



STATE EMPLOYEES'
RETIREMENT SYSTEM
OF ILLINOIS

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SERS

Introductory
Section



STATE EMPLOYEES'
RETIREMENT SYSTEM
OF ILLINOIS

2815 WEST WASHINGTON, P.O. BOX 19255, SPRINGFIELD, IL 62794-9255, PH. 217/753-0444

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

December 15, 1988

Dear Board Members:

The component unit annual financial report of the State Employees' Retirement System of Illinois for the fiscal year ended June 30, 1988 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.

The report consists of six sections:

1. An Introductory Section which contains this letter of transmittal and the identification of the administrative organization;
2. The Financial Section which contains the report of the independent public accountants, the financial statements of the System, and the supplementary and additional financial information;
3. The Actuarial Section which contains the report of the Actuary as well as the summary of major actuarial assumptions and certain tables;
4. The Investment Section which contains a summary of the System's investment management approach and selected summary tables, including investment performance;
5. The Statistical Section which contains significant statistical data; and
6. A summary of the System's plan provisions.

The combined financial statements include the State Employees' Retirement System Trust Fund and the Social Security Contribution Fund, an Agency Fund. Based primarily upon the criteria of financial interdependency and ability to significantly influence operations and accountability for fiscal matters, the System has included the Social Security Contribution Fund in its combined financial statements.

REVENUES

Collection of employer and employee retirement contributions, as well as income from investments, provide the reserves necessary to finance retirement benefits. These income sources totaled \$344.7 million during the fiscal year ending June 30, 1988, which is a significant decrease from revenue reported for fiscal year 1987, shown as follows:

| Retirement System Trust Fund Contributions: | 1988 | 1987 | Increase/(Decrease) | |
|--|----------------|----------------|---------------------|----------------|
| | (Millions) | (Millions) | (Millions) | (Percentage) |
| Employees | \$ 95.9 | \$ 90.1 | \$ 5.8 | 6.4% |
| Employers | 100.0 | 109.6 | (9.6) | (8.8%) |
| Investments | 148.8 | 226.9 | (78.1) | (34.4%) |
| | <u>344.7</u> | <u>426.6</u> | <u>(81.9)</u> | <u>(19.2%)</u> |
| Social Security Contribution Fund General Revenue, less balance lapsed | .1 | .2 | (.1) | (50.0%) |
| | <u>\$344.8</u> | <u>\$426.8</u> | <u>\$ (82.0)</u> | <u>(19.2%)</u> |

As indicated in the total above, a substantial portion of the total revenue is derived from investment income, including the realization of substantial gains on the sales of investments, during both fiscal years 1988 and 1987.

EXPENSES

The primary expense of a retirement system relates to the purpose for which it is created; namely the payment of benefits. The payments, together with the expense to administer the plan, constitute the total expenses of the System Trust Fund. Expenses of the System Trust Fund and Social Security Contribution Fund for 1988 and 1987 are shown for comparison purposes.

| Retirement System Trust Fund | 1988 | 1987 | Increase/(Decrease) | |
|-----------------------------------|----------------|----------------|---------------------|----------------|
| Benefits: | (Millions) | (Millions) | (Millions) | (Percentage) |
| Retirement annuities | \$132.2 | \$119.8 | \$12.4 | 10.4% |
| Survivors' annuities | 20.3 | 18.9 | 1.4 | 7.4% |
| Disability benefits | 14.7 | 14.5 | .2 | 1.4% |
| Lump-sum death benefits | 6.4 | 6.4 | - | - % |
| | <u>173.6</u> | <u>159.6</u> | <u>14.0</u> | <u>8.8%</u> |
| Refunds | 12.0 | 12.2 | (.2) | (1.6)% |
| Administrative expenses | <u>3.2</u> | <u>3.0</u> | <u>.2</u> | <u>6.7%</u> |
| | <u>\$188.8</u> | <u>\$174.8</u> | <u>\$14.0</u> | <u>8.0%</u> |
| Social Security Contribution Fund | | | | |
| Administrative expenses | <u>.1</u> | <u>.2</u> | <u>(.1)</u> | <u>(50.0)%</u> |
| | <u>\$188.9</u> | <u>\$175.0</u> | <u>\$13.9</u> | <u>7.9%</u> |

The increase in benefit payment resulted primarily from a growth in the number of benefits paid and in the average benefit payment.

INVESTMENTS

Income from investments has, over the years, increasingly become a greater share of the total revenue of the System. Net investment income, combined with a net realized gain on the sale of investments, amounts to \$148,802,057 during fiscal year 1988, a decrease of \$78,127,546 from fiscal year 1987. This reflects the generally downward trend in the financial markets during the last fiscal year. Income from investments represents 43.2% of total fund revenue.

FUNDING AND RESERVES

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 actuarial determined liability of the System at June 30, 1988, amounted to \$3.642 billion. The fund balances for participant contributions, interest accumulations and other future benefits amounted to \$2.382 billion as of the same date. The amount by which the liability exceeds the reserves is called the "unfunded accrued benefit cost". The unfunded accrued benefit cost amounts to \$1.260 billion and reflects the continuing state policy of appropriating funds based upon a percentage of the total amount of benefit payments made to current recipients. A detailed discussion of funding is provided in the Actuarial Section of this report.

ECONOMIC CONDITION AND OUTLOOK

The state's policy on pension funding has been based on variations of the pay-as-you-go approach. From fiscal year 1973 through fiscal year 1981, the state's contribution was approximately equal to 100% of payout (the dollar amount expected to be paid out in benefits each year).

Beginning in fiscal year 1982, however, state appropriations have been less than 100% of payout. In fiscal year 1982, the appropriation fell to 62.5% of payout, while in fiscal year 1983 the appropriation declined to just over 50% of payout. These reductions were due in large part to the state's poor fiscal condition. From fiscal year 1984 to fiscal year 1987, the state's appropriation was approximately 60% of payout. The fiscal year 1988 regular contribution was approximately 48% of payout.

Financing the retirement benefits that are being earned is one of the most important issues facing the State Employees' Retirement System. Over the years, a number of organizations have stressed the need for sound funding of the System. However, before funding needs can be discussed, attention must first be focused on the current financial condition of the System.

Assessing the financial status of any retirement system is a difficult task. The valuation of pension liabilities is a complex procedure requiring the application of actuarial techniques. It is not possible

to provide a simple measure of the financial status of a retirement system because no universally accepted measure of the financial status presently exists. By any reasonable actuarial standard, however, the System's present financial condition must be described as precarious due to the continually increasing dollar level of the unfunded liability. The current economic outlook for the State of Illinois as a whole does not allow us to assume that additional resources will be available under existing tax structures to allocate toward retirement funding. The events in the financial markets, especially the stock market during the past fiscal year, serve as a constant reminder of the fact that no source of revenue can be guaranteed and that the ultimate responsibility for a sound funding policy and the related liability for contributions rests ultimately with the State of Illinois.

MAJOR INITIATIVES for the System are detailed in the Report of the Chairman of the Board of Trustees.
ACCOUNTING SYSTEM AND 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 assets, liabilities, revenues and expenses of the State Employees' Retirement Trust Fund. Revenues are recognized in the accounting period in which they are earned, without regard to the date of collection, and expenses are recorded when the corresponding liabilities are incurred, regardless of when payment is made. The administrative expenses of the Social Security Contribution Fund are appropriated annually by the Illinois State Legislature and included in the financial statements of the System's Trust Fund. The Contribution Fund uses the modified accrual basis of accounting. The State Employees' Retirement System also uses the State of Illinois, Comptroller's Uniform Statewide Accounting System (CUSAS) 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 operations of the System. Actuarial services are provided by The Wyatt Company, Chicago, Illinois. The annual financial audit of the System was conducted by the accounting firm of Arthur Andersen & Company under the direction of the Auditor General of the State of Illinois. In addition to the annual financial audit, a two year compliance audit was also performed by the auditors. The purpose of the compliance audit was to determine whether the State Employees' Retirement 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.


The Government Finance Officers Association (GFOA) awarded a Certificate of Achievement for Excellence in Financial Reporting to the State Employees' Retirement System of Illinois for its component unit financial report for the fiscal year ended June 30, 1987. This was the second consecutive year that the System has received this prestigious award. In order to be awarded this certificate, a governmental unit must publish an easily readable and efficiently organized component unit financial report, in which the contents conform to program standards. Such reports must satisfy both generally accepted accounting principles and applicable legal requirements. A certificate of achievement is valid for a period of one year only. We believe our current report continues to conform to the Certificate of Achievement Program's requirements, and we are submitting it to the GFOA to determine its eligibility for another certificate.

The preparation of this report reflects the combined efforts of the System's staff under the direction of the Retirement Board. 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 as a means for determining responsible stewardship for the assets contributed to 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 assure the successful operation of the System.

Respectfully submitted,


Michael L. Mory
Executive Secretary


Nicholas C. Merrill, Jr.
Chief Fiscal Officer



December 15, 1988

To All Members, — State Employees' Retirement System of Illinois:

It is with mixed feelings that I report on the progress that was made during the spring session of the General Assembly to address long-term actuarial funding of the Retirement System. Senate Bill 1470 was passed which provided for funding of the System on an actuarial basis. The unfunded liability as of June 30, 1988 is \$1.260 billion. The bill mandated that this be funded over a period of 40 years as a level percentage of active payroll. It is interesting to note that this legislation received almost unanimous approval from both houses. Efforts to secure funding for the new legislation through implementation of an increase in the state income tax were unsuccessful leaving no practical way to meet the mandate of the legislation during fiscal year 1989. Based on a failure to be able to fund the new legislation, the possibilities of a gubernatorial veto appeared likely. Fortunately, the Governor took a slightly different tack by exercising his amendatory veto power to postpone the implementation date to FY-90. To our disappointment; however, the amendatory veto was not accepted by the General Assembly during the fall 1988 veto session.

Failure to secure passage of a tax increase also eliminated any possibility of securing the benefit improvements endorsed by the System, such as increasing the basic pension formula and compounding the 3% cost of living allowance. It is unfortunate that the new funding legislation was considered based solely on the current benefit structure. We believe, based on comparison studies done with surrounding states, that the System's benefit proposals are totally justified. It must be recognized that without additional revenues, these improvements will not become a reality.

Although unimpressive in an absolute sense, the total rate of return on System investments for FY-88 was a positive 2.5%. In view of events which took place in the financial markets during October 1987, the end result is favorable on a comparative basis. The Illinois State Board of Investment invests nearly \$2.4 billion for the System using the "prudent person rule". This means that they are required to make investments that they believe would provide a fair return over a long period of time based upon the degree of risk incurred. This requirement is met through diversification of the investment portfolio as opposed to attempting to time favorable market sectors. As a result, during October 1987, the System was not involved in the massive sell-off which further depressed market values. While it is hoped that we will not see a repeat of this turbulent condition in the financial markets, it certainly did provide a reminder that, over the long run we cannot expect to make up for inadequate employer contributions through excess investment returns.

Another area of continuing concern involves the ever increasing number of mandates which flow from the federal government. The most current example is the requirement that retirement benefits be paid to active employees in the year following attainment of age 70½. While this change came about as a result of perceived abuses of the federal tax laws, it mandates a situation which has always been considered improper for governmental employees, i.e. receiving salary and a pension at the same time. This point notwithstanding, our ability to comply with these mandates is severely restricted since any change to the Retirement Plan requires approval of legislation by the General Assembly. During this past year, a proposal was offered to allow the state-financed retirement systems to comply with federal mandates on an administrative basis. This proposal was not approved as it was thought to be an improper delegation of legislative authority. While we can appreciate the concern, this or similar authority should be considered in the future to prevent the assessment of penalties by the federal government against the System or its members due to compliance failures.

During March of this year, the System's Board of Trustees took initial action to approve the construction of a permanent office facility for the Retirement System. Since its inception in 1944, the System has rented office space in several locations. For the past nine years we have leased space from the

Teachers' Retirement System. With rental costs continually increasing, currently exceeding \$200,000 per year, the Board has determined that leasing is not a cost effective option in the future. The new facility, which will be constructed in Springfield at the intersections of Greenbriar Boulevard and Veterans Parkway, is designed to meet the needs of the System for at least the next 30 years. Long-term savings from the project considering other investment alternatives, are expected to exceed \$1.7 million.

During the past fiscal year several projects were initiated to provide more timely and accurate services for the System's membership. These projects included the development of an overall disaster plan for the Retirement System, including offsite storage and a backup data processing facility, and the development of a video tape program by the Field Services Division for presentation during benefit seminars. The video tape provides a broad perspective of the benefits available to the membership and is part of the ongoing goal to provide more education and assistance to the membership and beneficiaries of the System. On a continuing basis, each division within the System has worked towards a more automated and streamlined operating system through the use of computers while still providing personal service to members. Projects for Fiscal Year 1989 include a review of the existing employer contribution system, establishment of a data base for Field Services personnel, continued emphasis on the automation of internal reports and the location of members who are currently in an inactive account status.

While not all of our goals and objectives were met during the past fiscal year, significant accomplishments did occur. I believe that with the active support of the membership, this momentum can be maintained or even accelerated in the future. At the close of this very eventful fiscal year, I wish to thank the other members of the Board and staff for their dedication and service to the members and beneficiaries of the State Employees' Retirement System.

Respectfully submitted,



Kenneth W. Obrecht
Chairman



BOARD OF TRUSTEES

Seated, left to right, **DORIS M. CLARK**, Elected Annuitant — **KENNETH OBRECHT**, Chairman, Appointed by the Governor — **ALICE KIRBY**, Representing Roland W. Burris, Comptroller — Standing — **MICHAEL L. MORY**, Executive Secretary — **WILLIAM LEDBETTER**, Representing Robert L. Mandeville, Director, Bureau of the Budget — **JOSEPH T. PISANO**, State Employee, Appointed by the Governor — **DENNIS PATRICK**, Elected State Employee — **J. WAYNE CHAMBERS**, Annuitant, Appointed by the Governor.

ADMINISTRATIVE STAFF

MICHAEL L. MORY
Executive Secretary

ROBERT V. KNOX
Associate Executive Secretary

TERRY E. RADLIFF
Internal Auditor

BARBARA BAIRD
Manager, Chicago Division

MICHAEL K. BLANKENSHIP
Manager, Social Security Division

PATRICK P. CUMMINGS
Manager, Claims Division

DWIGHT N. GARMON
Manager, Data Processing Division

JOSEPH S. MAGGIO
Manager, Service and Refunds Division

NICHOLAS C. MERRILL, JR.
Manager, Accounting Division

WILLIAM T. WEIR
Manager, Administrative Services Division



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

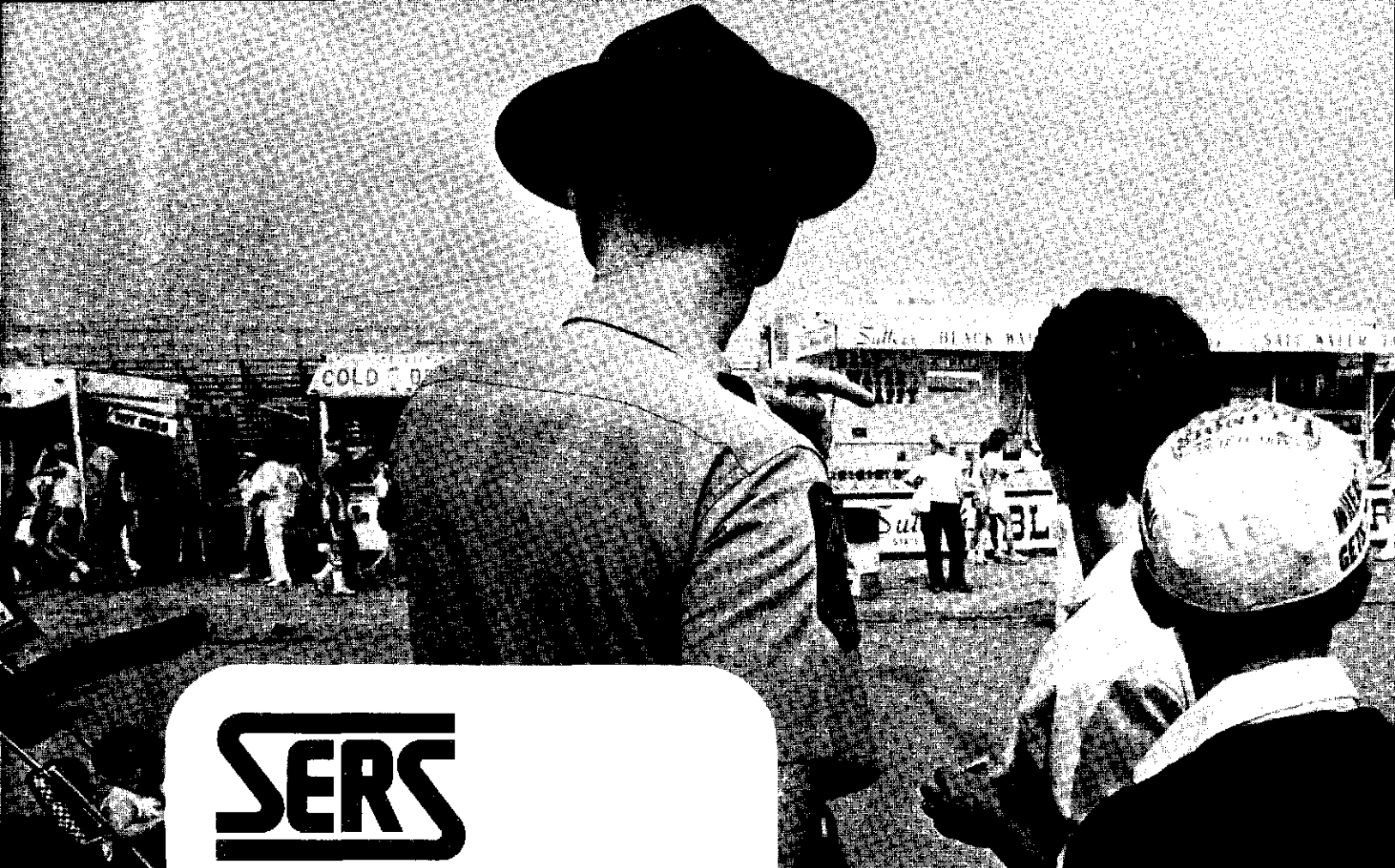
June 30, 1987

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.



President

Executive Director



SERS

ARTHUR ANDERSEN & CO.

CHICAGO, ILLINOIS

Honorable Robert G. Cronson
Auditor General
State of Illinois

Board of Trustees
State Employees' Retirement
System of Illinois

We have examined the financial statements of the STATE EMPLOYEES' RETIREMENT SYSTEM OF ILLINOIS as of and for the years ended June 30, 1988 and 1987, as listed in the table of contents. Our examinations were made in accordance with generally accepted auditing standards and the standards for financial audits contained in the U.S. General Accounting Office's Standards for Audits of Governmental Organizations, Programs, Activities and Functions and, accordingly, included such tests of the accounting records and such other auditing procedures as we considered necessary in the circumstances.

In our opinion, the financial statements referred to above present fairly the financial position of the State Employees' Retirement System of Illinois as of June 30, 1988 and 1987, and the results of its operations and the changes in its financial position for the years then ended, in conformity with generally accepted accounting principles applied on a consistent basis.

Our examinations were made for the purpose of forming an opinion on the financial statements taken as a whole. The statements of supplementary financial information listed in the table of contents are presented for purposes of additional analysis and are not a required part of the basic financial statements of the State Employees' Retirement System of Illinois. The supplementary financial information has been subjected to the auditing procedures applied in our examinations of the basic financial statements and, in our opinion, is fairly stated in all material respects in relation to the financial statements taken as a whole.


ARTHUR ANDERSEN & CO.

October 14, 1988



STATE EMPLOYEES' RETIREMENT SYSTEM OF ILLINOIS

Combined Balance Sheets • June 30, 1988 and 1987

| Assets | 1988 | 1987 |
|--|------------------------|-------------------------|
| Cash | \$ 9,893,839 | \$ 5,977,771 |
| Cash, restricted for Social Security remittances | 2,252,064 | 4,334,906 |
| Receivables: | | |
| Contributions receivable: | | |
| Participants | 3,937,685 | 4,506,275 |
| Employing state agencies | 2,454,280 | 5,269,062 |
| Other accounts receivable | 539,128 | 414,451 |
| | <u>\$ 6,931,093</u> | <u>\$ 10,189,788</u> |
| Investments - held in the Illinois State Board of Investment Commingled Fund at cost (Market value: 1988, \$2,485,230,297 1987, \$2,416,626,806) (Note 4) | 2,367,063,722 | 2,211,906,317 |
| Property and equipment, net of accumulated depreciation (Notes 9 and 12) | <u>823,484</u> | <u>168,785</u> |
| Total Assets | <u>\$2,386,964,202</u> | <u>\$2,232,577,567</u> |
| Liabilities and Fund Balance | | |
| Benefits payable | \$ 1,476,752 | \$ 1,144,997 |
| Refunds payable | 375,069 | 223,318 |
| Administrative expenses payable (Note 8) | 409,660 | 411,370 |
| Participants' deferred service credit accounts | 644,591 | 579,830 |
| Unremitted Social Security contributions | 1,822,858 | 4,037,829 |
| Amounts held for Social Security remittances | <u>429,206</u> | <u>297,077</u> |
| Total Liabilities | <u>\$ 5,158,136</u> | <u>\$ 6,694,421</u> |
| Fund Balance | | |
| Actuarially determined accrued benefit cost (Notes 6 and 14) | 3,641,579,030 | 3,361,722,501 |
| Less unfunded accrued benefit cost representing an obligation of the State of Illinois | <u>1,259,772,964</u> | <u>1,135,839,355</u> |
| Total Fund Balance (Note 13) | <u>\$2,381,806,066</u> | <u>\$ 2,225,883,146</u> |
| Total Liabilities and Fund Balance | <u>\$2,386,964,202</u> | <u>\$2,232,577,567</u> |

See accompanying notes to financial statements.



STATE EMPLOYEES' RETIREMENT SYSTEM OF ILLINOIS
State Employees' Retirement System Trust Fund
Statements of Revenue, Expenses and Changes in Fund Balance
Years ended June 30, 1988 and 1987

| | 1988 | 1987 |
|--|-------------------------|-------------------------|
| Revenue: | | |
| Contributions: | | |
| Participants | \$ 95,928,239 | \$ 90,096,279 |
| Employing State agencies and appropriations | <u>99,990,922</u> | <u>109,559,940</u> |
| Total Contributions revenue | 195,919,161 | 199,656,219 |
| Investments: | | |
| Net investments income | 132,301,594 | 119,922,351 |
| Interest earned on cash balances | 644,652 | 725,599 |
| Net realized gain on sale of investments | <u>15,855,811</u> | <u>106,281,653</u> |
| Total Investments revenue | <u>148,802,057</u> | <u>226,929,603</u> |
| | 344,721,218 | 426,585,822 |
| General Revenue Fund appropriations, less balances lapsed | <u>127,288</u> | <u>168,326</u> |
| Total Revenue | <u>344,848,506</u> | <u>426,754,148</u> |
| Expenses: | | |
| Benefits: | | |
| Retirement annuities | 132,265,411 | 119,758,023 |
| Survivors' annuities | 20,319,659 | 18,955,079 |
| Disability benefits | 14,660,199 | 14,521,296 |
| Lump-sum death benefits | <u>6,399,280</u> | <u>6,379,930</u> |
| | 173,644,549 | 159,614,328 |
| Refunds | 11,983,814 | 12,177,841 |
| Administrative expense, System Trust Fund (Note 8) | 3,169,935 | 3,000,932 |
| Transfers to reciprocating retirement systems | <u>-</u> | <u>4,258</u> |
| | 188,798,298 | 174,797,359 |
| Administrative expense, Contribution Fund (Note 8) | <u>127,288</u> | <u>168,326</u> |
| Total Expenses | <u>188,925,586</u> | <u>174,965,685</u> |
| Excess of revenue over expenses | \$ <u>155,922,920</u> | \$ <u>251,788,463</u> |
| Fund Balance at beginning of year | <u>2,225,883,146</u> | <u>1,974,094,683</u> |
| Fund Balance at end of year | <u>\$ 2,381,806,066</u> | <u>\$ 2,225,883,146</u> |

See accompanying notes to financial statements.



STATE EMPLOYEES' RETIREMENT SYSTEM OF ILLINOIS

State Employees' Retirement System Trust Fund Statements of Changes in Financial Position

Years ended June 30, 1988 and 1987

| | 1988 | 1987 |
|---|-------------------|---------------------|
| Sources of working capital: | | |
| Working capital provided by operations — excess of revenue over expenses | \$ 155,922,920 | \$ 251,788,463 |
| Add (Deduct) items not providing working capital — net realized (gain) on sale of investments | (15,855,811) | (106,281,653) |
| reinvested earnings | (132,301,594) | (119,922,351) |
| Depreciation expense | 51,354 | 35,657 |
| Other | 7,070 | 4,923 |
| Total sources of working capital | <u>7,823,939</u> | <u>25,625,039</u> |
| Uses of working capital: | | |
| Amounts transmitted by SERS for investment purchases (net) | 7,000,000 | 26,000,000 |
| Additions to fixed assets | 713,123 | 84,449 |
| Total uses of working capital | <u>7,713,123</u> | <u>26,084,449</u> |
| Net (decrease) in working capital | <u>\$ 110,816</u> | <u>\$ (459,410)</u> |
| Elements of net (decrease) in working capital: | | |
| Cash | \$ 3,916,068 | \$ (1,641,038) |
| Receivables | (3,258,695) | 1,258,171 |
| Benefits payable | (331,755) | 174,497 |
| Refunds payable | (151,751) | (85,030) |
| Administrative expenses payable | 1,710 | (33,055) |
| Participants' deferred service credit accounts | (64,761) | (132,955) |
| Net increase (decrease) in working capital | <u>\$ 110,816</u> | <u>(459,410)</u> |

See accompanying notes to financial statements.

STATE EMPLOYEES' RETIREMENT SYSTEM OF ILLINOIS

Notes to Financial Statements

June 30, 1988 and 1987

(1) Reporting Entity

The State Employees' Retirement System of Illinois (System) is a component unit of the State of Illinois and is composed of the State Employees' Retirement System, a trust fund (System Trust Fund) and the Social Security Contribution Fund, an agency fund (Contribution Fund). The System Trust Fund and the Contribution Fund are considered part of the State of Illinois financial reporting entity and are included in the state's comprehensive annual financial report as a pension trust fund and an agency fund, respectively.

The System has developed criteria to determine whether other state agencies, boards or commissions which benefit the members of the System should be included within its financial reporting entity. The criteria include, but are not limited to, whether the System exercises oversight responsibility on financial interdependency, selection of governing authority, designation of management, ability to significantly influence operations and accountability for fiscal matters, scope of public service and special financing relationships.

Based primarily upon the criteria of financial interdependency and ability to significantly influence operations and accountability for fiscal matters, the System has included the Social Security Contribution Fund in its combined financial statements.

(2) Plan Description

The System is the administrator of single-employer public employee retirement system (PERS) established and administered by the State of Illinois to provide pension benefits for its employees. At June 30, 1988 and 1987, the number of participating state agencies, boards and commissions totalled:

| | 1988 | 1987 |
|------------------------------|-----------|-----------|
| State agencies | 42 | 42 |
| State boards and commissions | 46 | 45 |
| Total | <u>88</u> | <u>87</u> |

At June 30, 1988 and 1987, the System Trust Fund membership consisted of:

| | 1988 | 1987 |
|----------------------------------|---------------|---------------|
| Retirees and beneficiaries | | |
| currently receiving benefits: | | |
| Retirement annuities | 23,038 | 22,529 |
| Survivors' annuities | 8,296 | 8,015 |
| Disability benefits | 1,536 | 1,577 |
| | <u>32,870</u> | <u>32,121</u> |
| Inactive employees entitled | | |
| to benefits but not yet | | |
| receiving them | <u>2,262</u> | <u>2,129</u> |
| Total | <u>35,132</u> | <u>34,250</u> |
| Current Employees: | | |
| Vested: | | |
| Coordinated with Social Security | 34,901 | 32,567 |
| Noncoordinated | 8,652 | 9,185 |
| Nonvested: | | |
| Coordinated with Social Security | 30,236 | 31,997 |
| Noncoordinated | 1,134 | 983 |
| Total | <u>74,923</u> | <u>74,732</u> |

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

(a) Eligibility and Membership

Membership is automatic for most state employees who are not eligible for another state-sponsored retirement plan. All persons entering state service, except those in positions subject to membership in other state sponsored retirement systems, persons employed after June 30, 1979 as public service employment program participants under the Federal CETA program, and enrollees in the Illinois Young Adult Conservation Corps, become members of the System upon completion of six months service. Employees appointed by the Governor and requiring confirmation by the State of Illinois Senate may elect to become members of the System Trust Fund.

(b) Contributions

Participating members contribute specified percentages of their salaries for retirement annuities and survivors' annuities. Contributions are excluded from gross income for Federal and State income tax purposes. The total contribution rate is 4% if the member is coordinated with Social Security and 8% if the member is not coordinated. Certain employment categories which are eligible for benefits under alternative formulas contribute at the rate of 5½% or 9½% depending upon whether or not the employee is coordinated with 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 contributions, all allowances, annuities, any benefits granted under Article 14 of the Illinois Pension Code (Code) and all administrative expenses of the System Trust Fund to the extent specified in the Code.

(c) Benefits

The System is governed by Article 14 of the Code. Vesting and benefit provisions under the System Trust Fund are defined in the Code. Employees who retire at or after age 60 with 8 years of credited service (or at age 55 with at least 30 years of credited service with reduced benefits) are entitled to an annual retirement benefit, payable monthly for life, in an amount based upon final average compensation and credited service. Employees with 35 years of credited service may retire at any age with full benefits. Final average compensation for retirement and survivor 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.

Occupational and nonoccupational (including temporary) disability benefits are available through the System Trust Fund. To be eligible for nonoccupational (including temporary) disability benefits, an employee must have at least eighteen months of credited service with the System Trust Fund and be less than seventy years old. 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 from the date of employment provided that the member is under age 70 and 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 Trust Fund. Certain nonoccupational death benefits vest after eighteen months of credited service. Occupational death benefits are provided from the date of employment.

(3) Description of the Contribution Fund

The Contribution Fund was established pursuant to the 1951 Social Security Enabling Act, Article 21 of the Illinois Pension Code. It is a special fund in the State Treasury which serves as a clearinghouse account for the collection and transmittal of federal Social Security contributions of participating state employees and employing agencies and political subdivisions.

Effective January 1, 1987, the responsibility for the collection and transmittal of Social Security contributions for state agencies and participating state employees was transferred from the System to the Office of the Comptroller of the State of Illinois. As of that same date, political subdivisions of the state became responsible for their own remittance of Social Security contributions to the federal government. The balances in this fund are being maintained for final settlement of open years.

(4) Summary of Significant Accounting Policies and Plan Asset Matters

(a) Basis of Accounting — System Trust Fund

The financial transactions of the System Trust Fund are recorded on the accrual basis of accounting and

in conformity with generally accepted accounting principles. Employee and employer contributions are recognized as revenues in the period in which employee services are performed.

The System Trust Fund also recognizes revenue representing supplemental state funding on an accrual basis. This funding is the result of reduced appropriations to the System for the year ended June 30, 1983. The amount of the reduction in that period amounted to \$11,000,000. The state has agreed to repay the under appropriation and interest at the rate of six percent over the succeeding five fiscal years. The System has not recorded the unpaid amounts as an asset because repayment in any given year is subject to state appropriation of funds, which is subject to numerous conditions. Consequently, repayment of principal and interest are recognized in the current year once the legislature has approved an amount to be provided to the System Trust Fund. Final payment of the under funding is recognized as revenue in the FY-88 financial statements.

(b) Method Used to Value Investments

The System Trust Fund retains all of its available cash in a commingled investment pool managed by the Treasurer of the State of Illinois. "Available cash" is determined to be that amount which is required for the current operating expenditures of the System Trust Fund. The excess of available cash is transferred to the Illinois State Board of Investment (ISBI) for purposes of long-term investment for the System Trust Fund.

Investments are managed by the ISBI pursuant to Article 22A of the Illinois Pension Code and are maintained in the ISBI Commingled Fund. Such investments are valued at the cost of the System Trust Fund's units of participation in the ISBI Commingled Fund. Units of the ISBI Commingled Fund are issued to the member systems on the last day of the month based on the unit net asset value calculated as of that date. Net investment income of the ISBI Commingled Fund is allocated to each of the member systems on the last day of the month on the basis of percentage of accumulated units owned by the respective systems. Management expenses are deducted monthly from income before distribution. Investment income is recognized when earned.

The investment authority of the ISBI is provided in Illinois Revised Statutes Chapter 108-½, Article 22A-112. 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.

Governmental Accounting Standards Board (GASB) Statement No. 3 entitled "Deposits with Financial Institutions, Investments (including Repurchase Agreements), and Reverse Repurchase Agreements" requires certain financial statement disclosure of deposits and investments, such as the disclosure of carrying amounts by type of investment and classification into one of three categories based upon credit risk. Investments in pools managed by other governmental agencies, in general, are to be disclosed but not categorized because they are not evidenced by securities that exist in physical or book entry form.

The System Trust Fund 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 (either internal or external). 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 agent of the master custodian is Depository Trust Company.