

State Employees' Retirement System of the State of Illinois

Compliance Examination

For the Year Ended June 30, 2017
Performed as Special Assistant Auditors for
the Auditor General, State of Illinois



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

Year Ended June 30, 2017

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Financial Statement Report

The System's financial statement report for the year ended June 30, 2017, which includes the independent auditor's report, management's discussion and analysis, basic financial statements and notes, required supplementary information other than management's discussion and analysis, supplementary information, and the independent auditor's report on internal control over financial reporting and on compliance and other matters based on an audit of financial statements performed in accordance with *Government Auditing Standards* has been issued separately.

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

For the Year Ended June 30, 2017

System Officials

Executive Secretary
Accounting Division Manager
Internal Auditor

Timothy B. Blair
Alan Fowler, CPA
Casey Evans

Office Locations

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Springfield, Illinois 62794-9255

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March 30, 2018

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

Ladies and Gentlemen:

We are responsible for the identification of, and compliance with, all aspects of laws, regulations, contracts, or grant agreements that could have a material effect on the operations of the State Employees' Retirement System. We are responsible for and we have established and maintained an effective system of internal controls over compliance requirements. We have performed an evaluation of the System's compliance with the following assertions during the year ended June 30, 2017. Based on this evaluation, we assert that during the year ended June 30, 2017, the State Employees' Retirement System has materially complied with the assertions below.

- A. The State Employees' Retirement System has obligated, expended, received and used public funds of the State in accordance with the purpose for which funds have been appropriated or otherwise authorized by law.
- B. The State Employees' Retirement System has obligated, expended, received and used public funds of the State in accordance with any limitations, restrictions, conditions or mandatory directions imposed by law upon such obligation, expenditure, receipt or use.
- C. The State Employees' Retirement System has complied, in all material respects, with applicable laws and regulations, including the State uniform accounting system, in its financial and fiscal operations.
- D. State revenues and receipts collected by the State Employees' Retirement System are in accordance with applicable laws and regulations and the accounting and recordkeeping of such revenues and receipts is fair, accurate and in accordance with law.
- E. The money or negotiable securities or similar assets handled by the State Employees' Retirement System on behalf of the State or held in trust by the State Employees' Retirement System have been properly and legally administered and the accounting and recordkeeping relating thereto is proper, accurate and in accordance with law.

Yours very truly,

State Employees' Retirement System

SIGNED ORIGINAL ON FILE

Timothy B. Blair, Executive Secretary

SIGNED ORIGINAL ON FILE

Alan Fowler, CPA, Accounting Division Manager

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

Year Ended June 30, 2017

Compliance Report

Summary

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

Accountant's Report

The Independent Accountant's Report on State Compliance, on Internal Control Over Compliance, and on Supplementary Information for State Compliance Purposes does not contain scope limitations, disclaimers or other significant non-standard language.

Summary of Findings

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

Schedule of Findings

Item No.	Page	Description	Finding Type
FINDINGS (STATE COMPLIANCE)			
2017-001	10	Change Management Weaknesses	Noncompliance and Significant Deficiency
2017-002	11	Board of Trustees Vacancy	Noncompliance and Significant Deficiency
2017-003	12	Monitoring of Contracts	Noncompliance and Significant Deficiency
PRIOR FINDINGS NOT REPEATED			
A	13	Noncompliance with the Fiscal Control and Internal Auditing Act	

Exit Conference

System officials elected to waive a formal exit conference in correspondence dated February 15, 2018. The responses to the recommendations were provided by Casey Evans, Internal Auditor, in correspondence dated March 5, 2018.

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

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

Compliance

As Special Assistant Auditors for the Auditor General, we have examined the State Employees' Retirement System of the State of Illinois' (System) compliance with the requirements listed below, as more fully described in the Audit Guide for Financial Audits and Compliance Attestation Engagements of Illinois State Agencies (Audit Guide) as adopted by the Auditor General, during the year ended June 30, 2017. The management of the System is responsible for compliance with these requirements. Our responsibility is to express an opinion on the System's compliance based on our examination.

- A. The System has obligated, expended, received, and used public funds of the State in accordance with the purpose for which such funds have been appropriated or otherwise authorized by law.
- B. The System has obligated, expended, received, and used public funds of the State in accordance with any limitations, restrictions, conditions or mandatory directions imposed by law upon such obligation, expenditure, receipt or use.
- C. The System has complied, in all material respects, with applicable laws and regulations, including the State uniform accounting system, in its financial and fiscal operations.
- D. State revenues and receipts collected by the System are in accordance with applicable laws and regulations and the accounting and recordkeeping of such revenues and receipts is fair, accurate and in accordance with law.
- E. Money or negotiable securities or similar assets handled by the System on behalf of the State or held in trust by the System have been properly and legally administered and the accounting and recordkeeping relating thereto is proper, accurate, and in accordance with law.

Our examination was conducted in accordance with attestation standards established by the American Institute of Certified Public Accountants; the standards applicable to attestation engagements contained in *Government Auditing Standards* issued by the Comptroller General of the United States; the Illinois State Auditing Act (Act); and the Audit Guide as adopted by the Auditor General pursuant to the Act (the Audit Guide). Those standards, the Act, and the Audit Guide require that we plan and perform the examination to obtain reasonable assurance about whether the System complied, in all material respects, with the specified requirements listed above. An examination involves performing procedures to obtain evidence about whether the System complied with the specified requirements listed above. The nature, timing and extent of the procedures selected depend on our judgement, including an assessment of the risks of material noncompliance, whether due to fraud or error.

We believe that the evidence we obtained is sufficient and appropriate to provide a reasonable basis for our opinion. Our examination does not provide a legal determination on the System's compliance with specified requirements.

In our opinion, the System complied, in all material respects, with the compliance requirements listed in the first paragraph of this report during the year ended June 30, 2017. However, the results of our procedures disclosed instances of noncompliance with the requirements, which are required to be reported in accordance with criteria established by the Audit Guide, issued by the Illinois Office of the Auditor General and which are described in the accompanying schedule of findings as items 2017-001, 2017-002 and 2017-003.

The System's responses to the findings identified in our examination are described in the accompanying schedule of findings. The System's responses were not subjected to the procedures applied in the compliance examination and, accordingly, we express no opinion on the responses.

The purpose of this report on compliance is solely to describe the scope of our testing and the results of that testing in accordance with the requirements of the Audit Guide issued by the Illinois Office of the Auditor General. Accordingly, this report is not suitable for any other purpose.

Internal Control

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

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

Our consideration of internal control over compliance was for the limited purpose described in the first paragraph of this section and was not designed to identify all deficiencies in internal control over compliance that might be material weaknesses or significant deficiencies and therefore, material weaknesses or significant deficiencies may exist that were not identified. We did not identify any deficiencies in internal control over compliance that we consider to be material weaknesses. However, we identified certain deficiencies in internal control over compliance, as described in the accompanying schedule of findings as items 2017-001, 2017-002 and 2017-003 that we consider to be significant deficiencies.

There were no immaterial findings that have been excluded from this report.

The System's responses to the internal control findings identified in our examination are described in the accompanying schedule of findings. The System's responses were not subjected to the procedures applied in the compliance examination and, accordingly, we express no opinion on the responses.

The purpose of this report on internal control over compliance is solely to describe the scope of our testing of internal control over compliance and the results of that testing based on the requirements of the Audit Guide, issued by the Illinois Office of the Auditor General. Accordingly, this report is not suitable for any other purpose.

Supplementary Information for State Compliance Purposes

As Special Assistant Auditors for the Auditor General, we have audited and issued under separate cover the Statement of Fiduciary Net Position of the System as of June 30, 2017 and the Statement of Changes in Fiduciary Net Position for the year then ended, and have issued our report thereon dated January 19, 2018, which contained an unmodified opinion on those financial statements. Our audit was conducted for the purpose of forming an opinion on the financial statements that collectively comprise the System's basic financial statements. We did not audit the 2017 financial statements of the Illinois State Board of Investment, an internal investment pool of the State of Illinois, which statements represent 98 percent, 99 percent and 47 percent, respectively, of total assets, net position restricted for pension benefits, and total additions to the System. Those financial statements were audited by other auditors whose report thereon has been furnished to us, and our opinion, insofar as it relates to the amounts included for the Illinois State Board of Investment is based solely on the report of the other auditors. We have not performed any procedures with respect to the audited financial statements subsequent to January 19, 2018. The accompanying supplementary information for State compliance purposes in Schedules 1 through 7, for the year ended June 30, 2017 is presented for purposes of additional analysis and is not a required part of the basic financial statements of the System. Such information is the responsibility of management and was derived from and relates directly to the underlying accounting and other records used to prepare the basic financial statements. The accompanying supplementary information for State compliance purposes in Schedules 1 through 7 for the year ended June 30, 2017 has been subjected to the auditing procedures applied in the audit of the basic financial statements and certain additional procedures, including comparing and reconciling such information directly to the underlying accounting and other records used to prepare the basic financial statements or to the basic financial statements themselves, and other additional procedures in accordance with auditing standards generally accepted in the United States of America. In our opinion, the accompanying supplementary information for State compliance purposes in Schedules 1 through 7 for the year ended June 30, 2017 is fairly stated in all material respects in relation to the basic financial statements as a whole for the year ended June 30, 2017.

We also have previously audited, in accordance with auditing standards generally accepted in the United States of America, the System's basic financial statements as of and for the year ended June 30, 2016 (not presented herein), and have issued our report thereon dated January 4, 2017, which contained an unmodified opinion on those basic financial statements. We did not audit the 2016 financial statements of the Illinois State Board of Investment, an internal investment pool of the State of Illinois, which statements represent 97 percent, 98 percent and (6) percent respectively of total assets, net position restricted for pension benefits, and total additions of the System. Those financial statements were audited by other auditors whose report thereon has been furnished to us, and our opinion, insofar as it relates to the amounts included for the Illinois State Board of Investment is based solely on the report of other auditors. The accompanying supplementary information for the year ended June 30, 2016 in Schedules 2 through 7 is the responsibility of management and was derived from and relates directly to the underlying accounting and other records used to prepare the June 30, 2016 financial statements. The accompanying supplementary information for the year ended June 30, 2016 in Schedules 2 through 7 has been subjected to the auditing procedures applied in the audit of the June 30, 2016 basic financial statements and certain additional procedures, including comparing and reconciling such information directly to the underlying accounting and other records used to prepare those basic financial statements or to those basic financial statements themselves, and other additional procedures in accordance with auditing standards generally accepted in the United States of America. In our opinion, the accompanying supplementary information for the year ended

June 30, 2016 in Schedules 2 and 4 through 7 is fairly stated in all material respects in relation to the basic financial statements as a whole from which it has been derived.

The System's basic financial statements as of and for the year ended June 30, 2015 (not presented herein), were audited by other auditors whose report thereon dated December 18, 2015, expressed an unmodified opinion on the basic financial statements. The report of other auditors dated December 18, 2015 stated that the accompanying supplementary information for State compliance purposes for the year ended June 30, 2015 in Schedule 2 was subjected to the auditing procedures applied in the audit of the June 30, 2015 basic financial statements and certain additional auditing procedures, including comparing and reconciling such information directly to the underlying accounting and other records used to prepare those basic financial statements or to those basic financial statements themselves, and other additional procedures in accordance with auditing standards generally accepted in the United States of America and, in their opinion, was fairly stated in all material respects in relation to the basic financial statements as a whole for the year ended June 30, 2015.

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

SIGNED ORIGINAL ON FILE

Schaumburg, Illinois
March 30, 2018, except for our report on the Supplementary Information
for State Compliance Purposes, as to which the date is
January 19, 2018



RSM US LLP

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

Honorable Frank J. Mautino
Auditor General

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

As Special Assistant Auditors for the Auditor General, we have audited, in accordance with the auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards* issued by the Comptroller General of the United States, the financial statements of the State Employees' Retirement System of the State of Illinois (System), as of and for the year ended June 30, 2017, and the related notes to the financial statements, which collectively comprise the System's basic financial statements as listed in the table of contents and have issued our report thereon dated January 19, 2018. Our report includes a reference to other auditors who audited the financial statements of the Illinois State Board of Investment, an internal investment pool of the State of Illinois, as described in our report on the System's financial statements. This report does not include the results of the other auditors' testing of internal control over financial reporting or compliance and other matters that are reported on separately by those auditors.

Internal Control Over Financial Reporting

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

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

Our consideration of internal control was for the limited purpose described in the first paragraph of this section and was not designed to identify all deficiencies in internal control that might be material weaknesses or significant deficiencies. Given these limitations, during our audit we did not identify any deficiencies in internal control that we consider to be material weaknesses. However, material weaknesses may exist that have not been identified.

Compliance and Other Matters

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

Purpose of this Report

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

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Schaumburg, Illinois
January 19, 2018

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

Schedule of Findings - State Compliance

Year Ended June 30, 2017

Finding No. 2017-001 Change Management Weaknesses

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

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

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

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

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

The lack of adequate change control procedures increases the risk that unauthorized changes are put into production that could compromise system integrity and data. (Finding Code No. 2017-001, 2016-002)

Recommendation:

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

System Response:

The System accepts the finding. IT management is working to implement an upgrade to existing software in calendar year 2018 which will remedy the change management weaknesses noted.

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

Schedule of Findings - State Compliance (Continued)

Year Ended June 30, 2017

Finding No. 2017-002 Board of Trustees Vacancy

The State Employees' Retirement System of the State of Illinois (System) has had a vacancy in one of its thirteen required trustees of the Board for more than two years as of the end of fieldwork on November 17, 2017.

During the current compliance examination, the auditors noted that a Board member resigned from the Board on October 15, 2015. The System's Executive Secretary informed the Board of the resignation on that same day. In addition, on November 4, 2015 the Executive Secretary communicated this vacancy to the Governor's Office via email requesting that the vacancy be filled. As of the end of fieldwork on November 17, 2017 the vacancy had not been filled and there has been no further follow-up communications with the Governor's Office by the System.

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

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

System officials stated the Executive Secretary communicated with the Governor's Office requesting appointment of a new member to fill the vacancy at the time the vacancy occurred and has not yet received an official response. Further, System officials stated the System Board has been able to establish a quorum and conduct the business of the System for every meeting held in fiscal year 2017.

Failure to operate with the full thirteen members of the Board of Trustees could impact the Board's ability to establish a quorum and timely conduct the business of the System. (Finding Code No. 2017-002, 2016-003)

Recommendation:

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

System Response:

The System accepts the finding, but understandably this is an issue in which the System cannot unilaterally remedy. System management will communicate with the Office of the Governor to seek an appointment which will fully staff the Board.

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

Schedule of Findings - State Compliance (Continued)

Year Ended June 30, 2017

Finding No. 2017-003 Monitoring of Contracts

The State Employees' Retirement System (System) did not properly monitor its contracts during the engagement period resulting in a contract that was not timely signed by the System.

During the sample testing of six contracts, we noted 1 (17%) contract had a contract period start date which commenced prior to the contract being formally signed by the System. This contract was a renewal of an existing annual contract for software licenses in the amount of \$132,532 procured through the Department of Central Management Services, which expired and was not renewed timely. The contract was signed 17 days late.

The Fiscal Control and Internal Auditing Act (30 ILCS 10/3001) requires all State agencies to establish and maintain a system, or systems, of internal fiscal and administrative controls so that revenues, expenditures and transfers of assets, resources, or other funds applicable to operations are properly recorded and accounted for to permit the preparation of accounts and reliable financial and statistical reports and to maintain accountability over the State's resources. Prudent business practices and good internal controls require contracts to be signed prior to the effective date of the agreement.

System management stated the exception was due to an oversight by staff and lack of communication with the vendor.

Failure to actively monitor contracts in place and to timely sign contract agreements could result in unnecessary legal risk to the System. (Finding Code No. 2017-003)

Recommendation:

We recommend the System monitor compliance with its contracts to ensure that every contract is properly approved and signed prior to commencement of services or receipt of goods.

System Response:

The System accepts the finding and will ensure all contracts for renewal of services are executed prior the existing contract term expiring.

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

Schedule of Findings

Year Ended June 30, 2017

Prior Finding Not Repeated

A. Finding - Noncompliance with the Fiscal Control and Internal Auditing Act

In the prior year, the State Employees' Retirement System (System) was not in compliance with the Fiscal Control and Internal Auditing Act (the Act). The act (30 ILCS 10/2003) required the chief executive officer to ensure that internal audits of all major systems of internal control are conducted at least once every two years. The System was unable to complete internal audits of all major systems of internal control at least every two years as required by the Act. (Finding Code No. 2016-001)

During the current fiscal year, the System's Board created and funded an additional internal auditor position to aid the Chief Internal Auditor in performing audit duties. The additional internal auditor allowed the internal audit department to complete the required internal audits of all major systems of internal control in fiscal years 2016 and 2017.

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

Year Ended June 30, 2017

Supplementary Information for State Compliance Purposes

Summary

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

- Fiscal Schedules and Analysis:
 - Schedule of Appropriations, Expenditures and Lapsed Balances
 - Comparative Schedule of Net Appropriations, Expenditures and Lapsed Balances
 - Schedule of Changes in State Property
 - Comparative Schedule of Cash Receipts
 - Reconciliation Schedule of Cash Receipts to Deposits Remitted to the State Comptroller
 - Comparative Schedule of Cash Balances
 - Comparative Schedule of Changes in Investment Balances

- Analysis of Operations (Unaudited):
 - System Functions and Planning Program (Unaudited)
 - Progress in Funding the System (Unaudited)
 - Analysis of Significant Variations in Expenditures (Unaudited)
 - Analysis of Significant Variations in Cash Receipts (Unaudited)
 - Analysis of Significant Lapse Period Spending (Unaudited)
 - Analysis of Contributions Receivable (Unaudited)
 - Budget Impasse Disclosures (Unaudited)
 - Alternative Financing in Lieu of Appropriations and Programs to Address
 Untimely Payments to Vendors (Unaudited)
 - Interest Costs on Fiscal Year 2017 Invoices (Unaudited)
 - Money-Weighted Rate of Return (Unaudited)
 - Average Number of System Employees (Unaudited)
 - Comparison of Administrative Expenses to Total Expenses (Unaudited)
 - Schedule of Contributions/Deductions and Effect on Investments (Unaudited)
 - Service Efforts and Accomplishments (Unaudited)

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

Schedule of Appropriations, Expenditures and Lapsed Balances
Expenditure Authority for Fiscal Year 2017
Fifteen Months Ended September 30, 2017

	Expenditure Authority (Net of Transfers)	Expenditures Through June 30	Lapse Period Expenditures July 1 to September 30	Total Expenditures 15 Months Ended September 30	Balances Lapsed September 30
Continuing Appropriations and Court Orders					
Appropriated Funds					
General Revenue Fund - 001					
Personal services	\$ -	\$ 38,344	\$ 2,593	\$ 40,937	\$ -
Retirement contributions	1,309,399,650	1,309,399,650	-	1,309,399,650	-
Social Security and Medicare contributions	-	2,861	157	3,018	-
Total appropriated funds		\$ 1,309,440,855	\$ 2,750	\$ 1,309,443,605	
Nonappropriated Funds					
State Employees' Retirement System Fund - 0479					
Personal services		\$ 4,890,520	\$ 263,910	\$ 5,154,430	
Employee retirement pickup		36,014	1,505	37,519	
Retirement contributions		2,184,178	117,728	2,301,906	
Social Security and Medicare contributions		360,781	19,945	380,726	
Group insurance		1,448,561	62,549	1,511,110	
Contractual services		1,163,668	103,872	1,267,540	
Travel		11,963	2,594	14,557	
Commodities		15,165	1,074	16,239	
Printing		24,606	4,329	28,935	
Equipment		9,341	6,778	16,119	
Electronic data processing		5,560,305	349,365	5,909,670	
Telecommunications		51,694	33,876	85,570	
Automotive		10,372	1,231	11,603	
Nonrecurring refunds and distributions		16,797,986	-	16,797,986	
Payments to general obligation bond retirement and interest fund		21,260,381	3,063,356	24,323,737	
Pensions, annuities and benefits		2,305,738,204	(1,051,569)	2,304,686,635	
Permanent improvements		28,762	-	28,762	
Refunds of prior calendar year contributions		172,138	7,456	179,594	
Refunds, not classified elsewhere		110,390,043	1,791	110,391,834	
Subtotal - Fund 0479		2,470,154,682	2,989,790	2,473,144,472	
State Employees' Retirement System Excess Benefit Fund - 0788					
Pensions, annuities and benefits		532,331	-	532,331	
Total nonappropriated funds		2,470,687,013	2,989,790	2,473,676,803	
Grand Total, All Funds		\$ 3,780,127,868	\$ 2,992,540	\$ 3,783,120,408	

Note 1: Expenditure authority, appropriations, expenditures, and lapsed balances were obtained from the State Comptroller records as of September 30, 2017 and have been reconciled to System records.

Schedule of Appropriations, Expenditures and Lapsed Balances (Continued)
Expenditure Authority for Fiscal Year 2017
Fifteen Months Ended September 30, 2017

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

Note 3: The State Pension Funds Continuing Appropriation Act (40 ILCS 15/1.2) provides a continuing annual appropriation for the State's Contributions to the System such that the State's total contributions are no less than the required State contributions lawfully submitted by the System under the Illinois Pension Code (40 ILCS 5/14-135.08). The Circuit Court of Cook County in *People v. Munger* (15 CH 10243) ordered the State Comptroller, in the absence of enacted annual appropriations, to process and pay certified invoice vouchers from the System pursuant to this Statute. Therefore, the System's fiscal year 2017 appropriation for Fund 001 was established as the amount certified to the Governor and General Assembly as the State's required contribution January 12, 2016.

Note 4: The Circuit Court of St. Clair County in *AFSCME Council 31 vs Munger* (15 CH 475) ordered the State Comptroller, in the absence of enacted annual appropriations, to "draw and issue warrants accomplishing payment of wages [for all State employees] at their normal rates of pay." As Public Act 100-0021 states appropriation authority granted by the General Assembly does not supersede any court order directing the expenditure of funds and states such payments are added to the appropriations granted by the General Assembly, the System was able to submit vouchers to pay its employees in full from Fund 001 without a maximum expenditure limit for personal service costs during Fiscal Year 2017.

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

Schedule 2

Comparative Schedule of Net Appropriations,
Expenditures and Lapsed Balances
For the Years Ended June 30, 2017, 2016 and 2015

	Fiscal Year		
	2017	2016	2015
	Continuing Appropriation and Court Orders	Continuing Appropriation and Court Orders	P.A. 98-0679 and P.A. 98-0680
Appropriated Funds			
<u>General Revenue Fund - 0001</u>			
Appropriations	\$ 1,309,399,650	\$ 1,367,138,589	\$ 1,148,701,430
Expenditures			
Continuing appropriation for pension contributions	1,309,399,650	1,329,170,050	1,136,479,500
Continuing appropriation for fiscal year shortfall	-	37,968,539	12,130,929
Personal services	40,937	38,509	40,188
Social Security and Medicare contributions	3,018	2,871	2,904
Employee retirement contributions paid by employer	-	-	10,000
Contractual services	-	-	15,700
Travel	-	-	1,015
Commodities	-	-	100
Electronic data processing	-	-	500
Telecommunications	-	-	300
Total expenditures	1,309,443,605	1,367,179,969	1,148,681,136
Lapsed balances	\$ -	\$ -	\$ 20,294
Grand Total - Appropriated Funds			
Appropriations (Net of transfers)	\$ 1,309,399,650	\$ 1,367,138,589	\$ 1,148,701,430
Total expenditures	1,309,443,605	1,367,179,969	1,148,681,136
Lapsed balances	\$ -	\$ -	\$ 20,294
Nonappropriated Funds			
<u>Kanerva vs State Trust Fund - 0234</u>			
Expenditures			
Annuitant disbursement	\$ -	\$ -	\$ 34,749,730
<u>State Employees' Retirement System Fund - 0479</u>			
Expenditures			
Personal services	5,154,430	5,365,920	5,737,994
Employee retirement contributions paid by employer	37,519	32,838	38,302
Retirement contributions	2,301,906	2,450,563	2,431,230
Social Security and Medicare contributions	380,726	397,003	425,526
Group insurance	1,511,110	1,573,530	1,467,162
Contractual services	1,267,540	1,740,943	1,782,465
Travel	14,557	12,210	15,653
Commodities	16,239	12,380	18,629
Printing	28,935	38,172	48,463
Equipment	16,119	15,334	28,890
Electronic data processing	5,909,670	5,998,051	5,502,099
Telecommunications	85,570	59,726	170,576
Automotive	11,603	6,253	9,853

Comparative Schedule of Net Appropriations,
Expenditures and Lapsed Balances (Continued)
For the Years Ended June 30, 2017, 2016 and 2015

	Fiscal Year		
	2017	2016	2015
	Continuing	Continuing	P.A. 98-0769 and
	Appropriation and	Appropriation and	P.A. 98-0680
	Court Orders	Court Orders	
Nonappropriated Funds			
<u>State Employees' Retirement System Fund - 0479</u>			
(Continued)			
Nonrecurring refunds and distributions	\$ 16,797,986	\$ 19,573,651	\$ 15,102,606
Payments to general obligation bond retirement and interest fund	24,323,737	24,872,635	28,977,468
Pensions, annuities and benefits	2,304,686,635	2,162,995,037	2,011,149,454
Permanent improvements	28,762	185,751	126,540
Refunds, prior calendar year contributions	179,594	255,175	296,199
Refunds, not elsewhere classified	110,391,834	26,840,083	23,523,103
Total expenditures - Fund 0479	<u>2,473,144,472</u>	<u>2,252,425,255</u>	<u>2,096,852,212</u>
<u>State Employees' Retirement Excess Benefit Fund - 0788</u>			
Expenditures			
Pensions, annuities and benefits	532,331	468,046	340,941
Total nonappropriated expenditures	<u>2,473,676,803</u>	<u>2,252,893,301</u>	<u>2,131,942,883</u>
Grand total expenditures, all Funds	<u>\$ 3,783,120,408</u>	<u>\$ 3,620,073,270</u>	<u>\$ 3,280,624,019</u>

Note 1: Expenditure authority, appropriations, expenditures, and lapsed balances were obtained from the State Comptroller records as of September 30, 2017 and September 30, 2016 and have been reconciled to System records.

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

Note 3: The State Pension Funds Continuing Appropriation Act (40 ILCS 15/1.2) provides a continuing annual appropriation for the State's Contributions to the System such that the State's total contributions are no less than the required State contributions lawfully submitted by the System under the Illinois Pension Code (40 ILCS 5/14-135.08) and the FY2015 Shortfall certified under Pension Code (40 ILCS 5/14-131(k)). The Circuit Court of Cook County in *People v. Munger* (15 CH 10243) ordered the State Comptroller, in the absence of enacted annual appropriations, to process and pay certified invoice vouchers from the System pursuant to this Statute. Therefore, the System's fiscal years 2016 and 2017 appropriations for Fund 001 were established as the amount certified to the Governor and General Assembly as the State's required contribution for those fiscal years.

Note 4: The Circuit Court of St. Clair County in *AFSCME Council 31 vs Munger* (15 CH 475) ordered the State Comptroller, in the absence of enacted annual appropriations, to "draw and issue warrants accomplishing payment of wages [for all State employees] at their normal rates of pay." As the System never received enacted personal services appropriations for Fund 001 the System was able to submit vouchers to pay its employees in full without a maximum expenditure limit for personal service costs during fiscal years 2016. As Public Act 100-0021 states appropriation authority granted by the General Assembly does not supersede any court order directing the expenditure of funds and states such payments are added to the appropriations granted by the General Assembly, the System was able to submit vouchers to pay its employees in full from Fund 001 without a maximum expenditures limit for personal service costs during Fiscal Year 2017.

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

Schedule 3

**Schedule of Changes in State Property
For the Year Ended June 30, 2017**

	Beginning Balance	Additions	Deletions	Ending Balance
State Employees' Retirement System Trust				
Fund				
Land	\$ 655,241	\$ -	\$ -	\$ 655,241
Land improvements	315,779	-	-	315,779
Building	4,045,571	28,762	-	4,074,333
Furniture and equipment	2,783,202	379,646	(83,163)	3,079,685
Capitalized software costs	4,420,932	1,055,354	-	5,476,286
Total	12,220,725	1,463,762	(83,163)	13,601,324
Accumulated depreciation	(5,281,776)	(691,737)	73,758	(5,899,755)
Property and equipment - net	\$ 6,938,949	\$ 772,025	\$ (9,405)	\$ 7,701,569
Social Security Contribution Fund				
Furniture and equipment	\$ 3,292	\$ -	\$ -	\$ 3,292

Note 1: This schedule has been reconciled to property reports (C-15 Agency Report of State Property) submitted to the Office of the State Comptroller.

Note 2: This summary schedule was prepared using State property records required by the Illinois Administrative Code. The capitalization policy in the code is different than the capitalization policy established by the Office of the State Comptroller for financial reporting in accordance with generally accepted accounting principles.

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

Schedule 4

**Comparative Schedule of Cash Receipts
For the Years Ended June 30, 2017 and 2016**

	2017	2016
Receipts:		
Participant contributions	\$ 240,395,054	\$ 247,670,465
Employer contributions (net of bond principal and interest)	694,272,601	645,258,707
General Revenue Fund / Pension Contribution Fund	1,206,007,429	1,359,109,815
Transfers from the Illinois State Board of Investment	230,000,000	100,000,000
Interest income on cash balances	1,249,194	703,936
Claims Receivable Payments	6,018,363	5,546,060
Installment Payments	2,927,872	3,120,620
Other	228,435	211,061
	<hr/>	<hr/>
Total cash receipts, per book	\$ 2,381,098,948	\$ 2,361,620,664

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

Schedule 5

**Reconciliation Schedule of Cash Receipts
to Deposits Remitted to the State Comptroller
For the Years Ended June 30, 2017 and 2016**

	2017	2016
Total cash receipts, per books	\$ 2,381,098,948	\$ 2,361,620,664
Add (deduct)		
Bond principal and interest payments collected and remitted to the State of Illinois	24,182,472	25,624,320
Interest on cash balances	(1,249,194)	(703,936)
Cancelled warrants and adjustment deposits classified by the Comptroller as reductions of expenditures	(5,492,176)	(5,267,059)
Intergovernmental Transfers submitted to the Comptroller's Office but not yet released / deposited into Trust Fund (Fund 479) **	54,558,339	55,382,088
Prior year intergovernmental payment vouchers deposited into the Trust Fund (Fund 479) during the current fiscal year**	(55,382,088)	(47,353,314)
Cash in Transit		
Beginning of year	275,026	272,411
End of year	(483,450)	(275,026)
Deposits in transit		
Beginning of year	126,548	142,684
End of year	(68,498)	(126,548)
Deposits remitted to the State Comptroller for order into the State Treasury	<u>\$ 2,397,565,927</u>	<u>\$ 2,389,316,284</u>
Fund 788	\$ 565,991	\$ 558,271
Fund 479	2,396,999,936	2,388,758,013
	<u>\$ 2,397,565,927</u>	<u>\$ 2,389,316,284</u>

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

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

Schedule 6

**Comparative Schedule of Cash Balances
For the Years Ended June 30, 2017 and 2016**

	2017	2016
State Treasury	\$ 228,087,491	\$ 300,189,652
Vouchers in transit	(627,236)	(2,223)
Deposits and cash in transit	82,329	141,201
	<u>227,542,584</u>	<u>300,328,630</u>
Petty cash fund	200	200
	<u>\$ 227,542,784</u>	<u>\$ 300,328,830</u>

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

**Comparative Schedule of Changes in Investment Balances
For the Years Ended June 30, 2017 and 2016**

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

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

Comparison of the changes in the System's investments held in the ISBI Commingled Fund for the years ended June 30, 2017 and 2016 is summarized as follows:

	2017	2016
Balance at beginning of year, at fair value	\$ 14,741,054,632	\$ 14,967,254,053
Net cash added (withdrawn) to/(from) investments, net	(230,000,000)	(100,000,000)
	<u>14,511,054,632</u>	<u>14,867,254,053</u>
Investment income		
Interest, dividends and other	397,922,111	449,189,664
Expenses	(28,874,161)	(38,394,629)
	<u>369,047,950</u>	<u>410,795,035</u>
Net appreciation (depreciation) in fair value of investments		
Net realized gain (loss) on sales of investments	434,071,475	127,975,145
Net unrealized gain (loss) on investment	1,008,431,279	(664,969,601)
	<u>1,442,502,754</u>	<u>(536,994,456)</u>
Total net investment income (loss)	<u>1,811,550,704</u>	<u>(126,199,421)</u>
Balance at end of year, at fair value	<u>\$ 16,322,605,336</u>	<u>\$ 14,741,054,632</u>

Securities lending collateral decreased by \$863.0 thousand in fiscal year 2017 compared to the fiscal year 2016 ending balance (\$63,393,000 from \$64,256,000). The State Treasurer lends securities to broker-dealers and other entities for collateral that will be returned for the same security in the future. Each year the Treasurer provides an allocation to the Comptroller to adjust each State Agency's financial statements to include their proportionate share of the securities lending transaction balances at year end. Securities lending activity can vary from year to year depending on market conditions and the availability of securities to lend.

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

Analysis of Operations (Unaudited) For the Years Ended June 30, 2017 and 2016

System Functions and Planning Program (Unaudited)

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

The System is governed by Article 14 of the Illinois Pension Code (Chapter 40 of the Illinois Compiled Statutes). As of June 30, 2017, the System had approximately 60,612 active members and 71,805 benefit recipients.

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

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

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

Program planning activities of the System are under the direct supervision of the Executive Secretary and involve coordination between the governing Board and other executive staff of the System. The current planning program identifies various operational projects for fiscal year 2017. The planning summary for each project includes the project scope and objectives, implementation phases and timing, resource application and expected benefits. Each project is assigned to a divisional level manager who acts as project leader during all implementation phases of the project. Implementation progress is reported to the Executive Secretary, who in turn reports such progress directly to the System's Board of Trustees.

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

Analysis of Operations (Unaudited) (Continued) For the Years Ended June 30, 2017 and 2016

System Functions and Planning Program (Unaudited) (Continued)

The IT operational plan for FY 2017 encompassed numerous system modernization (re-engineering) projects and enhancements. These included the new benefit setup process, service purchase, accounts receivable and pension calculations, system performance tuning, and changes to the annual benefit statements. Additionally, the IT staff continued to perform work to implement the new CMS benefit systems, completed the implementation of the new hyper-converged infrastructure, performed vulnerability/penetration testing remediation, completed full disaster recovery planning and testing, upgraded all Windows Servers to 2012 and upgraded staff computers to Windows 10.

New IT projects planned for FY 2018 include: the complete conversion of IT security infrastructure into the new Fort iGATE security system, complete the initial implementation of the new benefit setup and pension calculation, service purchase set up, cash receipts, and receivables. Additionally, the IT staff will upgrade to Office 365 and Microsoft Azure.

Progress in Funding the System (Unaudited)

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

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

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

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

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

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

Analysis of Operations (Unaudited) (Continued) For the Years Ended June 30, 2017 and 2016

Progress in Funding the System (Unaudited) (Continued)

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

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

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

Under the State's funding plan, the actuarial accrued liability of the System at June 30, 2017 amounted to approximately \$46.7 billion. The actuarial value of assets (at smoothed value) at June 30, 2017 amounted to approximately \$16.6 billion. The difference between the actuarial accrued liability and the actuarial value of assets of \$30.1 billion reflects the unfunded actuarial accrued liability of the System at June 30, 2017 under the State's funding plan. The System had a funded ratio (based on the State's funding plan) of 35.5% at June 30, 2017.

For financial reporting purposes, the System adopted GASB Statement No. 67, *Financial Reporting for Pension Plans*, in the fiscal year ended June 30, 2014. GASB Statement No. 67 requires the use of the market value of assets rather than the actuarial value of assets (smoothed value) used under the State's funding plan in calculating the net pension liability. It also requires that the System use the entry age actuarial cost method rather than the projected unit costs method used under the State's funding plan for calculating the total pension liability. In addition, it requires the System use a blended rate of return of 6.78% combining the assumed rate of return of 7.0% and a municipal bond rate of 3.56% based on an index of 20-year general obligation bonds with an average AA rating for investments in the event the System's assets are exhausted in the future.

On June 30, 2017, the System reported for financial reporting purposes under GASB Statement No. 67 that the market value of assets was \$16.5 billion. The difference between the total pension liability of \$49.4 billion and the market value of assets was the net pension liability of \$32.9 billion and the funded ratio was 33.4%. On June 30, 2016, the market value of assets was \$15.0 billion. The difference between the System's June 30, 2016 total pension liability of \$49.2 billion and the market value of assets was the June 30, 2016 net pension liability of \$34.1 billion and the funded ratio was 30.6%.

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

**Analysis of Operations (Unaudited) (Continued)
For the Years Ended June 30, 2017 and 2016**

Progress in Funding the System (Unaudited) (Continued)

The market value of the assets of the fund, that were available for benefits, increased from \$15.0 billion at June 30, 2016 to \$16.5 billion at June 30, 2017. This increase is due to the increased return on fund assets. The actuarial value of the assets of \$16.6 billion at June 30, 2017, is \$28.7 million higher than the market value of the assets due to recognition of 100% of the actuarial gain in fiscal year 2013, 80% of the actuarial gain in fiscal year 2014, 60% of the actuarial gain in fiscal year 2015, and 40% of the actuarial loss in fiscal year 2016, and 20% of the actuarial gain in 2017.

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

Year Ended June 30	Required State Contribution (in millions)
2018	\$ 2,029.6
2019	2,165.8
2020	2,311.2
2021	2,432.8
2022	2,552.5

The Schedule of the State's Net Pension Liability (in billions) for fiscal years ending June 30, 2017 and 2016 are noted in the table below.

	2017	2016
Total pension liability	\$ 49.437	\$ 49.184
Plan fiduciary net position	16.530	15.039
State's net pension liability (asset)	\$ 32.907	\$ 34.145
Plan fiduciary net position as a percentage of the total pension liability	33.44 %	30.58 %
Covered payroll	\$ 4.193	\$ 4.282
State's net pension liability (asset) as a percentage of covered payroll	784.89 %	797.41 %

The Schedule of State Contributions (in millions) for the fiscal years ending June 30, 2017 and 2016 are noted in the table below.

Year Ended June 30,	Actuarially Determined Contribution	Contributions Received	Contribution (Deficiency) Excess	Covered Payroll	Contributions Received as a Percentage of Covered Payroll
2017	\$2,129.5	\$1,798.3	(\$331.2)	\$4,192.6	42.89%
2016	2,019.7	1,882.2	(137.5)	4,282.0	43.96%

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

**Analysis of Operations (Unaudited) (Continued)
For the Years Ended June 30, 2017 and 2016**

Notes to the Schedule of State Contributions

Valuation date:	June 30, 2015
Notes:	Actuarially determined contribution rates are calculated as of June 30, which is 12 months prior to the beginning of the fiscal year in which the contributions will be made. Covered payroll for fiscal years June 30, 2017 and 2016 were restated to comply with the requirements of GASB Statement No. 82.

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

Actuarial Cost Method:	Projected Unit Credit
Amortization Method:	Normal cost plus a level percentage of capped payroll amortization of the unfunded accrued liability.
Remaining Amortization Period:	25 years, closed
Asset Valuation Method:	5 year smoothed market
Inflation:	3.00%
Salary Increases:	Salary increase rates based on age-related productivity and merit rates plus inflation.
Post-Retirement Benefits:	Post-retirement benefit increases of 3.00%, compounded, for Tier 1 and 3.00% or one-half of the annual increase in the Consumer Price Index whichever is less, simple, for Tier 2.
Investment Rate of Return:	7.25%
Retirement Age:	Experience-based table of rates that are specific to the type of eligibility condition. Last updated for the June 30, 2014, valuation pursuant to an experience study of the period July 1, 2009 to June 30, 2013.
Mortality:	105% of the RP2014 Healthy Annuitant table, sex distinct

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

**Analysis of Operations (Unaudited) (Continued)
For the Years Ended June 30, 2017 and 2016**

Analysis of Significant Variations in Expenditures (Unaudited)

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

	2017	2016	Increase (Decrease)
Fund 0001:			
Continuing appropriation for fiscal year shortfall	\$ -	\$ 37,968,539	\$ (37,968,539) (1)
Fund 0479:			
Refunds, not elsewhere classified	110,391,834	26,840,083	83,551,751 (2)

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

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

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

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

For FY 2016, there was an FY Overpayment, payable by the System in FY 2017, so there was not a Shortfall from FY 2016 paid to the System in FY 2017.

- (2) There was an FY 2016 "Overpayment" payable to the General Revenue Fund that was paid in FY 2017 (\$83.7 million). In FY 2015, there was a "Shortfall" that was due to the Retirement System from the General Revenue Fund (\$37.9 million), receipted in FY 2016 (not an "Overpayment").

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

**Analysis of Operations (Unaudited) (Continued)
For the Years Ended June 30, 2017 and 2016**

Analysis of Significant Variations in Cash Receipts (Unaudited)

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

	2017	2016	Increase
Transfers from the Illinois State Board of Investment	\$ 230,000,000	\$ 100,000,000	\$ 130,000,000 (1)

(1) During FY 2017, \$230 million was drawn from the ISBI to cover benefit payments due primarily to the timing of the release of the GRF employer contribution for any particular month.

Analysis of Significant Lapse Period Spending (Unaudited)

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

There was no significant lapse period spending during fiscal year 2017.

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

**Analysis of Operations (Unaudited) (Continued)
For the Years Ended June 30, 2017 and 2016**

Analysis of Contributions Receivable (Unaudited)

	2017	2016
Participants' contributions	\$ 12,374,224	\$ 11,893,976
Employing State agencies	71,478,289	70,171,117
Other accounts	5,256,241	4,477,002
Total receivables	<u>\$ 89,108,754</u>	<u>\$ 86,542,095</u>

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

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

**Analysis of Operations (Unaudited) (Continued)
For the Years Ended June 30, 2017 and 2016**

Budget Impasse Disclosures (Unaudited)

All of the System's Fiscal Year 2016 and Fiscal Year 2017 costs were paid pursuant to continuing appropriations / court orders or from nonappropriated funds. The System did not have any outstanding unpaid invoices from Fiscal Year 2016 or Fiscal year 2017 after the closure of the Fiscal Year 2016 Lapse Period on August 31, 2016, or the closure of the Fiscal Year 2017 lapse period on September 30, 2017, respectively.

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

The System and its vendors did not participate in alternative financing in lieu of enacted appropriations involving the Illinois Finance Authority during Fiscal Year 2016 and Fiscal Year 2017.

None of the System's vendors participated in the Vendor Payment Program (VPP) or the Vendor Support Initiative Program (VSI) during Fiscal Year 2016 and Fiscal Year 2017.

Interest Costs on Fiscal Year 2017 Invoices (Unaudited)

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

Money-Weighted Rate of Return (Unaudited)

Pursuant to Article 22A of the Illinois Pension Code, investments of the State Employees' Retirement System of Illinois are managed by the Illinois State Board of Investment (ISBI) and are held in the ISBI Commingled Fund. ISBI operates under a long-range investment plan with the objective to maximize the total rate of return. The objectives set forth are as follows:

- At least equal to the assumed actuarial interest rate, currently 7.00% per year.
- At least equal to the return of a composite benchmark of market indices in the same proportions as the Board's asset allocation policy targets.

The time-weighted rate of return of the ISBI Commingled Fund was 12.3% for fiscal year 2017. The ISBI's total fund performance was more than the composite benchmark of 12.0% for the year ended June 30, 2017.

The annual money-weighted rate of return, net of investment expense, as of June 30, 2017 and 2016 was as follows:

	<u>2017</u>	<u>2016</u>
Money-weighted return*	12.4%	(0.9)%

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

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

**Analysis of Operations (Unaudited) (Continued)
For the Years Ended June 30, 2017 and 2016**

Average Number of System Employees (Unaudited)

System Employees' Retirement System Trust Fund

The average number of employees (not including the General Revenue Fund – Social Security Division) during the years ended June 30, 2017, 2016 and 2015 is summarized by functional classification as follows:

	<u>2017</u>	<u>2016</u>	<u>2015</u>
Executive and administrative	22	23	23
Accounting, bookkeeping and clerical	38	38	38
Other office employees	18	13	15
Electronic data processing	<u>21</u>	<u>23</u>	<u>23</u>
Total	<u>99</u>	<u>97</u>	<u>99</u>

Social Security Contribution Fund

The Social Security Contribution Fund had one employee for the years ended June 30, 2017, 2016 and 2015.

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

**Analysis of Operations (Unaudited)
For the Years Ended June 30, 2017 and 2016**

Comparison of Administrative Expenses to Total Expenses (Unaudited)

	<u>2017</u>	<u>2016</u>	<u>2015</u>
Total expenses			
Benefits	\$ 2,328,620,783	\$ 2,190,501,203	\$ 2,034,858,435
Refunds of contributions, including transfers to reciprocating systems	26,608,011	26,708,730	23,128,975
Administrative expenses	<u>15,957,439</u>	<u>16,126,997</u>	<u>16,547,823</u>
	<u>\$ 2,371,186,233</u>	<u>\$ 2,233,336,930</u>	<u>\$ 2,074,535,233</u>
Administrative expenses as a percentage of total expenses	<u>0.7%</u>	<u>0.7%</u>	<u>0.8%</u>

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

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

	<u>2017</u>	<u>2016</u>	<u>2015</u>
Contributions			
Participant Contributions	\$ 251,610,974	\$ 256,198,172	\$ 266,139,156
Employer Contributions	<u>1,798,348,440</u>	<u>1,882,243,268</u>	<u>1,804,319,356</u>
Total Contributions	<u>2,049,959,414</u>	<u>2,138,441,440</u>	<u>2,070,458,512</u>
Deductions			
Retirement Benefits	2,111,021,041	1,977,598,561	1,833,999,371
Survivor Benefits	136,359,106	128,689,627	121,930,337
Disability Benefits	64,167,865	64,057,780	63,929,747
Lump-Sum Death Benefits	17,072,771	20,155,235	14,998,980
Refunds (including transfers to reciprocating systems)	26,608,011	26,708,730	23,128,975
Administrative Expenses	<u>15,957,439</u>	<u>16,126,997</u>	<u>16,547,823</u>
Total Deductions	<u>2,371,186,233</u>	<u>2,233,336,930</u>	<u>2,074,535,233</u>
Contributions in Excess of Deductions (Investments Used to Pay Benefits and Expenses)	<u>\$ (321,226,819)</u>	<u>\$ (94,895,490)</u>	<u>\$ (4,076,721)</u>

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

**Analysis of Operations (Unaudited) (Continued)
For the Years Ended June 30, 2017 and 2016**

Service Efforts and Accomplishments (Unaudited)

	<u>2017</u>	<u>2016</u>	<u>2015</u>
Membership data			
Coordinated members	83,043	84,991	86,022
Noncoordinated members	2,328	2,446	2,559
	<hr/>		
Total members	85,371	87,437	88,581
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Active members	60,612	61,317	63,273
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Benefit payments processed			
Recurring			
Retirement annuities	58,453	56,825	54,802
Survivors' annuities	11,186	11,043	10,889
Disability benefits	2,166	2,163	2,263
	<hr/>		
Total	71,805	70,031	67,954
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Termination refunds processed	2,595	2,792	2,293
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Retirement counseling			
Preretirement sessions			
Number of sessions	138	102	86
Number of attendees	3,991	4,751	3,654
Postretirement seminars			
Number of sessions	27	28	28
Number of attendees	985	1,123	1,100
Regional and other meetings			
Number of sessions	17	20	4
Number of attendees	748	786	872
Retirement coordinator site visits	63	51	18
One-on-one meetings	3,562	4,138	3,605