

**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, 1997**

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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INTRODUCTORY SECTION

- Letter of Transmittal
- Administration, Board of Trustees and Administrative Staff
- Certificate of Achievement for Excellence in Financial Reporting



- State Employees' Retirement System of Illinois
- General Assembly Retirement System
- Judges' Retirement System of Illinois

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

December 1, 1997

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, 1997 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 and the Certificate of Achievement for Excellence in Financial Reporting;
2. The Financial Section which contains the report of the Independent Auditors, the financial statements of the System, and certain required and other supplementary financial information;
3. The Actuarial Section which contains an Actuary's Certification Letter and the results of the annual actuarial valuation;
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 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; 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 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, 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. 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 AND 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 non-occupational 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, 1997 are approximately \$6.0 billion, and there are 79,697 active members.

ADDITIONS TO PLAN NET ASSETS

The collection of employer and employee retirement contributions, as well as income from investments, provide the reserves necessary to finance retirement benefits. These revenue sources totaled \$1,256.5 million during the fiscal year ending June 30, 1997, which is a significant increase from revenue reported for fiscal year 1996, shown as follows:

	1997 (Millions)	1996 (Millions)	Increase / (Decrease)	
			(Millions)	(Percentage)
Contributions:				
Employees	\$ 145.7	\$ 137.2	\$ 8.5	6.2%
Employer	158.2	146.4	11.8	8.1
Investments	952.6	736.2	216.4	29.4
	<u>\$1,256.5</u>	<u>\$1,019.8</u>	<u>\$236.7</u>	<u>23.2%</u>

As indicated in the above schedule, approximately 91% of the total revenue increase was attributable to an increase in investment income which was largely the result of significant net appreciation in the fair value of investments.

DEDUCTIONS FROM PLAN NET ASSETS

The primary expense of a retirement system relates to the purpose for which it is created; namely the payment of benefits. These payments, together with the expense to administer the plan, constitute the total expenses of the System. Expenses of the System for 1997 and 1996 are shown for comparison purposes.

	1997 (Millions)	1996 (Millions)	Increase / (Decrease)	
			(Millions)	(Percentage)
Benefits:				
Retirement annuities	\$ 298.4	\$ 286.2	\$ 12.2	4.3%
Survivors' annuities	35.2	33.0	2.2	6.7
Disability benefits	23.8	22.4	1.4	6.3
Lump-sum death benefits	11.3	10.8	.5	4.6
	<u>\$ 368.7</u>	<u>\$ 352.4</u>	<u>\$ 16.3</u>	<u>4.6%</u>
Refunds (including Transfers)	12.7	13.4	(.7)	(5.2)
Administrative expenses	5.7	5.7	-	-
	<u>\$ 387.1</u>	<u>\$ 371.5</u>	<u>\$ 15.6</u>	<u>4.2%</u>

The increase in benefit payments results primarily from an increase in the average benefit payment amount.

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 serves to reduce overall risk and increase returns.

Income from investments has, over the years, increasingly become a greater share of the total revenue of the System. Net investment income, combined with the net appreciation of fair value of investments, amounted to \$952.6 million during fiscal year 1997, an increase of \$216.4 million from fiscal year 1996. Income from investments represents 75.8% of total fund revenue. The Illinois State Board of Investment had an 18.8% rate of return on market values for the year ended June 30, 1997.

A detailed discussion of investment performance and strategies is provided in the Investment Section. Information regarding investment professionals providing services to the ISBI can be found in the separately issued ISBI report. To receive a copy of the ISBI annual financial report, please refer to the address contained in the Investment Section.

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.

Senate Bill 533, which was signed into law by Governor Edgar on August 22, 1994, as Public Act 88-0593, enacted a new funding plan for the System. The financing objective of this funding plan 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 those fiscal years up through 2010, the required state contributions 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. In addition, the funding legislation also provided for the establishment of a continuing appropriation of the required state contributions to the System. This will, in effect, remove 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, 1997, amounted to \$7.548 billion. The actuarial value of assets (at fair value) amounted to \$6.048 billion as of the same date.

A detailed discussion of funding is provided in the Actuarial Section of this report.

MAJOR EVENTS/INITIATIVES

During the past fiscal year, the System has continued its efforts to: enhance the annual member benefit statement; comply with federal mandates; upgrade the documentation of various computer systems; and convert to a new governmental accounting pension reporting standard.

Projects for Fiscal Year 1998 will primarily involve an agency wide effort to implement a new benefit package signed into law by Governor Jim Edgar on July 15, 1997. This new pension legislation will

increase the basic retirement benefits earned by over 62,000 state employees. In addition, several other bills were signed by the Governor and will take effect on or after July 1, 1997. A general description of all recent legislation is contained in the Plan Summary and Legislative Section of this annual report.

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 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. Effective July 1, 1996 the System adopted and has implemented in these financial statements Governmental Accounting Standards Board (GASB) Statement No. 25, Financial Reporting for Defined Benefit Pension Plans and Note Disclosures for Defined Contribution Plans. The 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 operation of the System. Actuarial services are provided by Watson Wyatt Worldwide, Chicago, Illinois. Tax consulting services are provided by the accounting firm of KPMG Peat Marwick, 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 one year compliance audit was also performed by the auditors. The purpose of the compliance audit 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, 1996. 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 eleven consecutive years (fiscal years ended June 30, 1986 through June 30, 1996). 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 AND COMMENTS

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 as a means 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.

On a sad note, Mr. Edward L. Stewart, a SERS Board member for approximately six years, passed away. While on the Board, Mr. Stewart primarily represented the interests of the System's annuitants. He also had a long and distinguished career as a state employee and will be remembered for his dedication to the Board and devotion to the System's membership.

Respectfully submitted,

Michael L. Mory
Michael L. Mory
Executive Secretary

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

Board of Trustees



Loren Iglarsh
Representing Loleta A. Didrickson
Comptroller



Kenneth W. Obrecht
Chairman, appointed
by the Governor



Sharon Ward
Representing Joan Walters
Director of the Bureau of the Budget



Edward L. Stewart
(Deceased)
Annuitant, Appointed
by the Governor



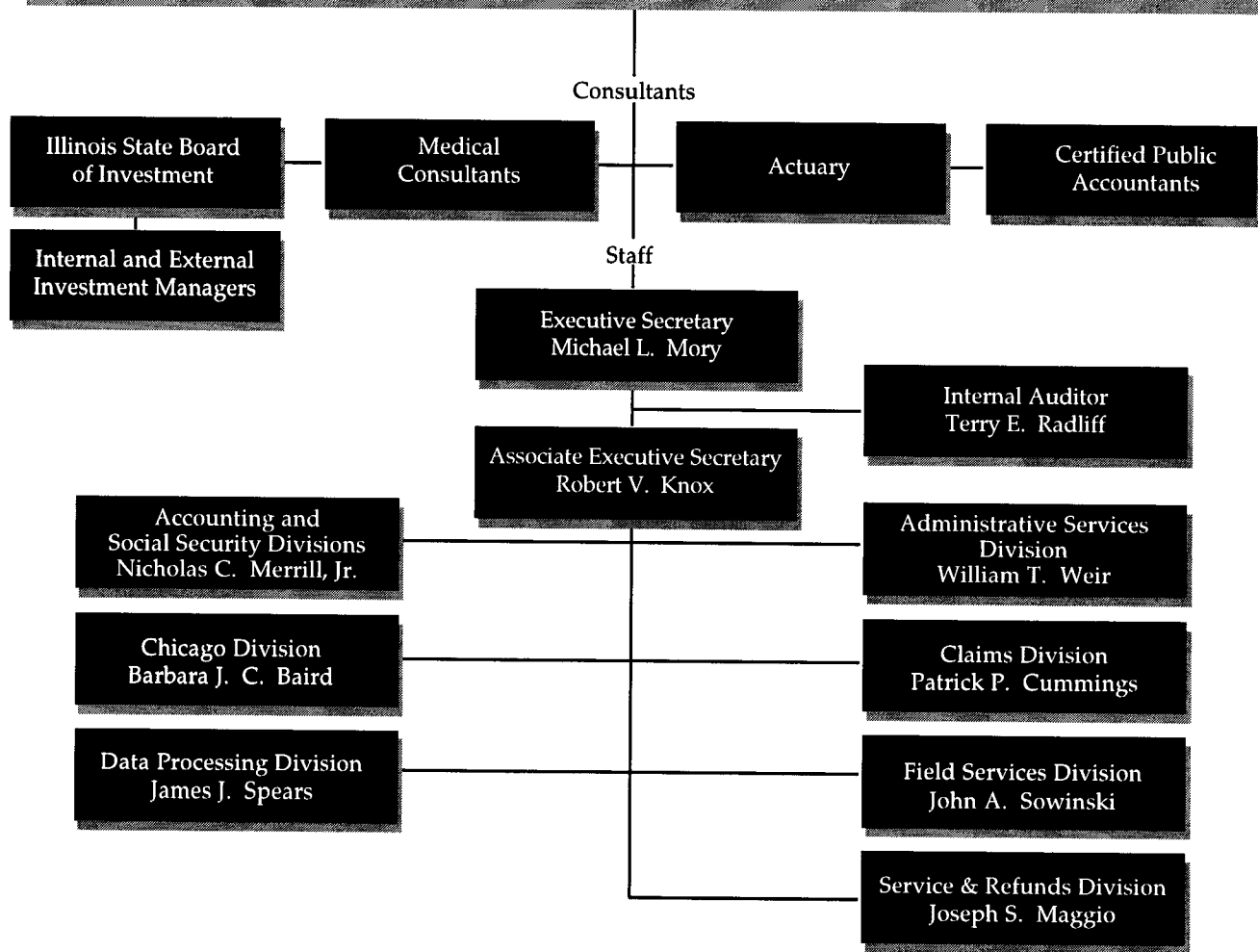
Doris Clark
Elected Annuitant



Caryl Wadley-Foy
Elected Employee



William T. Margalus
State Employee, Appointed
by the Governor



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, 1996

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.



Linda K. Savitsky
President

Jeffrey L. Esler
Executive Director

FINANCIAL SECTION

- Independent Auditor's Report
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