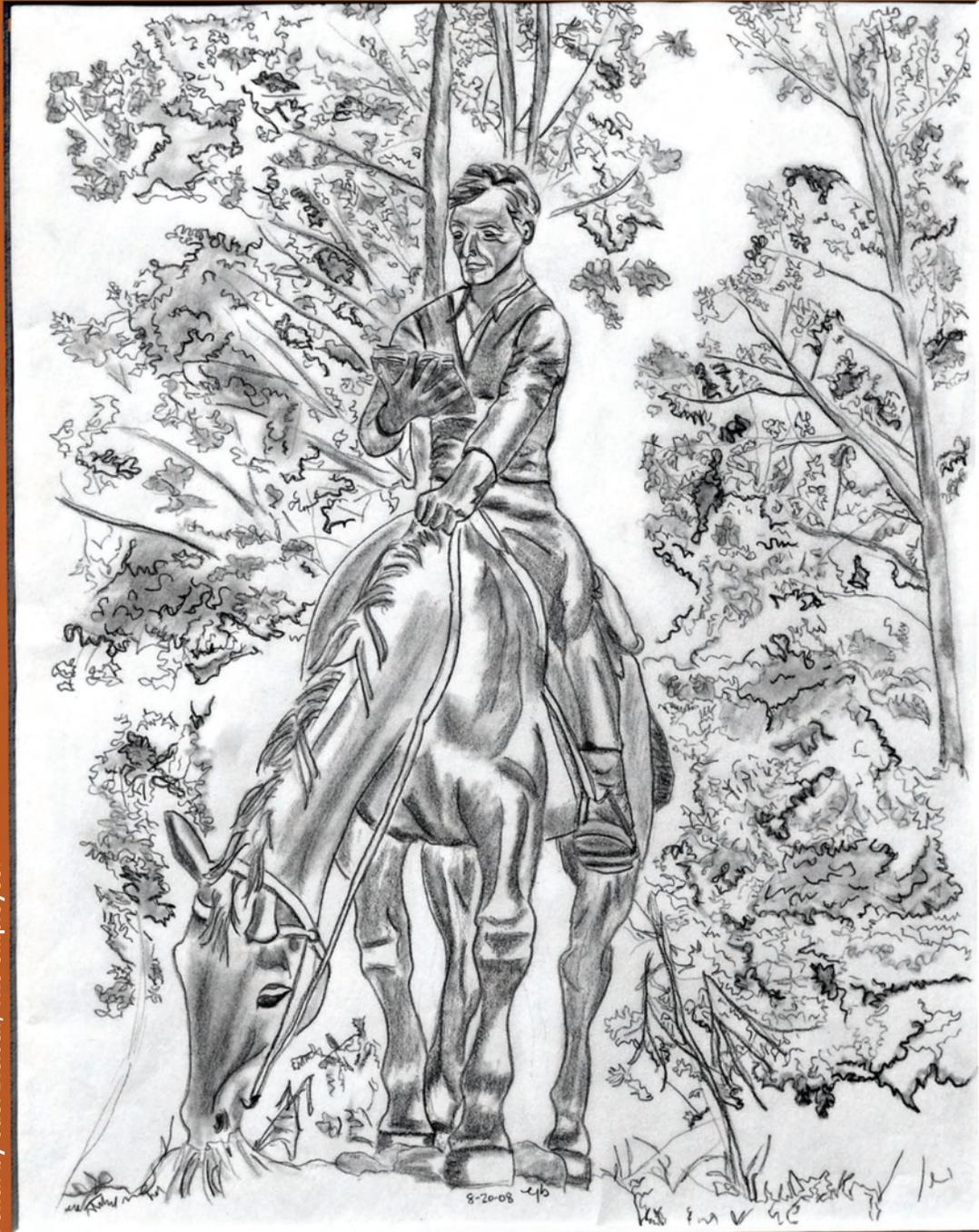


INTRODUCTION



Pencil by Jael Bietsch, TRS employee.

“A capacity and taste for reading gives access to whatever has been discovered by others.”

Certificate of Achievement for Excellence in Financial Reporting

Presented to

Teachers' Retirement System
of the State of Illinois

For its Comprehensive Annual
Financial Report
for the Fiscal Year Ended

June 30, 2007

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.



Chris S. Cox
President

Jeffrey L. Esser
Executive Director



Retirement Security for Illinois Educators

Teachers' Retirement System of the State of Illinois

Jon Bauman, Executive Director
2815 West Washington, P.O. Box 19253
Springfield, Illinois 62794-9253

Letter of Transmittal

December 10, 2008

To the Board of Trustees and TRS Members:

We are pleased to present the *Comprehensive Annual Financial Report (CAFR)* for the Teachers' Retirement System of the State of Illinois (TRS) for the fiscal year ended June 30, 2008. This year's report commemorates Abraham Lincoln and the upcoming bicentennial of his birthday in February 2009.

Lincoln said in his first political announcement on March 9, 1832 at New Salem:

"Upon the subject of education... I can only say that I view it as the most important subject which we as a people can be engaged in. That everyone may receive at least a moderate education appears to be an objective of vital importance."

TRS may share a "hometown" with this great man, but our members share Lincoln's values in their professions. His desire for an education is widely published. As a man who had less than one year of formal education, Lincoln would be appreciative of the extensive public education system in Illinois. We believe that he would also recognize how fortunate today's students are to have dedicated teachers as instructors and mentors.

As the "Great Emancipator," Lincoln's leadership has made him an iconic role model for generations of Americans. As present role models, teachers have the powerful ability to be mentors and leaders to students who will contribute to our upcoming society. Our members' influence in the classroom will, in part, be measured by their students' future successes.

The pencil and graphite artwork in this year's report features a historical feel. Two TRS employees, Julie Dailey and Jael Bietsch, created the Lincoln artwork that appears throughout the report. Both were inspired by visiting the Lincoln sites. In displaying the artistic talents of our staff, we also are consciously depicting Lincoln throughout his life in Illinois. We hope you find this year's theme both educational and inspirational.

While commemorating Lincoln, we are also complying with state law that requires the annual publication of this report. It is intended to provide financial, investment, actuarial, and statistical information in a single publication. TRS management and staff are responsible for the accuracy and completeness of this report and for ensuring that all material disclosures have been made. A framework of internal controls is maintained to establish reasonable assurance that assets are safeguarded, transactions are accurately executed, and financial statements are fairly presented.

Profile of TRS

TRS was established by the State of Illinois on July 1, 1939, to provide retirement, disability, and death benefits to teachers employed by Illinois public elementary and secondary schools outside the city of Chicago. An 11-member Board of Trustees governs TRS. The Board includes the state superintendent of education, four members of TRS who are elected by active members, four representatives of the public

who are appointed by the governor, and two retired members who are elected by annuitants. The Board of Trustees appoints the executive director, who is responsible for the detailed administration of TRS.

The annual budget for TRS administrative expenses is prepared by staff and approved by the Board of Trustees. The TRS annual operating budget request is prepared in conjunction with a review of the long-range strategic plan.

Financial Information

Our staff issues a CAFR within six months of the close of each fiscal year. The report contains basic financial statements presented in conformity with generally accepted accounting principles (GAAP) within guidelines established by the Governmental Accounting Standards Board (GASB).

A system of internal controls helps us monitor and safeguard assets and promote efficient operations. Each year TRS's financial statements, records, and internal controls are examined by special assistant auditors employed by the Illinois Auditor General. In addition, an annual compliance attestation examination is performed to review compliance with applicable statutes and codes. The Independent Auditors' Report on TRS's financial statements is included in the Financial Section of this report.

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

Revenues and Expenses

The three sources of TRS funding include member contributions, investment income, and employer contributions through state appropriations and payments by school districts. TRS expenses include payments of benefits, refunds, and administrative expenses. Negative amounts are shown in parentheses () throughout this report.

Revenues (\$ millions)

Source	2008	2007	Increase/(Decrease)	
			Amount	% Change
Member contributions	\$865	\$826	\$39	4.7%
State of Illinois	1,041	738	303	41.1
Employer contributions	131	116	15	12.9
Total investment income (loss)	<u>(2,015)</u>	<u>6,831</u>	<u>(8,846)</u>	<u>(129.5)</u>
Total	<u>\$22</u>	<u>\$8,511</u>	<u>(\$8,489)</u>	<u>(99.7%)</u>

Expenses (\$ millions)

Source	2008	2007	Increase/(Decrease)	
			Amount	% Change
Benefits payments	\$3,424	\$3,112	\$312	10.0%
Refunds	60	60	-	-
Administrative/Other	17	15	2	13.3
Total	<u>\$3,501</u>	<u>\$3,187</u>	<u>\$314</u>	<u>9.9%</u>

Despite recent turmoil in the financial markets, the TRS Board of Trustees and staff believe the overall investment strategy remains sound. In the future, we will continue to prudently invest for the benefit of our membership and for the long-term success of the system.

Investments

TRS investments declined 4.5 percent gross of fees for the fiscal year ending June 30, 2008 as the United States and global markets entered a very difficult and prolonged period of economic uncertainty. Assets fell to \$38.4 billion, down from \$41.9 billion. The fund also modestly underperformed its performance benchmark, which declined 4.1 percent during the one-year period. In light of the changing economic environment, TRS staff and the Board of Trustees remained diligent in the prudent positioning of the fund for long-term rebalancing over the course of the fiscal year.

The Investment Section of this report contains a summary of the portfolio and investment activities.

Funding

During the year ended June 30, 2008, the funded ratio of the Teachers' Retirement System decreased from 63.8 percent to 56.0 percent. The actuarial value of assets at year end (net assets at market value) was \$38.4 billion and the actuarial accrued liability was \$68.6 billion. The decline in the funded ratio was primarily a result of investment losses and asset sales which were offset slightly by actuarial gains during the year.

The Actuarial Section of this report contains the actuary's letter and further information on TRS funding.

Major Initiatives

In 2006, TRS Board and staff members composed the following TRS mission statement "*Safeguard benefit security through committed staff, engaged members, and responsible funding.*" This statement reminds us of our commitment to make decisions that benefit and stabilize the retirement system. In the future, we will continue to prudently invest for the gain of our membership and attempt to improve our funded ratio.

GFOA Award

The Government Finance Officers Association of the United States and Canada (GFOA) awarded a Certificate of Achievement for Excellence in Financial Reporting to TRS for its *Comprehensive Annual Financial Report* for the fiscal year ended June 30, 2007. The Certificate of Achievement is a prestigious national award recognizing excellence in the preparation of state and local government financial reports.

To be awarded the certificate, a government unit must publish an easily readable and efficiently organized comprehensive annual financial report 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. TRS has received a certificate for the last 19 years. We believe our current report continues to meet the program requirements and are submitting it to the GFOA for consideration again this year.

Acknowledgements

Information for this report was gathered by and reflects the combined efforts of TRS staff under the leadership of the Board of Trustees and the executive director. It is intended to provide complete and reliable information as a basis for making management decisions, to determine our compliance with legal provisions, and as a means of determining responsible stewardship of the assets contributed by members and their employers.

This report is made available to members of the General Assembly, participating employers, and to other interested persons by request. The participating employers of TRS form a link between TRS and its members. Their cooperation contributes significantly to our success. We hope all recipients of this report find it informative and useful. This report is also available to the general public on our Web site, trs.illinois.gov.

We would like to take this opportunity to express our gratitude to staff, professional consultants, and others who have worked so diligently to ensure TRS's successful operation.



Jon Bauman
Executive Director



Jana Bergschneider, CPA
Director of Administration

Pencil by Jael Bieisch, TRS employee.



Board of Trustees

As of December 1, 2008



Christopher A. Koch, Ed.D.
President
Bloomington



Molly Phalen
Vice President
Rockford



**Marcia Boone
O'Fallon**



James Bruner
Jacksonville



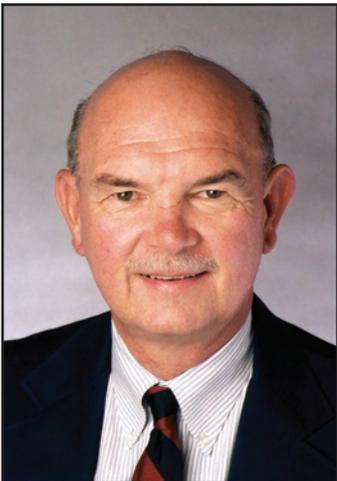
**Jan Cleveland
Carmi**



Cinda Klickna
Rochester



Sharon Leggett
Evanston



Bob Lyons
Hoffman Estates



**Cynthia O'Neill
Carlyle**



William Orrill
Carbondale

Organizational Structure

Executive Staff Members as of December 1, 2008

Board of Trustees



Jon Bauman
Executive Director



Jana Bergschneider, CPA
Director of
Administration



Kathleen Farney, CEBS
Director of
Research



Eva Goltermann
Public Information
Officer



Tom Gray
General Counsel



Gina Larkin
Director of
Human Resources



Kathy Pearce
Communications
Manager



Stan Rupnik, CFA
Chief Investment
Officer



Sally Sherman
Director of
Member Services



Stacy Smith, CPA
Director of
Internal Audit

Consulting and Professional Services

Actuary

Buck Consultants, an ACS Company
Chicago, Illinois

External Auditors

(As special assistants to the Office of the Auditor General)

BKD, L.L.P.
Decatur, Illinois

Information Systems

E Loyalty Corporation
Chicago, Illinois

Sentinel Technologies
Chicago, Illinois

Systems Evaluation & Analysis
Springfield, Illinois

Hupp Information Technologies
Springfield, Illinois

SunGard Availability Services
Chicago, Illinois

VeriSign, Inc.
Toronto, Ontario

Investment Consultants

(Investment management firms are listed in the Investment Section.)

Callan Associates Inc.
(real estate consultant)
San Francisco, California

Risk Resources
(real estate insurance)
Elmhurst, Illinois

PCG Asset Management L.L.C.
(private equity consultant)
La Jolla, California

R.V. Kuhns & Associates, Inc.
(general consultant)
Portland, Oregon

External Legal Counsel

Cavanagh & O'Hara
Springfield, Illinois

Holland & Knight L.L.P.
Chicago, Illinois

Loewenstein Hagen & Smith
Springfield, Illinois

Sorling Northrup Hanna Cullen
Springfield, Illinois

Heyl Royster Voelker & Allen
Springfield, Illinois

Howard & Howard
Peoria, Illinois

Mayer Brown Rowe & Maw
Chicago, Illinois

Master Trustee

The Northern Trust Company
Chicago, Illinois