cash balance, end of year	$ 226,751,078	$ 204,525,471

SCHEDULE OF PAYMENTS TO CONSULTANTS & ADVISORS

	2006	2005
Legal Services	$ 32,689	$ 36,209
Actuarial Costs	107,894	184,164
Audit Expense	56,248	56,557
Physicians and Disability Inspections	162,535	160,490
Financial Planning	47,506	47,056
TOTAL	$ 406,872	$ 484,476

INVESTMENT SECTION

INVESTMENT REPORT

By state law, the System's investment function is managed by the Illinois State Board of Investment (ISBI). The ISBI was created in 1969 to provide a means of centralizing the investment management function for public employee pension funds and retirement systems operating in the state.

In addition to the assets of the State Employees' Retirement System, the ISBI also manages the investment function for the Judges' and General Assembly Retirement Systems. All ISBI investments are accounted for in a commingled fund (ISBI Fund).

As of June 30, 2006, total net assets under management valued at market, amounted to $11.316 billion. Of the total market value of assets under management, $10.655 billion or approximately 94% represented assets of the State Employees' Retirement System.

A summary of the portfolio's largest holdings, as well as the complete listing of the ISBI portfolio, are included in the ISBI Annual Report. A schedule of fees and commissions paid by brokerage firm and a listing of transactions executed, including transaction value, are also contained in the ISBI Annual Report. The following investment information and analysis has been prepared by the ISBI.

INVESTMENT POLICY

The ISBI operates under a strategic investment policy. The investment objective of the total portfolio is to maximize the rate of return on investments within a prudent level of risk. To achieve this objective, the ISBI invests in different types of assets and uses multiple managers to ensure diversification.

The ISBI continues to seek an appropriate level of diversity among the investment professionals charged with meeting the ISBI's mission. Towards those ends, the ISBI has adopted policies regarding utilization of minority and female owned brokers, minority and female owned money managers, and emerging managers. As of April, 2006, the ISBI had achieved its minimum goal of 5% of the total portfolio being managed by emerging minority managers.

In fiscal year 2006, 41% of the ISBI's domestic equity trades were executed through minority/female owned brokers, 29% of fixed income par value trades were executed with minority/female owned brokers, and 23% of the total Plan assets were managed by minority/female owned investment advisors, and 5% of assets were managed by emerging managers.

Over an investment cycle, the ISBI seeks to achieve a rate of return that is at least equal to the assumed actuarial interest rate, currently 8.5% per year, and at least equal to the return of the composite (policy-weighted) benchmark, a theoretical "indexed" implementation of the ISBI's asset allocation policy.

ASSET ALLOCATION

The investment policy of the ISBI establishes asset allocation targets and ranges for each asset class, selected to achieve overall risk and return objectives. This policy is implemented by allocations to investment managers with assignments to invest in specific asset classes, with defined security selection styles and methodologies.

Most of the new activity in fiscal year 2006 took place in the illiquid asset classes. Two core separate account real estate relationships of $300 million each were established, and $180 million was committed to six enhanced/high return real estate funds. Four long/short hedge fund of fund managers were selected with allocations of $100 million apiece. Private equity allocations totaling $115 million were made to four funds during the fiscal year. During fiscal year 2006, public market searches led to the addition of four new relationships, and the termination of two.

INVESTMENT RESULTS

	Actual Asset Allocation	Policy Target
U.S. Equity	47%	45%
U.S. Equity Hedge Funds	4	5
International Equity	10	10
Fixed Income	23	25
Real Estate	10	10
Private Equity	4	5
Cash	2	-
Total	100%	100%

In fiscal year 2006, investors benefited from strong returns in all asset classes with the exception of fixed income. The ISBI total fund was up 11.0% for fiscal year 2006, net of expenses. This follows a 10.1%, 16.4% and 0.3% return for fiscal years 2005, 2004 and 2003, respectively, and a loss of (6.9)% for fiscal year 2002. The long-term objective of the 8.0% assumed actuarial interest rate was surpassed, with the portfolio trailing the composite benchmark return by 0.5% in fiscal year 2006. While the ISBI continues to be concerned by some underperformance by specific managers; the overall performance of the fund meets or beats the expectations as expressed in the 2003 asset allocation model.

INTERNATIONAL EQUITIES

The Morgan Stanley EAFE Index returned 27.1% for the fiscal year; approximately 17 percentage points above the U.S. return. As a result, international markets were the strongest performing asset class in fiscal year 2006. Further, the ISBI's international equity portfolio was up 28.9%, exceeding the benchmark for the fiscal year by 1.8%. As with the U.S. equity portfolio, the ISBI has the twin objectives of limiting tracking error relative to the benchmark and adding value with active management.

INTERNATIONAL EQUITIES

	1 Year	3 Years	5 Years
ISBI	28.9%	24.2%	10.7%
MSCI-EAFE Index	27.1	24.4	10.4

FIXED INCOME

The ISBI's fixed income portfolio had a positive return of 0.8% for the fiscal year compared to the Lehman U.S. Universal Bond Index which returned a negative (0.3)% for the year. The ISBI believes that the structure adopted in December 2003 will minimize negative surprises, such as those experienced in the past, and result in more predictable fixed income returns.

FIXED INCOME

	1 Year	3 Years	5 Years
ISBI	0.8%	2.8%	4.4%
Lehman U.S. Univ. Bond Index	(0.3)	2.7	5.4

U.S. EQUITIES

For the twelve months ended June 30, 2006, the Wilshire 5000 Index, a broad representation of the U.S. market, was up 10.0%. Value stocks substantially exceeded growth stocks, with the Russell 3000 Value Index up 12.3%, compared to the Russell 3000 Growth Index up 6.8%. Small capitalization stocks outperformed large capitalization stocks, with the Russell 2000 Index returning 14.6% compared with the S&P 500 Index at 8.6%. The ISBI's U.S. equity portfolio was up 10.7% for the fiscal year, 0.7% above the Wilshire 5000 Index. The ISBI, through structure analysis, rebalancing and risk management, continues to achieve its objective of tracking the market with predictable consistency.

U.S. EQUITIES

	1 Year	3 Years	5 Years
ISBI	10.7%	13.7%	4.4%
Wilshire 5000 Index	10.0	13.1	4.1

REAL ESTATE

The ISBI's real estate portfolio earned a 19.5% return. The NCREIF Real Estate Index, a measure of core, operating, non-leveraged real estate, earned 18.7%. Prior to the 2003 asset allocation model, the ISBI's real estate policy was to exploit higher risk, higher return value-added or opportunistic strategies. However, over the last three years, the ISBI has increased the real estate strategic allocation from 5% to 10% of the total fund with the new allocation targeting 70% of its real estate to core, income producing real estate, with the balance in higher return strategies. The ISBI's real estate portfolio is invested primarily through interests in limited partnerships, trusts, and other forms of pooled investments. The ISBI is in the process of converting a sizable portion of its real estate portfolio to separate account structures.

REAL ESTATE

	1 Year	3 Years	5 Years
ISBI	19.5%	14.4%	11.3%
NCREIF Real Estate Index	18.7	15.8	12.0

PRIVATE EQUITY

The ISBI's private equity portfolio provided a return of 21.3% for the fiscal year. The private equity portfolio consists of interests in limited partnerships and other commingled vehicles that invest in venture capital, management buyouts, and other private placement equity strategy activities. In spite of the setbacks during previous years, long-term results show that private equity remains the best performing asset class for the ten-year period ended June 30, 2006.

MANAGEMENT EXPENSES

The ISBI's total expenses for fiscal year 2006, based on $11.3 billion in total assets were $30.1 million, compared to $24.5 million based on $10.9 billion in total assets for fiscal year 2005. The resulting expense ratio (expenses divided by average fair value of assets) was .26% for fiscal year 2006, as compared to .23% for fiscal year 2005. Increased expenses in fiscal year 2006 were mainly a result of the utilization of hedged funds of funds, with sizable management fees, and the increased use of active managers, as opposed to passive managers, in fiscal year 2005.

INVESTMENT PORTFOLIO SUMMARY

	June 30, 2006		June 30, 2005	
Investments, at fair value				
Government and Agency Obligations	$ 1,110,919,988	9.82%	$ 1,130,079,107	10.37%
Foreign Obligations	104,455,671	0.92	88,970,486	0.82
Corporate Obligations	1,382,574,163	12.22	1,643,935,794	15.08
Convertible Bonds	-	0.00	1,404,244	0.01
Common Stock & Equity Funds	5,369,124,032	47.45	5,529,033,328	50.71
Preferred Stock	1,057,334	0.01	1,593,391	0.01
Foreign Equity Securities	1,113,268,102	9.84	1,035,874,373	9.50
Hedge Funds	416,462,183	3.68	-	0.00
Real Estate Investments	1,134,025,154	10.02	778,951,123	7.14
Private Equity	482,264,036	4.26	466,871,030	4.28
Money Market Instruments	320,641,552	2.83	283,461,008	2.60
Forward Foreign Exchange Contracts	26,145	0.00	(497,874)	0.00
	11,434,818,360	101.05	10,959,676,010	100.52
Other Assets, Less Liabilities	(118,333,506)	(1.05)	(57,196,343)	(0.52)
Net Assets, at Fair Value	$ 11,316,484,854	100.00%	$ 10,902,479,667	100.00%

ANALYSIS OF INVESTMENT PERFORMANCE

	2006	2005	2004	2003	2002
Total Return* - Past 3 years		12.4%			
Total Return* - Past 5 years			5.8%		
Total Return* - year by year	11.0%	10.1%	16.4%	0.3%	(6.9)%
Actuarial Assumed Rate of Return			8.5%		

Comparative rates of return on fixed income securities					
Total fixed income - ISBI	0.8%	6.9%	0.7%	8.3%	5.5%
Comparison index:					
Lehman U.S. Universal Bond Index	(0.3)%	7.4%	1.0%	11.5%	7.7%

Comparative rates of return on equities					
U.S. equities - ISBI	10.7%	9.3%	21.7%	0.9%	(14.6)%
Comparison index:					
Wilshire 5000 Index	10.0%	8.4%	21.2%	1.3%	(16.6)%

* Total return is the combined effect of income earned and market appreciation (depreciation).

ADDITIONAL INVESTMENT INFORMATION

The following table shows a comparison of ISBI investment operations of the System for fiscal years 2006 and 2005:

	2006	2005	Increase/(Decrease) Amount	Increase/(Decrease) Percentage
Balance at beginning of year,				
at fair value	$ 10,271,356,795	$ 9,840,077,880	$ 431,278,915	4.4%
Cash transferred from ISBI	(721,000,000)	(518,000,000)	(203,000,000)	39.2
Net ISBI investments revenue:				
ISBI Commingled Fund income	$ 292,393,986	$ 250,491,153	$ 41,902,833	16.7
Less ISBI Expenses	(28,380,570)	(23,068,356)	(5,312,214)	23.0
Net ISBI investments income	$ 264,013,416	$ 227,422,797	$ 36,590,619	16.1
Net appreciation				
in fair valueof ISBI investments	840,493,512	721,856,118	118,637,394	16.4
Net ISBI investments revenue	$ 1,104,506,928	$ 949,278,915	$ 155,228,013	16.4
Balance at end of year, at fair value	$ 10,654,863,723	$ 10,271,356,795	$ 383,506,928	3.7%

In addition, interest on the average balance in the System's cash account in the State Treasury for FY 2006 was $8,724,784 compared to $4,300,338 during FY 2005.

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ACTUARIAL SECTION

INTRODUCTION

Annually, the System's actuarial consultant prepares a valuation of the liabilities and reserves of the System in order to make a determination of the amount of contributions required from the state. These results are then certified to the Board.

The Board, in turn, has the duty of certifying an employer contribution amount, required to be paid to the System by the state during the succeeding fiscal year.

The System receives contributions from several sources which can be considered as employer contributions, with the largest source being the regular state appropriation.

The employers' contribution amount, together with members' contributions, income from investments and any other income received by the System, shall be sufficient to meet the cost of maintaining and administering the System on a funded basis in accordance with actuarial reserve requirements, pursuant to Chapter 40, Section 5/14-131 of the Illinois Compiled Statutes.

The statutes define "actuarial reserves" as "An accumulation of funds in advance of benefit payments which will be sufficient with respect to each member and his beneficiaries, if any, to pay the prescribed benefits, computed according to the actuarial tables, without further contributions by or on behalf of the member."

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 that:

- For fiscal years 1996 through 2010, the contribution to the System, as a percentage of the payroll, shall be increased in equal annual increments so that by fiscal year 2010 the contribution rate is at the same level as the contribution rate for fiscal years 2011 through 2045.

- For fiscal years 2011 through 2045, the minimum contribution to the System for each fiscal year shall be an amount determined to be sufficient to bring the total assets of the System up to 90% of the total actuarial liabilities of the System by the end of fiscal year 2045. In making these determinations, the required contribution shall be calculated each year as a level percentage of payroll over the years remaining to and including fiscal year 2045 and shall be determined under the projected unit credit actuarial cost method.

- Beginning in fiscal year 2045, the minimum contribution to the System for each fiscal year shall be the amount needed to maintain the total assets of the System at 90% of the total actuarial liabilities of the System.

In April, 2003, House Bill 2660 was signed into law as Public Act 93-0002. This legislation authorized the sale of $10 billion of General Obligation bonds for the purpose of making contributions to the five state-financed retirement systems. This legislation also modified the funding plan by mandating that, beginning in fiscal year 2005, the required state contribution for each fiscal year not exceed the state contributions that would have been required had the General Obligation bond program not been in effect, reduced by the total debt service for each year for the System's portion of the General Obligation bond proceeds.

In June, 2005, Senate Bill 0027 was signed into law as Public Act 94-0004. 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. 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.

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

Although long-term in nature, this legislation has been a positive step forward which will ensure the long-term financial integrity of the state's retirement systems including the State Employees' Retirement System.

The amortization period required by the state's funding plan, as described above, does not meet the parameters of GASB Statement No. 25.

For fiscal years 2006 and 2005, the System received the actuarially determined employer contributions in accordance with the state's funding plan described above.

ACTUARIAL COST METHOD & SUMMARY OF MAJOR ACTUARIAL ASSUMPTIONS

For fiscal years 2006 and 2005, a projected unit credit normal cost method is used. Under this method, the projected pension at retirement age is first calculated and the value thereof at the individual member's current or attained age is determined.

The normal cost for the member for the current year is equal to the value so determined divided by the member's projected service at retirement. The normal cost for the plan for the year is the sum of the individual normal costs.

Actuarial gains and losses are recognized immediately in the unfunded actuarial liability of the System. For purposes of determining future employer contributions, however, the actuarial gains and losses are amortized in accordance with the funding plan as previously described.

For ancillary benefits for active members, in particular disability benefits, death and survivor benefits, termination benefits, and the post-retirement increments, the same procedure as outlined above is followed.

A description of the actuarial assumptions utilized for FY-06 and FY-05 follows:

Dates of Adoption: The Projected Unit Credit Normal Cost Method was adopted June 30, 1989; all other assumptions were adopted June 30, 2006.

Mortality: 1994 Group Annuity Mortality Table for males and females. Five percent of deaths amongst active employees are assumed to be in the performance of their duty.

Interest: 8.5% per annum, compounded annually

Salary Increases: Illustrative rates of increase per annum, compounded annually:

Age	Males & Females	Components Merit	Inflation
25-29	8.35%	5.35%	3.0%
30-34	7.22	4.22	3.0
35-39	6.41	3.41	3.0
40-44	5.80	2.80	3.0
45-49	5.33	2.33	3.0
50-54	4.95	1.95	3.0
55-59	4.65	1.65	3.0
60-64	4.39	1.39	3.0
65-69	4.17	1.17	3.0
70	4.00	1.00	3.0

Termination: Illustrative rates follow. It is assumed that terminated employees will not be rehired. The rates apply only to employees who have not fulfilled the service requirements necessary for retirement at any given age.

SELECT WITHDRAWAL RATE

Years of Service	General Employees Male	General Employees Females	Alternative Formula Employees Males	Alternative Formula Employees Females
0	.2000	.2000	.0600	.1100
1	.0800	.0800	.0450	.0550

ULTIMATE WITHDRAWAL AGE

Age	General Employees Male	General Employees Females	Alternative Formula Employees Males	Alternative Formula Employees Females
25-29	.0375	.0450	.0250	.0375
30-34	.0350	.0400	.0200	.0300
35-39	.0250	.0300	.0150	.0225
40-44	.0175	.0200	.0100	.0170
45-49	.0150	.0150	.0100	.0160
50-54	.0125	.0150	.0100	.0140
55-59	.0125	.0150	.0100	.0140
60	.0125	.0150	.0100	.0140
65	.0125	.0150	.0100	.0140

Retirement Rates: Listed below are sample rates of retirement that vary by age. The rates apply only to employees who have fulfilled the service requirement necessary for retirement at any given age:

Age	General Employees Male	General Employees Females	Alternative Formula Employees Males	Alternative Formula Employees Females
50	5.0%	5.0%	20.0%	25.0%
55	5.0	5.0	20.0	20.0
60	12.5	15.0	35.0	20.0
65	20.0	30.0	80.0	55.0
70	100.0	100.0	100.0	100.0

Assets: Assets available for benefits are valued at fair value (market).

Expenses: As estimated and advised by SERS staff, based on current expenses with an allowance for expected increases.

Marital Status: 85% of active male employees are assumed to be married, 65% of active females are assumed to be married. Actual marital status at benefit commencement is used for retirees.

Spouse's Age: The female spouse is assumed to be three years younger than the male spouse.

In addition to the above, other assumptions used include disability incidence, recovery from disability, mortality of disabled lives, remarriage rates, ages, and numbers of children and Social Security benefit levels.

Postretirement Benefit Increases: 3% annually, compounded.

Experience Review: Pursuant to state law, the System had the actuary's perform this review for the four year period ended June 30, 2005, which was updated for values as of June 30, 2006.

NOTE: The actuarial assumptions have been recommended by the actuary, and adopted by the System's Board of Trustees, at the dates indicated previously.

SUMMARY OF & CHANGES TO THE PLAN PROVISIONS

Refer to the Plan Summary and Legislative Section for a summary of the plan provisions and legislative amendments that were evaluated and considered by the actuary during the valuation process.

SHORT-TERM SOLVENCY TEST

A short-term solvency test is one means of checking a system's progress under its funding program. In a short-term solvency test, the plan's present assets (primarily cash and investments) are compared with:

1. Active member contributions on deposit.
2. The liabilities for future benefits to present retired lives.
3. The liabilities for service already rendered by active members.

In a system that has been following level percent of payroll financing, the liabilities for service already rendered by active members (liability 3) should be partially covered by the remainder of present assets. If the system continues using level cost financing, the funded portion of liability 3 will increase over time, although it is very rare for a system to have its liability 3 fully funded.

VALUATION RESULTS

	June 30, 2006	June 30, 2005
Actuarial Liability		
For Annuitants:		
For Benefit Recipients:		
Retirement Annuities	$ 11,887,291,843	$ 11,680,354,170
Survivor Annuities	527,992,636	563,956,566
Disability Annuities	190,903,963	225,613,350
Deferred:		
Retirement Annuities	6,156,986	5,793,380
Survivor Annuities	9,365,638	9,215,600
TOTAL	$ 12,621,711,066	$ 12,484,933,066
For Inactive Members:		
Eligible for Deferred Vested Pension Benefits	264,460,160	299,253,188
Eligible for Return of Contributions Only	24,601,701	24,372,891
TOTAL	$ 289,061,861	$ 323,626,079
For Active Members	$ 7,963,768,983	$ 6,496,087,503
Actuarial Present Value of Credited Projected Benefits	$ 20,874,541,910	$ 19,304,646,648
Assets, Fair Value	10,899,853,065	10,494,147,953
Unfunded Actuarial Present Value of Credited Projected Benefits	$ 9,974,688,845	$ 8,810,498,695

COMPUTED ACTUARIAL VALUES (in thousands of dollars)

Fiscal Year	Member Contributions (1)	Current Retirees and Beneficiaries (2)	Active and Inactive Members, Employer Financed Portion (3)	Net Assets Available For Benefits*	Percentage of Actuarial Values Covered by Net Assets Available (1)	(2)	(3)
1997	$ 1,311,265	$ 3,563,672	$ 2,673,271	$ 6,048,027	100.0%	100.0%	43.9%
1998	1,370,487	4,044,429	3,926,981	7,064,495	100.0	100.0	42.0
1999	1,442,469	4,547,403	4,008,333	7,986,433	100.0	100.0	49.8
2000	1,513,430	5,039,952	4,359,606	8,910,901	100.0	100.0	54.1
2001	1,579,779	5,753,225	5,239,236	8,276,661	100.0	100.0	18.0
2002	1,650,377	6,789,310	5,851,357	7,673,893	100.0	88.7	0.0
2003	1,443,513	11,621,084	4,529,383	7,502,111	100.0	52.1	0.0
2004	1,570,508	11,949,559	4,922,598	9,990,187	100.0	70.1	0.0
2005	1,683,382	12,484,933	5,136,332	10,494,148	100.0	70.6	0.0
2006	1,819,899	12,621,711	6,432,932	10,899,853	100.0	71.9	0.0

* Net assets are reported at fair value.

RECONCILIATION OF UNFUNDED ACTUARIAL LIABILITY

	FY-06	FY-05
Unfunded Liability, Beginning of Fiscal Year	$ 8,810,498,695	$ 8,452,477,960
Contributions Due		
Interest on the Unfunded Liability	748,892,389	718,460,627
Participants (includes Repayment of Refunds)	214,108,896	209,334,207
Total Normal Cost	233,042,654	221,096,859
Interest on Normal Cost	18,616,409	17,920,280
Total Due	$ 1,214,660,348	$ 1,166,811,973
Contributions Paid		
Participants (includes Repayment of Refunds)	$ 214,108,896	$ 209,334,207
Employing State Agencies and Appropriations	210,499,791	427,434,612
Interest on Contributions	17,677,875	26,510,808
Total Paid	$ 442,286,562	$ 663,279,627
Increase in the Unfunded Liability	$ 772,373,786	$ 503,532,346
Actuarial (Gains) Losses		
a. Retirements	$ 76,028,539	$ 110,248,251
b. Incidence of Disability	(19,433,343)	(2,919,468)
c. In-Service Mortality	(1,776,689)	(19,030,614)
d. Retiree Mortality	(58,182,474)	(67,202,475)
e. Salary Increases	33,070,466	(166,479,933)
f. Terminations	(39,821,726)	-
g. Investment Income	(250,685,826)	(123,132,472)
h. New Entrant Liability	28,140,306	25,109,487
i. Other	(71,931,416)	97,895,613
Total Actuarial (Gain)/Loss	$ (304,592,163)	$ (145,511,611)
Plan Provision Changes	$ (14,567,008)	-
Assumption Changes	710,975,535	-
Total Increase in Actuarial Liability	$ 1,164,190,150	$ 358,020,735
Unfunded Liability, End of Fiscal Year	$ 9,974,688,845	$ 8,810,498,695

SUMMARY OF ACCRUED & UNFUNDED ACCRUED LIABILITIES (Analysis of Funding)

In an inflationary economy, the value of the dollar decreases. This environment results in employees' pay and retirement benefits increasing in dollar amounts resulting in unfunded accrued liabilities which increase in dollar amounts, all at a time when the actual substance of these items may be decreasing.

Looking at just the dollar amounts of unfunded accrued liabilities can be misleading. The ratio of the unfunded accrued liabilities to active employee payroll provides an index which clarifies understanding. The smaller the ratio of unfunded liabilities to active member payroll, the stronger the system.

Observation of this relative index over a period of years will give an indication of whether the system is becoming financially stronger or weaker.

ACCRUED & UNFUNDED ACCRUED LIABILITIES

(in thousands of dollars)

Fiscal Year	Total Actuarial Liability	Net Assets*	Net Assets as a % of Actuarial Liability	Total Unfunded Actuarial Liability	Member Payroll	Unfunded Actuarial Liability as a % of Member Payroll
1997	$ 7,548,208	$ 6,048,027	80.1%	$ 1,500,181	$ 3,003,628	49.9%
1998	9,341,898	7,064,495	75.6	2,277,403	3,096,087	73.6
1999	9,998,205	7,986,433	79.9	2,011,772	3,212,569	62.6
2000	10,912,988	8,910,901	81.7	2,002,087	3,370,696	59.4
2001	12,572,240	8,276,661	65.8	4,295,579	3,564,441	120.5
2002	14,291,044	7,673,893	53.7	6,617,151	3,713,020	178.2
2003	17,593,980	7,502,111	42.6	10,091,869	3,639,334	277.3
2004	18,442,665	9,990,187	54.2	8,452,478	3,439,251	245.8
2005	19,304,647	10,494,148	54.4	8,810,499	3,475,528	253.5
2006	20,874,542	10,899,853	52.2	9,974,689	3,572,541	279.2

*Net assets are reported at fair value.

SCHEDULE OF ACTIVE MEMBER VALUATION DATA

Valuation Date	Number	Annual Payroll	Annual Average Pay	% Increase In Average Pay
6/30/97	79,697	$ 3,003,628,000	$ 37,688	4.0%
6/30/98	78,060	3,096,087,000	39,663	5.2
6/30/99	79,502	3,212,569,000	40,409	1.9
6/30/00	80,676	3,370,696,000	41,781	3.4
6/30/01	80,879	3,564,441,000	44,071	5.5
6/30/02	81,680	3,713,020,000	45,458	3.1
6/30/03	70,192	3,639,334,000	51,848	14.1
6/30/04	70,621	3,439,251,000	48,700	(6.1)
6/30/05	69,163	3,475,528,000	50,251	3.2
6/30/06	68,075	3,572,541,000	52,479	4.4

SCHEDULE OF RETIRANTS ADDED TO & REMOVED FROM ROLLS

Fiscal Year	Beginning Balance	Additions	(Removals)	Ending Balance
1997	27,900	1,017	(1,227)	27,690
1998	27,690	2,365	(1,281)	28,774
1999	28,774	1,841	(1,255)	29,360
2000	29,360	2,075	(1,298)	30,137
2001	30,137	2,270	(1,328)	31,079
2002	31,079	2,673	(1,328)	32,424
2003	32,424	11,372	(1,391)	42,405
2004	42,405	1,285	(1,383)	42,307
2005	42,307	1,782	(1,440)	42,649
2006	42,649	1,398	(1,371)	42,676

SCHEDULE OF SURVIVORS' ANNUITANTS ADDED TO & REMOVED FROM ROLLS

Fiscal Year	Beginning Balance	Additions	(Removals)	Ending Balance
1997	9,462	588	(485)	9,565
1998	9,565	715	(491)	9,789
1999	9,789	581	(560)	9,810
2000	9,810	605	(555)	9,860
2001	9,860	642	(607)	9,895
2002	9,895	675	(589)	9,981
2003	9,981	688	(628)	10,041
2004	10,041	639	(644)	10,036
2005	10,036	700	(695)	10,041
2006	10,041	672	(677)	10,036

SCHEDULE OF DISABILITY RECIPIENTS ADDED TO & REMOVED FROM ROLLS

Fiscal Year	Beginning Balance	Additions	(Removals)	Ending Balance
1997	1,870	2,097	(1,991)	1,976
1998	1,976	1,912	(2,020)	1,868
1999	1,868	2,000	(1,907)	1,961
2000	1,961	2,099	(1,963)	2,097
2001	2,097	2,074	(1,981)	2,190
2002	2,190	2,046	(2,084)	2,152
2003	2,152	1,952	(2,175)	1,929
2004	1,929	1,954	(1,928)	1,955
2005	1,955	2,026	(1,843)	2,138
2006	2,138	2,129	(2,111)	2,156

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STATISTICAL SECTION

ASSET BALANCES

FY Ended June 30	Cash	Receivables	Investments	Fixed Assets, Net of Accumulated Depreciation	Total
1997	$ 69,478,145	$ 14,423,277	$ 5,965,539,268	$ 3,771,484	$ 6,053,212,174
1998	79,514,954	17,870,937	6,969,135,972	3,622,304	7,070,144,167
1999	100,578,832	25,972,613	7,861,470,281	3,500,719	7,991,522,445
2000	97,638,073	27,920,145	8,786,654,484	3,354,788	8,915,567,490
2001	103,210,369	30,349,595	8,144,981,332	3,310,764	8,281,852,060
2002	97,562,972	34,549,705	7,543,749,485	3,227,188	7,679,089,350
2003	36,049,053	31,658,281	7,436,093,948	3,087,685	7,506,888,967
2004	66,642,027	85,035,275	9,840,077,880	3,152,081	9,994,907,263
2005	204,525,471	36,938,006	10,271,356,795	3,071,449	10,515,891,721
2006	226,751,078	29,505,581	10,654,863,723	2,886,428	10,914,006,810

LIABILITIES & RESERVE BALANCES

		RESERVES				
FY Ended June 30	Accounts Payable	Reserve For Member Contributions	Reserve For Interest Accumulations	Reserve For Future Operations	Total Reserves	Total
1997	$ 5,184,949	$ 1,311,265,106	$ 793,131,686	$ 3,943,630,433	$ 6,048,027,225	$ 6,053,212,174
1998	5,649,337	1,370,486,891	853,645,759	4,840,362,180	7,064,494,830	7,070,144,167
1999	5,089,476	1,442,468,720	927,479,803	5,616,484,446	7,986,432,969	7,991,522,445
2000	4,666,838	1,513,429,713	1,001,281,444	6,396,189,495	8,910,900,652	8,915,567,490
2001	5,190,708	1,579,779,470	1,067,313,542	5,629,568,340	8,276,661,352	8,281,852,060
2002	5,196,659	1,650,376,966	1,124,923,885	4,898,591,840	7,673,892,691	7,679,089,350
2003	4,777,551	1,443,512,621	909,604,406	5,148,994,389	7,502,111,416	7,506,888,967
2004	4,720,389	1,570,508,130	1,005,580,314	7,414,098,430	9,990,186,874	9,994,907,263
2005	21,743,768	1,683,382,315	1,098,150,098	7,712,615,540	10,494,147,953	10,515,891,721
2006	14,153,745	1,819,898,559	1,213,224,291	7,866,730,215	10,899,853,065	10,914,006,810

CHANGES IN NET ASSETS

Fiscal Year

	1997	1998	1999	2000	2001	2002	2003	2004	2005	2006
Additions										
Member contributions	$ 145,683,543	$ 155,898,112	$ 159,580,234	$ 164,792,356	$ 173,778,661	$ 196,915,424	$ 285,209,344	$ 199,826,465	$ 209,334,207	$ 214,108,896
Employer Contributions	158,611,008	200,741,736	315,525,007	340,872,521	366,028,937	386,116,583	396,067,236	1,864,673,411	427,434,612	210,499,791
Net investment income/(loss)	952,611,008	1,080,235,182	908,121,794	931,263,299	(612,302,652)	(546,111,398)	15,019,764	1,421,912,540	953,579,253	1,113,231,712
Total additions to plan net assets	1,256,474,065	1,436,875,030	1,383,227,035	1,436,928,176	(72,495,054)	36,920,609	696,296,344	3,486,412,416	1,590,348,072	1,537,840,399
Deductions										
Benefit Payments:										
Retirement annuities	298,359,093	322,676,817	363,649,705	405,944,513	446,598,967	522,544,406	733,969,930	879,638,039	935,677,837	985,503,023
Survivors' annuities	35,239,862	38,184,192	40,506,748	42,672,462	44,958,695	47,794,085	50,724,761	54,186,031	57,542,913	61,100,647
Disability	23,813,616	24,711,911	26,791,871	29,239,488	32,604,190	33,161,126	32,868,545	33,482,302	36,828,758	40,271,558
Lump-sum payments	11,256,372	13,867,165	9,894,097	12,058,958	13,429,872	14,418,870	13,923,360	10,894,638	33,920,915	23,710,733
Total beneftit payments	368,668,943	399,440,085	440,842,421	489,915,421	537,591,724	617,918,487	831,486,596	978,201,010	1,063,970,423	1,110,585,961
Refunds:										
Termination	11,349,768	11,953,276	11,523,273	13,090,272	13,459,556	10,457,845	11,924,654	10,174,522	10,661,887	10,771,309
Other	1,372,659	2,859,691	2,489,251	2,481,035	3,552,686	3,689,373	16,445,133	2,268,076	3,443,414	2,638,739
Total refunds	12,722,427	14,812,967	14,012,524	15,931,307	17,012,242	14,147,218	28,369,787	12,442,600	14,105,301	13,410,048
Administrative expenses	5,735,827	6,154,373	6,433,951	6,613,765	7,140,280	7,623,565	8,221,236	7,693,348	8,311,269	8,139,278
Total deductions from plan net assets	387,127,197	420,407,425	461,288,896	512,460,493	561,744,246	639,689,270	868,077,619	998,336,958	1,086,386,993	1,132,135,287
Change in net assets	$ 869,346,868	$ 1,016,467,605	$ 921,938,139	$ 924,467,683	$ (634,239,300)	$ (602,768,661)	$ (171,781,275)	$ 2,488,075,458	$ 503,961,079	$ 405,705,112

TOTAL MEMBERSHIP - COORDINATED/NONCOORDINATED

FY Ended June 30	COORDINATED MEMBERS Male	COORDINATED MEMBERS Female	COORDINATED MEMBERS Total	NONCOORDINATED MEMBERS Male	NONCOORDINATED MEMBERS Female	NONCOORDINATED MEMBERS Total	Total Male Members	Total Female Members	Total Members
1997	46,897	45,642	92,539	3,819	2,060	5,879	50,716	47,702	98,418
1998	47,065	45,443	92,508	3,445	1,852	5,297	50,510	47,295	97,805
1999	48,382	46,578	94,960	3,274	1,656	4,930	51,656	48,234	99,890
2000	50,153	46,978	97,131	3,257	1,424	4,681	53,410	48,402	101,812
2001	50,696	47,611	98,307	3,098	1,147	4,245	53,794	48,758	102,552
2002	51,545	48,345	99,890	2,967	989	3,956	54,512	49,334	103,846
2003	46,673	43,456	90,129	2,640	748	3,388	49,313	44,204	93,517
2004	46,722	43,474	90,196	2,569	653	3,222	49,291	44,127	93,418
2005	45,774	42,532	88,306	2,543	574	3,117	48,317	43,106	91,423
2006	44,656	41,657	86,313	2,586	548	3,134	47,242	42,205	89,447

ACTIVE MEMBERSHIP - COORDINATED/NONCOORDINATED

FY Ended June 30	COORDINATED MEMBERS Male	COORDINATED MEMBERS Female	COORDINATED MEMBERS Total	NONCOORDINATED MEMBERS Male	NONCOORDINATED MEMBERS Female	NONCOORDINATED MEMBERS Total	Total Male Members	Total Female Members	Total Active Members	Annual Earnings Reported
1997	37,279	36,909	74,188	3,617	1,892	5,509	40,896	38,801	79,697	$3,003,628,000
1998	36,976	36,152	73,128	3,246	1,686	4,932	40,222	37,838	78,060	3,096,087,000
1999	37,941	36,977	74,918	3,072	1,512	4,584	41,013	38,489	79,502	3,212,569,000
2000	38,755	37,571	76,326	3,061	1,289	4,350	41,816	38,860	80,676	3,370,696,000
2001	39,089	37,868	76,957	2,898	1,024	3,922	41,987	38,892	80,879	3,564,441,000
2002	39,844	38,174	78,018	2,778	884	3,662	42,622	39,058	81,680	3,713,020,000
2003	34,438	32,660	67,098	2,450	644	3,094	36,888	33,304	70,192	3,639,334,000
2004	34,813	32,848	67,661	2,395	565	2,960	37,208	33,413	70,621	3,439,251,000
2005	34,239	32,070	66,309	2,363	491	2,854	36,602	32,561	69,163	3,475,528,000
2006	33,597	31,582	65,179	2,424	472	2,896	36,021	32,054	68,075	3,572,541,000

NUMBER OF RECURRING BENEFIT PAYMENTS / TERMINATION REFUNDS

FY Ended June 30	Retirement Annuities	Survivors' Annuities	Disability* Benefits	Total Recurring Benefit Payments	Termination Refunds
1997	27,690	9,565	1,976	39,231	2,244
1998	28,774	9,789	1,868	40,431	2,140
1999	29,360	9,810	1,961	41,131	2,190
2000	30,137	9,860	2,097	42,094	2,425
2001	31,079	9,895	2,190	43,164	2,494
2002	32,424	9,981	2,152	44,557	2,244
2003	42,405	10,041	1,929	54,375	2,269
2004	42,307	10,036	1,955	54,298	2,100
2005	42,649	10,041	2,138	54,828	1,910
2006	42,676	10,036	2,156	54,868	1,903

*** Includes individuals receiving total temporary disability payments under the Workers' Compensation Act.**

RETIREMENT ANNUITIES
Average Monthly Benefit For Current Year Retirees By Type

	Fiscal Year Ending June 30				
	2006	2005	2004	2003	2002
Not Coordinated with Social Security	$ 2,086.11	$ 2,566.46	$ 2,457.54	$ 2,624.86	$ 2,239.35
Coordinated with Social Security	1,549.89	1,756.40	1,322.80	2,183.53	1,522.13
Alternative Formula	6,239.07	5,617.20	5,754.54	5,059.41	5,315.46
Dept. of Corrections/DHS - Special Formula - Not Coordinated with Social Security	3,613.39	3,998.83	5,200.27	3,557.74	3,726.63
Dept. of Corrections/DHS - Special Formula Coordinated with Social Security	2,998.49	2,924.89	2,892.96	3,027.76	3,083.95
Air Pilots - Coordinated with Social Security	-	-	3,891.50	4,424.87	-
TOTAL AVERAGE	$ 1,974.35	$ 2,091.30	$ 2,042.47	$ 2,445.40	$ 2,264.61

RETIREMENT ANNUITIES
Current Age of Active Recipients

	Fiscal Year Ending June 30				
Age	2006	2005	2004	2003	2002
Under 51	212	302	526	885	40
51-55	3,129	3,708	4,208	4,622	1,269
56-60	6,798	6,767	6,439	6,341	2,878
61-65	7,836	7,557	7,207	6,853	5,250
66-70	7,133	6,927	6,611	6,520	6,027
71-75	5,998	5,950	5,932	5,878	5,849
76-80	5,011	5,016	5,041	5,107	5,048
81-85	3,672	3,615	3,552	3,478	3,402
86-89	1,687	1,655	1,693	1,659	1,618
Over 89	1,200	1,152	1,098	1,062	1,043
Total	42,676	42,649	42,307	42,405	32,424
Average Age	68.94	68.63	68.44	68.16	71.51

RETIREMENT ANNUITIES
Average Service (in months) for Current Year Retirees at Effective Date of Benefit

Fiscal Year Ending June 30	2006	2005	2004	2003	2002
Not Coordinated with Social Security	386.80	412.17	407.53	409.20	387.39
Coordinated with Social Security	291.40	304.33	288.30	356.18	292.52
Alternative Formula	318.89	321.22	326.26	322.90	339.30
Dept. of Corrections - Special Formula - Not Coordinated with Social Security	358.41	338.94	388.41	352.88	383.00
Dept. of Corrections -Special Formula - Coordinated with Social Security	317.05	323.11	326.20	331.18	339.82
Air Pilots - Coordinated with Social Security	-	-	300.00	305.68	-
TOTAL AVERAGE	300.11	314.58	310.49	351.48	319.54

Annuitants by Benefit Range (Monthly) June 30, 2006

Benefit Range	Total	Cumulative Total	% of Total	Cumulative % of Total
$ 1-100	391	391	0.9	0.9
101-200	1,118	1,509	2.6	3.5
201-300	1,764	3,273	4.1	7.6
301-400	1,865	5,138	4.4	12.0
401-500	1,815	6,953	4.3	16.3
501-600	1,682	8,635	3.9	20.2
601-700	1,541	10,176	3.6	23.8
701-800	1,449	11,625	3.4	27.2
801-900	1,402	13,027	3.3	30.5
901-1000	1,306	14,333	3.1	33.6
1001-1100	1,212	15,545	2.8	36.4
1101-1200	1,174	16,719	2.8	39.2
1201-1300	1,136	17,855	2.7	41.9
1301-1400	1,060	18,915	2.5	44.4
1401-1500	1,013	19,928	2.4	46.8
1501-1600	1,089	21,017	2.6	49.4
1601-1700	929	21,946	2.2	51.6
1701-1800	917	22,863	2.1	53.7
1801-1900	930	23,793	2.2	55.9
1901-2000	923	24,716	2.2	58.1
2001-2100	904	25,620	2.1	60.2
2101-2200	938	26,558	2.2	62.4
2201-5000	14,399	40,957	33.7	96.1
5000- & over	1,719	42,676	3.9	100.0

Widow's and Survivors' by Benefit Range (Monthly) June 30, 2006

Benefit Range	Total	Cumulative Total	% of Total	Cumulative % of Total
$ 1-100	887	887	8.8	8.8
101-200	1,465	2,352	14.6	23.4
201-300	1,723	4,075	17.2	40.6
301-400	1,307	5,382	13.0	53.6
401-500	1,169	6,551	11.6	65.2
501-600	760	7,311	7.6	72.8
601-700	529	7,840	5.3	78.1
701-800	307	8,147	3.1	81.2
801-900	262	8,409	2.6	83.8
901-1000	218	8,627	2.2	86.0
1001-1100	191	8,818	1.9	87.9
1101-1200	173	8,991	1.7	89.6
1201-1300	164	9,155	1.6	91.2
1301-1400	139	9,294	1.4	92.6
1401-1500	137	9,431	1.4	94.0
1501-1600	91	9,522	0.9	94.9
1601-1700	71	9,593	0.7	95.6
1701-1800	69	9,662	0.7	96.3
1801-1900	56	9,718	0.6	96.9
1901-2000	47	9,765	0.5	97.4
2001-2100	40	9,805	0.4	97.8
2101-2200	54	9,859	0.5	98.3
2201-5000	177	10,036	1.7	100.0
5000- & over	0	10,036	0.0	100.0

Occupational and Non-Occupational (Incl. Temp) Disabilities by Benefit Range (Monthly) June 30, 2006

Benefit Range	Total	Cumulative Total	% of Total	Cumulative % of Total
$ 1-100	32	32	1.5	1.5
101-200	40	72	1.9	3.4
201-300	100	172	4.6	8.0
301-400	147	319	6.8	14.8
401-500	174	493	8.1	22.9
501-600	133	626	6.2	29.1
601-700	99	725	4.6	33.7
701-800	87	812	4.0	37.7
801-900	73	885	3.4	41.1
901-1000	44	929	2.0	43.1
1001-1100	55	984	2.6	45.7
1101-1200	65	1,049	3.0	48.7
1201-1300	63	1,112	2.9	51.6
1301-1400	63	1,175	2.9	54.5
1401-1500	88	1,263	4.1	58.6
1501-1600	104	1,367	4.8	63.4
1601-1700	62	1,429	2.9	66.3
1701-1800	61	1,490	2.8	69.1
1801-1900	70	1,560	3.2	72.3
1901-2000	86	1,646	4.0	76.3
2001-2100	75	1,721	3.5	79.8
2101-2200	83	1,804	3.9	83.7
2201-5000	349	2,153	16.2	99.9
5000- & over	3	2,156	0.1	100.0

ACTIVE RETIREES BY STATE

Average Benefit Payments
Fiscal Years 1997 through 2006

	Years Credited Service						
Retirement Effective Dates	0-5	5-10	10-15	15-20	20-25	25-30	30+
Period 7/1/96 to 6/30/97							
Average monthly benefit	$ 31	$ 232	$ 328	$ 492	$ 817	$ 1,727	$ 1,813
Average final average salary	$ 4,705	$ 2,300	$ 2,631	$ 2,674	$ 2,874	$ 3,495	$ 3,552
Number of retired members	3	98	143	143	209	192	229
Period 7/1/97 to 6/30/98							
Average monthly benefit	$ -	$ 293	$ 530	$ 813	$ 1,134	$ 1,824	$ 2,506
Average final average salary	$ 7,384	$ 2,484	$ 2,798	$ 2,832	$ 3,041	$ 3,595	$ 3,901
Number of retired members	1	193	297	272	448	520	634
Period 7/1/98 to 6/30/99							
Average monthly benefit	$ -	$ 442	$ 649	$ 917	$ 1,216	$ 2,214	$ 2,458
Average final average salary	$ -	$ 2,798	$ 3,043	$ 3,073	$ 3,123	$ 3,985	$ 4,039
Number of retired members	-	96	180	204	355	415	591
Period 7/1/99 to 6/30/00							
Average monthly benefit	$ 392	$ 442	$ 654	$ 876	$ 1,267	$ 2,048	$ 2,484
Average final average salary	$ 1,367	$ 2,813	$ 3,098	$ 2,943	$ 3,247	$ 3,828	$ 4,107
Number of retired members	2	105	213	245	376	444	690
Period 7/1/00 to 6/30/01							
Average monthly benefit	$ 255	$ 447	$ 641	$ 950	$ 1,317	$ 2,046	$ 2,527
Average final average salary	$ 2,963	$ 2,848	$ 2,967	$ 3,257	$ 3,424	$ 3,878	$ 4,075
Number of retired members	1	90	194	212	296	433	1,044
Period 7/1/01 to 6/30/02							
Average monthly benefit	$ 2,721	$ 475	$ 659	$ 984	$ 1,760	$ 2,733	$ 2,805
Average final average salary	$ 5,458	$ 3,066	$ 3,065	$ 3,233	$ 3,655	$ 4,260	$ 4,235
Number of retired members	1	83	204	181	414	666	1,124
Period 7/1/02 to 6/30/03							
Average monthly benefit	$ -	$ 417	$ 774	$ 1,165	$ 1,921	$ 2,523	$ 2,889
Average final average salary	$ -	$ 2,799	$ 3,284	$ 3,533	$ 3,816	$ 4,210	$ 4,407
Number of retired members	-	36	317	812	2,017	2,362	5,828
Period 7/1/03 to 6/30/04							
Average monthly benefit	$ -	$ 532	$ 666	$ 939	$ 1,650	$ 3,214	$ 2,317
Average final average salary	$ -	$ 3,499	$ 3,283	$ 3,468	$ 3,953	$ 5,326	$ 4,685
Number of retired members	-	65	105	122	210	305	478
Period 7/1/04 to 6/30/05							
Average monthly benefit	$ -	$ 537	$ 744	$ 1,072	$ 1,642	$ 2,742	$ 2,659
Average final average salary	$ -	$ 3,464	$ 3,721	$ 3,799	$ 4,050	$ 4,807	$ 4,820
Number of retired members	-	99	145	177	235	400	726
Period 7/1/05 to 6/30/06							
Average monthly benefit	$ -	$ 536	$ 715	$ 1,090	$ 1,696	$ 2,893	$ 2,422
Average final average salary	$ -	$ 3,672	$ 3,614	$ 3,763	$ 4,169	$ 4,990	$ 4,769
Number of retired members	-	69	148	160	215	356	450

PLAN SUMMARY & LEGISLATIVE SECTION

SUMMARY OF RETIREMENT SYSTEM PLAN
(As of June 30, 2006)

1. Purpose

The State Employees' Retirement System of Illinois, a state agency, provides an orderly means whereby aged or disabled employees may be retired from active service without prejudice or hardship and enables the employees to accumulate reserves for themselves and their dependents for old age, disability, death and termination of employment.

2. Administration

Responsibility for the operation of the System and the direction of its policies is vested in a Board of Trustees consisting of seven members. The administration of the System is the responsibility of the Executive Secretary who is appointed by the Board of Trustees. Administrative policies and procedures are designed to ensure an accurate accounting of funds of the System and prompt payment of claims for benefits within the applicable statute.

3. Employee Membership

Generally, all persons entering state service become members of the System after serving a six-month qualifying period unless their position is subject to membership in another state supported system.

Employees appointed by the Governor and requiring confirmation by the State of Illinois Senate may elect to become members of the System. Other exceptions are identified in state law.

4. Member Contributions

Members are required to contribute a percentage of salary as their share of meeting the cost of the various benefits. Contribution rates are:

A. Members Coordinated with Social Security: 4% of salary

B. Members Without Social Security:
8% of salary

C. State Policemen, State Police Special Agents, Firefighters, Secretary of State Investigators, Conservation Police Officers, Department of Revenue Investigators, Central Management Services Security Police, Mental Health Police Officers, Dangerous Drug Investigators for Department of Alcoholism and Substance Abuse, State Police Investigators, Attorney General Investigators, Controlled Substance Inspectors, State's Attorneys Appellate Prosecutor Investigators, Commerce Comission Police Officers, and Arson Investigators: 12 1/2% of salary

D. Security Employees of the Department of Corrections and Department of Human Services, Air Pilots and State Highway Maintenance Workers:

1. Coordinated with Social Security:
   8 1/2% of salary
2. Without Social Security: 12 1/2% of salary

Members coordinated with Social Security also pay the current Social Security tax rate.

5. Retirement Annuity

A. Qualification of Member

Upon termination of state service, a member is eligible for a retirement annuity at age 60 with at least eight years of service credit; when the member's age and service equal 85 years; between ages 55 and 60 with 25 to 30 years of credit with the retirement annuity reduced by one-half of 1% for each month the member is under age 60.

Security employees of the Department of Corrections and the Department of Mental Health and Developmental Disabilities who are not eligible for the Alternative Formula must have at least 20 years of membership service to qualify for special retirement formulas which will apply only to the service earned while in a security position.

Members in Alternative Formula positions are eligible at age 50 with at least 25 years of eligible creditable service or at age 55 with at least 20 years of eligible creditable service in such a position.

B. Amount of Retirement Annuity

The retirement annuity is based on the member's final average compensation and the number of years of service credit that have been established. The retirement benefit formula available to general state employees is 1.67% for each year of covered service and 2.2% for each year of noncovered service. Alternative formula employees have a formula of 2.5% for covered service and 3.0% for noncovered service.

The maximum retirement annuity payable is 75% of final average compensation for regular employees and 80% for alternative formula employees. The minimum retirement annuity payable is $15.00 for each year of covered employment and $25.00 for each year of noncovered employment.

C. Optional Forms of Payment

Reversionary Annuity: A member may elect to receive a smaller retirement annuity during his lifetime in order to provide a designated dependent with a lifetime income. That payment would be in addition to any other benefit payable by the System.

Level Income: A member who contributes to social security as a state employee may elect to have his retirement annuity payments increased before the age at which the member can receive social security benefits and reduced after that age to provide a uniform retirement annuity income throughout his retired life.

To be eligible for this election the member must have established eligibility for a social security retirement annuity.

D. Annual Increase in Benefit

Post retirement increases of 3% are generally granted to members effective each January 1, after receipt of benefits for one full year.

6. Survivors' Annuity

A. Qualification of Survivor

If death occurs while in state employment, the member must have established at least 18 months of service credit. If death occurs after termination of state service and the member was not receiving a retirement annuity, the member must have established at least eight years of service credit.

An eligible spouse qualifies at age 50 or at any age if there is in the care of the spouse any unmarried children of the member under age 18 (age 22 if a full time student) or over 18 if mentally or physically disabled and unable to work; unmarried children under age 18 (age 22 if a full time student) if no spouse survives; or dependent parents at age 50 if neither an eligible spouse nor eligible children survive the member.

A spouse that is the sole nominated beneficiary and sole survivor may elect other death benefits as described in Number 9.

B. Amount of Payment

If the member's death occurs before retirement, the named beneficiary receives a lump sum refund of all the member's retirement contributions plus the interest credited to the member's account, excluding contributions for widow and survivors' benefits. A single lump sum payment of $1,000 is also made to the qualified survivor of the member.

An eligible spouse receives a monthly annuity equal to 30% of the member's final average compensation subject to a maximum of $400.
If children of the member are under the care of the spouse, the annuity is increased for each child, subject to a maximum of $600 or 80% of final average compensation.

If only eligible children survive, the monthly annuity may not exceed the lessor of $600 or 80% of final average compensation. The maximum combined monthly payment to parents may not exceed $400.

If the member's death occurs after retirement or after termination of state employment, but before the member receives a retirement annuity, the monthly benefit is the same as during active employment or 80% of the earned retirement annuity at date of death.

The minimum total survivor benefit payable to the survivor's annuity beneficiaries of a deceased member or annuitant shall be 50% of the amount of retirement annuity that was or would have been payable to the deceased member on the date of death.

Monthly benefits payable to survivors of a member who was covered by Social Security as a state employee are reduced by one-half of the amount of benefits they are eligible to receive from Social Security from the deceased member's account. The Social Security offset may not reduce the benefit by more than 50%.

C. Duration of Payment

The monthly annuity payable to a spouse terminates upon death; to children upon death, marriage, or attainment of age 18 (age 22 if a full time student), except for a child who at age 18 is physically or mentally disabled and unable to accept gainful employment, which terminate at death or gainful employment. Dependent parents' benefits terminate at death or remarriage.

D. Annual Increase in Benefit

The survivor benefit is increased by 3% each January 1, after receipt of benefits for one full year. Survivors of retired members receive an increase on January 1 following the commencement of the benefit.

7. Widow's Annuity

The widow of a male member who was a participant in the System prior to July 19, 1961, may have the option of taking a Widow's Annuity rather than the Survivors' Annuity.

A. Qualification of Widow
An eligible widow receives a Widow's Annuity if she is age 50 or over or has in her care any of the member's unmarried children under age 18 (age 22 if a full time student). If she is not age 50 and has no such children in her care, she becomes eligible at age 50.

B. Amount of Payment
The Widow's Annuity consists of a lump sum payment of $500, plus a monthly annuity equal to 50% of the retirement annuity earned or received by the member at the date of death.
If the widow has in her care eligible children of the member, the monthly annuity is increased 5% because of each child, subject to a maximum payment equal to 66 2/3% of the earned retirement annuity.

Monthly benefits payable to a widow of a member who was covered by Social Security as a state employee are reduced by one-half of the amount of benefits she is eligible to receive from Social Security as a widow. The Social Security offset may not reduce the benefit by more than 50%.

C. Duration of Payment
The monthly payment to the widow continues for her lifetime. If the amount of benefit was increased because of eligible children, it is adjusted downward as these children's benefits are terminated due to death, marriage or attainment of age 18, (age 22 if a full time student).

D. Annual Increase in Benefit
The widow's benefit is increased by 3% each January 1, after receipt of benefits for one full year. Widows of retired members receive the increase on January 1 following the commencement of the benefit.

8. Occupational Death Benefit

A. Qualification of Survivors
If a member's death results from a job related cause, the spouse may be eligible for an Occupational Death benefit. If only unmarried children under age 18 (age 22 if a full time student) survive, they may be eligible for the benefit. If neither spouse nor eligible children survive, a dependent father or mother may be eligible.

B. Amount of Payment
The nominated beneficiary receives a lump sum payment consisting of all contributions made by the member plus the interest credited to the member's account. A surviving spouse is entitled to a monthly benefit equal to 50% of the member's final average compensation.

If children under age 18 (age 22 if a full time student) also survive, the annuity is increased by 15% of such average because of each child subject to a maximum of 75%. If no eligible spouse and children under age 18 (age 22 if a full time student) survive, each child receives a monthly allowance of 15% of the final average compensation. The combined payment to children may not exceed 50% of the member's final average compensation.

If there is no eligible spouse or eligible children, a benefit of 25% of final average compensation is payable to each surviving dependent parent for life. The monthly benefit is reduced by any payments awarded under the Workers' Compensation Act or Workers' Occupational Diseases Act.

C. Duration of Payment
The monthly annuity payable to a spouse or dependent parent terminates at death; to children at death, or attainment of age 18 (age 22 if a full time student), or marriage.

D. Annual Increase in Benefit
The Occupational Death Benefit is increased by 3% each January 1 after receipt of benefits for one full year.

9. Other Death Benefits

If the beneficiary(ies) of the member do not qualify for any of the previously described death benefits, one of the following benefits is payable.

A. Before Retirement
If a member's death occurred while in state service, the benefit consists of:

1. A refund of all contributions plus the interest credited to the member's account;

2. A payment equal to one month's salary for each full year of service credit not to exceed six month's salary.

If the member had terminated state service, but not yet qualified for a retirement annuity, the benefit consists of a refund of all of the member's contributions to the System plus the interest credited to the member's account.

B. After Retirement
The benefit consists of a lump sum payment equal to the excess of contributions plus the interest credited to the member's account over the total amount of retirement annuity payments made to the member. The minimum payment is $500.

10. Nonoccupational Disabilty Benefit

A. Qualification and Amount of Payment

Available to any member who has established at least 18 months of creditable service and who has been granted a disability leave of absence by the employing agency. The benefit is 50% of final average compensation and credit to the member's account of service and contributions. It begins on the 31st day of absence from service on account of disability (including any periods for which sick pay was received).

If the member has Social Security coverage as a state employee, the benefit payable by the System is reduced by the amount of any disability or retirement payment to which he is entitled under Social Security.

B. Duration of Payment

The member is eligible for the monthly benefit until the occurrence of any of the following events:

1. Disability ceases;

2. Resumption of gainful employment;

3. Payments are made for a period of time equal to one-half of the service credit established as of the date disability began;

4. Attainment of age 65, if benefit commenced prior to the attainment of age 60;

5. The fifth anniversary of the effective date of the benefit if the benefit commenced on or after the attainment of age 60;

6. Death of the member.

C. Increase in Benefit

The Nonoccupational Disability benefit shall be increased by 7% following the fourth anniversary of the benefit and 3% each year thereafter.

11. Occupational Disability Benefit

A. Qualification and Amount of Payment

Provided for any member who becomes disabled as the direct result of injury or disease arising out of and in the course of state employment.

The benefit is 75% of final average compensation plus a credit to the member's account of service and contributions. The cash benefit is reduced by any payment received under the Workers' Compensation Act or Workers' Occupational Diseases Act.

B. Duration of Payment

Monthly benefits are payable until the occurrence of any of the following events:

1. Disability ceases;

2. Resumption of gainful employment;

3. Attainment of age 65, if benefit commenced prior to the attainment of age 60;

4. The fifth anniversary of the effective date of the benefit if the benefit commenced on or after the attainment of age 60;

5. Death of the member.

C. Increase in Benefit

The Occupational Disability benefit shall be increased by 7% following the fourth anniversary of the benefit and 3% each year thereafter.

12. Temporary Disability Benefit

A. Qualification and Amount of Payment

Available to any member who becomes disabled, has established at least 18 months of creditable service, has been denied benefits under the Workers' Compensation Act or the Workers' Occupational Diseases Act, or had benefits terminated, and has filed an appeal with the Industrial Commission of Illinois. The benefit is 50% of final average compensation plus credit to the member's account of service and contributions.

The benefit shall begin to accrue on the 31st day of absence from service and shall be payable upon the expiration of 31 days from the day the member last received compensation.

If the member has Social Security coverage as a state employee, the benefit payable by the System is reduced by the amount of any disability or, if age 65, any retirement payment to which he is eligible under Social Security.

B. Duration of Payment

The member is eligible for the monthly benefit until the occurrence of any of the following events:

1. Disability ceases;

2. Resumption of gainful employment;

3. Payments are made for a period of time equal to one-half of the service credit established as of the date disability began;

4. Attainment of age 65, if the benefit commenced prior to the attainment of age 60;

5. The fifth anniversary of the effective date of the benefit if the benefit commenced on or after the attainment of age 60;

6. Death of the member;

7. Benefits are paid or awarded under the Workers' Compensation Act or the Workers' Occupational Diseases Act.

13. Separation Benefits

Upon termination of state employment by resignation, discharge, dismissal or layoff, a member may obtain a refund of the contributions made to the System, excluding interest. The member must be off the payroll for 14 days to be eligible for a refund. By accepting a refund, a member forfeits all accrued rights and benefits in the System for himself and his beneficiaries.

LEGISLATION AMENDMENTS

Amendments with an effective date during Fiscal Year 2006:

Senate Bill 1442 (P.A. 94-0109, effective July 1, 2005)

Amends the State Employees Group Insurance Act of 1971. Provides that, beginning July 1,2005, the Director of Central Management services may establish a program of financial incentives to encourage annuitants receiving a retirement annuity from the State Employees' Retirement System, but who are not eligible for benefits under the federal Medicare health insurance program, to elect not to participate in the program of health benefits provided under the Act. Sets forth requirements for the election by an annuitant not to participate under the program. Provides that the financial incentives provided to these annuitants under the program may not exceed $150 per month for each annuitant electing not to participate in the program. Amends the State Employees Article of the Illinois Pension Code to provide for a new alternative retirement cancellation payment.

Senate Bill 1383 (P.A. 94-0455, effective August 4, 2005)

Amends the State Employees' Retirement System article of the Illinois Pension Code. Provides that, instead of repaying the entire amount of a refund, a member may repay a portion of the refund and receive credit for the portion of the refund that was repaid.

House Bill 0227 (P.A.94-0612, effective August 18, 2005)

Permits a member to establish service credit for a period of up to 8 years during which he or she was employed by the Visually Handicapped Managers of Illinois in a vending program operated under a contracted agreement with the Department of Rehabilitation Services.

Senate Bill 2899 (P. A. 94-0793, effective May 19, 2006)

Makes certain administrative changes to the State Employees' Retirement System article. Updates the agency name "Bureau of the Budget" to its new name of "Governor's Office of Management and Budget".

Senate Bill 0092 (P. A. 94-0696, effective June 1, 2006)

Amends the State Employees' Retirement System article of the Illinois Pension Code. Includes security employees of the newly created Department of Juvenile Justice under the alternative retirement formula. Identifies certain dates, positions, and /or physical location criteria in order to become eligible for the alternative formula benefit.

Senate Bill 1977 (Public Act 94-0839; effective June 6, 2006)

- Creates the Pension Stabilization Fund as a special fund in the State Treasury. Moneys in the fund shall be used for the sole purpose of making payments to the five state funded retirement systems. Such payments from the Pension Stabilization Fund to the five state funded retirement systems shall be in addition to, and not in lieu of, any State contributions required by the Illinois Pension Code.

- Directs the Comptroller to transfer from the General Revenue Fund to the Pension Stabilization Fund 1.0% or 0.5% of the estimated general fund revenues for each fiscal year when the General Assembly's appropriations and transfers or diversions as required by law from general funds do not exceed 98% or 99% of the estimated general funds revenues, respectively.

- Amends the State Employees' Retirement System article of the Illinois Pension Code to state that any amounts received from the Pension Stabilization Fund shall not reduce and do not constitute payment of any portion of the required minimum State contribution in that fiscal year. In addition, such amounts received shall not reduce, and shall not be included in the calculation of, the required State contributions in any future year until the System has reached a funding ratio of at least 90%.

NEW LEGISLATION

Amendments with an effective date after Fiscal Year 2006:

Senate Bill 1446 (P.A. 94-0657, effective July 1, 2006)

Amends the general provisions of the Illinois Pension Code pertaining to Qualified Illinois Domestic Relations Orders (QILDRO's). Defines who would receive earned benefits and allows for the division of non-periodic death benefits as well as the division of benefits on a percentage basis in addition to a specific dollar amount.

Senate Bill 0049 (P. A. 94-1057, effective July 31, 2006)

Changes the expiration date for which the Commission on Government Forecasting and Accountability shall determine and report to the General Assembly its estimate of certain projected savings as a result of the System's Early Retirement Incentive program. The date change was from calendar year 2013 to 2006.