

# STATE EMPLOYEES' RETIREMENT SYSTEM OF ILLINOIS

*A Pension Trust Fund of the State of Illinois*


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## COMPREHENSIVE ANNUAL FINANCIAL REPORT FOR THE FISCAL YEAR ENDED JUNE 30, 2002

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



- 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 217-785-7444

December 20, 2002

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, 2002 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 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, 2002 are approximately \$7.7 billion, and there are 81,680 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 Statutes, 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, this was a most challenging year in virtually all segments of the financial markets.

## 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.

A new funding plan for the System, enacted 1994, 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, 2002, amounted to \$14.3 billion. The unfunded accrued actuarial liability amounted to \$6.6 billion as of the same date. A detailed discussion of funding is provided in the Actuarial Section of this report.

## 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.

## Letter of Transmittal

### MAJOR EVENTS/INITIATIVES

The System's major events/initiatives during the year ended June 30, 2002 included the implementation of new legislation. HB 0250 (P.A. 92-0014) was signed into law by Governor Ryan on June 28, 2001, and affects the benefit calculation of all alternative formula employees. It also brought certain employees of the Department of Human Services under the alternative formula.

In addition, HB 0267 (P.A. 92-0257) became law on August 6, 2001. The main provision of this bill extends benefits of the alternative formula to state highway maintenance workers for the Illinois Department of Transportation and the Illinois State Toll Highway Authority.

Other projects for fiscal year 2002 included: 1. installation of a new general ledger; 2. a new billing system for payroll errors; 3. implementation of the changes resulting from the Economic Growth and Tax Relief Reconciliation Act of 2001; and 4. expansion of field services programs for our membership.

Projects for fiscal year 2003 will primarily involve the implementation of new legislation. HB 2671 (P.A. 92-0566) was signed into law by Governor Ryan on June 25, 2002, and provides for an Early Retirement Incentive (ERI) program for qualified state employees. The law allows a member to purchase up to five years of service and age enhancement. By participating in the ERI, members have two options:

1. If a member meets the ERI retirement eligibility requirement, they may retire by January 1, 2003, using the age and service enhancement.
2. If a member does not meet the ERI requirements at this time, (s)he may purchase ERI service, terminate employment by December 31, 2002, and receive retirement benefits when they become eligible.

## Letter of Transmittal

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. Tax consulting services are provided by the accounting firm of KPMG, LLP, 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, 2001.

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 sixteen consecutive years (fiscal years ended June 30, 1986 through June 30, 2001).

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

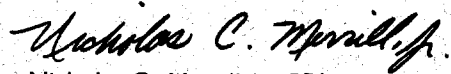
The preparation of this report reflects the combined efforts of the System's staff under the direction of the Board of Trustees. It is intended to provide complete and reliable information as a basis for making management decisions, as a means of determining compliance with legal provisions, and for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

  
Michael L. Mory

Executive Secretary



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

# BOARD OF TRUSTEES



(l to r) seated: **Doris Clark**, (Elected Annuitant, Vice Chairman), **Sharmin S. Doering** (State Employee, Appointed by the Governor), **Caryl Wadley-Foy** (Elected Employee). standing: **Loren Iglarsh** (Representing Daniel W. Hynes, Comptroller) **John Stevens**, (Representing Stephen Schnorf, Director of the Bureau of the Budget), **Mark W. Gallagher**, (Chairman, appointed by the Governor), **Joseph T. Pisano** (Annuitant, Appointed by the Governor).

