Working for You

Annual Financial Report Summary for the Fiscal Year Ended June 30, 2005

A Message from the Executive Director

December 15, 2005

Great things are often accomplished by relatively small numbers of people working together toward a great cause. At TRS, a staff of 165 employees shares the common goal of providing retirement security for over 325,000 Illinois educators. It is fitting that this report, which documents our stewardship of your retirement fund, also recognizes the exceptional contributions of the individuals who achieve a high level of stewardship on your behalf.

In various ways, the staff that serves you well year-in and year-out truly accomplished great things in 2005. During the "ERO surge" that increased retirements by 50 percent, our staff maintained a caring, personal and professional commitment to member service. TRS investments returned over 10.8 percent, substantially exceeding the median public fund return. Long-sought legislative goals were achieved and many operational improvements were implemented.

This year's annual report theme, "Working for you," salutes our valued workforce. As you view the photos and read the captions, I hope you will appreciate how our staff contributes to the success of the retirement system.

Influx of Retirement Applications Processed Quickly

The possibility that the Early Retirement Option (ERO) might not be extended prompted many members to retire under the existing law. Well over 6,900 members chose to retire, including 3,638 who opted for ERO. Quite remarkably, despite near-record retirements, initial benefit payments commenced in record time. Nearly half of all summer-season retirees received their first check prior to July 1, a substantial improvement over prior years. The advance resulted from noteworthy improvements and changes in the retirement process. For example, members were encouraged to initiate their Personalized Retirement Interview (PRI) much earlier in the year. The PRI itself was made available online in addition to the traditional on-site and telephone interviews. We encouraged school districts to file supplementary reports for retiring members in advance of the actual retirement date so that review and processing would be complete by the member's expected retirement date. The changes enhanced our efficiency and reduced our reliance on overtime.

Legislative Changes

ERO Extended. A difficult and lengthy effort to extend the Early Retirement Option concluded with reauthorization on a revenue-neutral basis. The modifications will allow the program to continue at least through 2012. The extension includes a "Pipeline" provision for members who notified their employers on or before June 1, 2005 of

their intention to retire under the terms of contracts or collective bargaining agreements. These members will be allowed to use the provisions of the law that expired on June 30, 2005.

Disability Return to Work Enacted. A new law allows individuals who have received TRS disability benefits for one year or more to return to part-time, TRS-covered employment if their medical conditions improve. On a limited basis, members may tutor, substitute, or part-time teach for a TRS-covered employer without loss of disability benefits as long as the combined earnings from teaching and disability benefits do not exceed 100 percent of the salary upon which the benefit was based.

Double-digit Investment Returns

Propelled by strong fourth quarter performance in all asset classes and the strength of the private equity market, the TRS investment portfolio enjoyed another outstanding year in fiscal year 2005. Among the year's major accomplishments:

- TRS's net assets reached $34 billion at June 30, an all-time high.
- The TRS pension obligation bond (POB) portfolio reached $1 billion in additional value since its inception two years ago.
- As in four of the last five years, TRS was the top performing Illinois state pension fund.
- TRS investment performance has consistently ranked at or near the top quartile and ranks in the top 10 percent of its peer universe over the last five years.

Working Harder for You

Our commitment to outstanding service is exemplified by the following:

- In response to member requests, Social Security numbers were removed from correspondence and reports.
- The secure area of the TRS Web site was redesigned with more features. Members may update their personalized information, pay TRS balances online, view information from their TRS Benefits Report, and more.
- Retirement, survivor, and disability benefit videos were also added to the Web site.
- A survey of TRS-covered employers gave TRS high marks in all areas. The staff also conducted 93 employer meetings to provide training and discuss issues affecting employers.

In Closing

Each year brings new challenges. For example, the reductions in TRS state funding for fiscal years 2006 and 2007 contained in Public Act 94-0004 will worsen our negative cash flow and increase the dependency upon successful investment performance to maintain financial stability. During the past year, my associates and I were sickened by revelations of misconduct by two former appointed trustees of the fund that extended to a former external counsel. While the revelations in no way implicated TRS or alleged any financial losses or misconduct, our good name was unfairly dishonored. Thankfully, our investment performance and our fundamental integrity remain strong.

Rest assured that the staff of TRS is more than equal to the tests of these and other challenges facing us in the year ahead. We will never stop working for you — the members, annuitants, and employers of TRS.

Sincerely,

Jon Bauman
Executive Director

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Executive Staff Members as of June 30, 2005

Jon Bauman
Executive
Director

Kathleen Farney
Director of
Research

Tom Gray
General Counsel

Todd Kennedy
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Administration

Gina Larkin
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Member Services

Nick Yelverton
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Condensed Comparative Statement of Plan Net Assets as of June 30

	2005	2004	Percentage Change
Cash	$3,777,107	$4,269,329	(11.5%)
Receivables and prepaid expenses	382,518,911	353,725,714	8.1
Investments	34,898,361,784	32,046,373,325	8.9
Invested securities lending collateral	4,386,594,663	3,466,114,601	26.6
Capital assets	2,320,275	2,273,510	2.1
Total assets	**39,673,572,740**	**35,872,756,479**	**10.6**
Total liabilities	**5,588,354,263**	**4,328,027,194**	**29.1**
Net assets	**$34,085,218,477**	**$31,544,729,285**	**8.1%**

Condensed Comparative Statement of Changes in Plan Net Assets For the Year Ended June 30

	2005	2004	Percentage Change
Contributions	$1,817,352,355	$6,258,086,538	(71.0%)
Total investment income	3,330,039,158	4,485,729,345	(25.8)
Total additions	5,147,391,513	10,743,815,883	(52.1)
Benefits and refunds	2,592,498,606	2,310,349,123	12.2
Administrative expenses	14,403,715	13,560,546	6.2
Total deductions	2,606, 902,321	2,323,909,669	12.2
Net increase in net assets	**2,540,489,192**	**8,419,906,214**	**(69.8)**
Net assets beginning of year	**31,544,729,285**	**23,124,823,071**	**36.4**
Net assets end of year	**$34,085,218,477**	**$31,544,729,285**	**8.1%**

Mary of Counseling Services in Lisle prepares teachers for retirement.

Kim of Counseling Services answers a member question about the retirement process.

Michael Bracey Photography

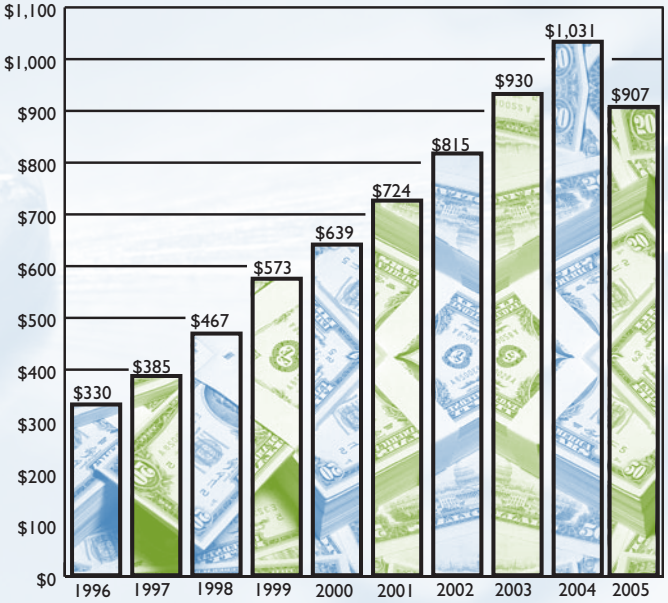
Financial Highlights

- TRS net assets at June 30, 2005, were $34.1 billion.
- During fiscal year 2005, TRS net assets increased $2.5 billion.
- Contributions from members, employers, and the state of Illinois were $1,817 million, a decrease of $4,441 million or 71.0 percent during the fiscal year. Pension obligation bond proceeds of $4,330 million were received from the state of Illinois in fiscal year 2004 so the decline in fiscal year 2005 receipts was relatively steep.
- Total investment income was $3,330 million, a decrease of $1,156 million compared to fiscal year 2004.
- Benefits and refunds paid to members and annuitants were $2,593 million, an increase of $283 million or 12.2 percent compared to fiscal year 2004.
- The pension benefit obligation or total actuarial accrued liability was $56.08 billion at June 30, 2005.
- The unfunded actuarial accrued liability increased from $19.40 billion at June 30, 2004 to $21.99 billion at June 30, 2005. The funded ratio decreased from 61.9 percent at June 30, 2004 to 60.8 percent at June 30, 2005.

State Funding

State funding is provided through a continuing appropriation that provides for automatic transfers of state monies to TRS. Fiscal year 2005 marked the tenth consecutive year that the state fully met its statutory funding obligations. The decline in the fiscal year 2005 appropriation is due to a revised calculation described by the pension obligation bond legislation of 2003. Public Act 94-0004 specifies significantly lower appropriations for fiscal years 2006 and 2007.

State Appropriations ($ in millions)



Russ, Shirley, and Kathie of the Member Services Call Center resolve a member issue.

Claire of Counseling Services and Paula of Human Resources work out a benefit estimate for a member.

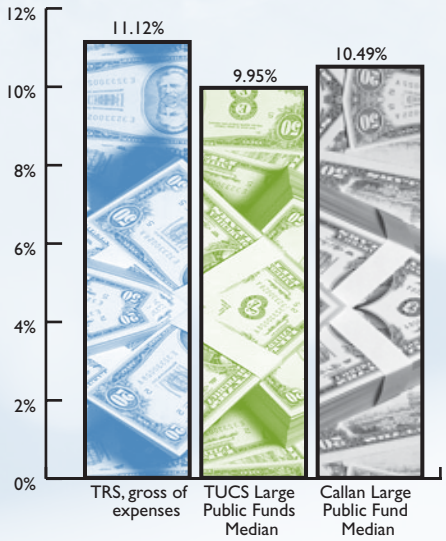
Investments

The TRS investment portfolio had another strong year, returning 10.8 percent net of fees. This number follows strong fiscal year 2004 performance of 16.5 percent, net of fees, as all asset classes again produced positive returns. Overall, the United States economy remained vibrant and inflation restrained, providing a healthy investment environment. Substantial gains were accumulated in the private markets in fiscal year 2005 with the TRS real estate portfolio generating a 19.9 percent return, net of fees, and the TRS private equity portfolio returning 20.0 percent, net of fees.

The TRS investment portfolio continued to rank highly against its peers. Over the past five years, TRS ranks in the top decile of the large public funds in the Callan Associates' universe and in the top 14 percent in the Wilshire Trust Universe Comparison Service (TUCS).

Total TRS investments, including accrued income, increased by nearly $2.9 billion during the year ended June 30, 2005. All asset classes had another positive year with private equity and real estate leading the way. International equity had another stellar year with a net of fees return of 17.3 percent, driven by the emerging markets. Rounding out the asset classes, domestic equity returned 8.1 percent, net of fees, and fixed income returned 6.6 percent, net of fees.

TRS Returns Compared to Other Large Public Funds*

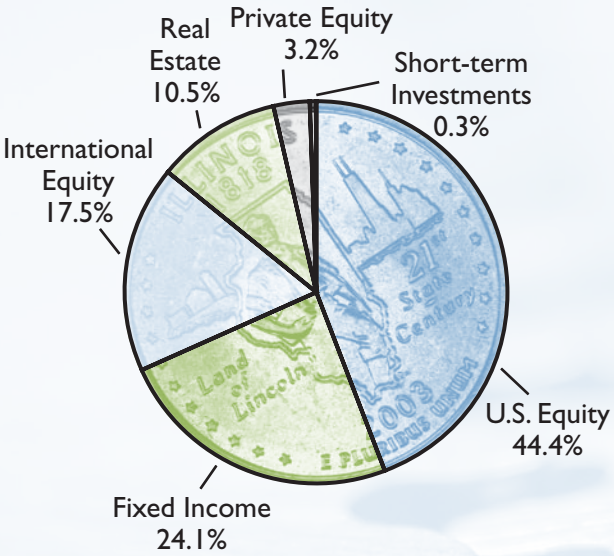


**The total return also surpassed the 8.5 percent actuarial return assumption and the real rate of return expectation, which is to exceed the rate of inflation, as measured by the Consumer Price Index, by 5.0 percent.*

Investment Portfolio

The TRS investment portfolio is well-diversified and is shown in actual figures as of June 30, 2005, on the chart below. By investing in a broad range of asset classes, TRS minimizes risk and achieves more consistent investment returns.

Fiscal Year 2005 Asset Allocation



TRS Investment Performance (net of fees)

	1 yr	2 yrs	3 yrs	5 yrs	10 yrs	20 yrs
Rate of return	10.8%	13.6%	10.6%	4.7%	9.5%	10.3%

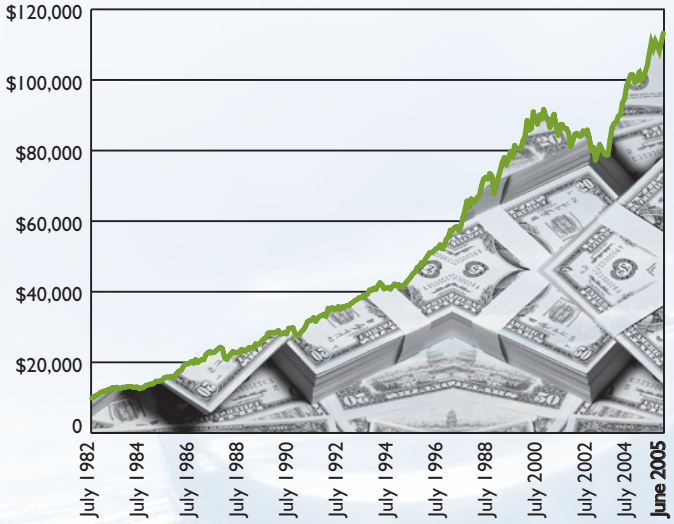
Top 10 U.S. Equity Holdings

Firm	Market Value
Citigroup, Inc.	$158,866,667
General Electric Co.	138,231,428
Pfizer, Inc.	110,492,154
Microsoft Corp.	109,546,064
Exxon Mobil Corp.	107,182,642
Chevron Corp.	92,150,680
Johnson & Johnson	86,904,155
Hewlett Packard, Co.	82,391,359
Time Warner, Inc.	78,761,683
American International Group, Inc.	75,790,869
Total	**$1,040,317,701**

Source: The Northern Trust Company

Growth of $10,000

Over the years, TRS's asset allocation has provided consistent overall returns, as represented by the following chart showing the growth of $10,000 over the last 23 years. Despite the economic downturn in 2000 through 2003, the overall trend is solidly favorable.



Actuarial

In simple terms, a retirement system accumulates dollars today to pay future pensions and benefits when members retire or die. Each year, our actuary measures the value in today's dollars of the benefits earned by our members and the value of TRS investments available to pay current and future benefits. Here are the key results of the current actuarial valuation compared to the prior year's valuation:

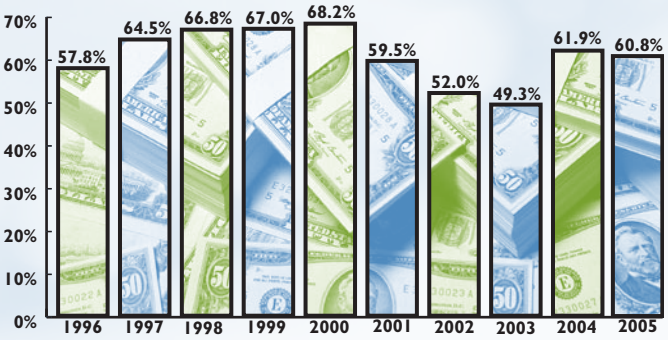
Actuarial Valuation ($ in thousands)

	Years Ended June 30	
	2005	**2004**
Actuarial accrued liability	$56,075,029	$50,947,451
Net assets at market value	$34,085,218	$31,544,729
Unfunded liability	$21,989,811	$19,402,722

Member Statistics

Full and Part-time Active Members	
Average age	42
Average years of service	12
Average annual salary	$55,237
Average Age of Substitutes	41
Retired Members	
Average age	69
Average service	29
Average annual benefit	$36,516
Oldest annuitant	106

Funded Ratio



Kim and Mindy of the Member Services Department discuss a survivor claim.

Marcy, Sue, Leah, and Debbie of the Accounting Department meet to discuss employer remittances.

Vickie and Jeff of the Employer Services Department discuss the employers' annual reporting season.

Fiscal Year Highlights

	2005	2004
Active contributing members	155,850	157,990
Inactive noncontributing members	87,328	89,641
Benefit recipients	82,575	76,905
Total membership	325,753	324,536
Actuarial accrued liability (AAL)	$56,075,029,000	$50,947,451,000
Less net assets held in trust for pension benefits	34,085,218,000	31,544,729,000
Unfunded actuarial accrued liability (UAAL)	$21,989,811,000	$19,402,722,000
Funded ratio (actuarial value of assets/AAL)	60.8%	61.9%
Total fund investment return, net of fees	10.8%	16.5%
Expenses		
Benefits paid	$2,533,102,848	$2,262,329,479
Refunds paid	59,395,758	48,019,644
Administrative Expenses	14,403,715	13,560,546
Total	$2,606,902,321	$2,323,909,669
Income		
Member contributions*	$761,790,009	$768,661,300
Employer contributions (includes State of Illinois contributions)	1,055,562,346	1,159,051,290
State of Illinois pension obligation bond proceeds	0	4,330,373,948
Total investment income	3,330,039,158	4,485,729,345
Total	$5,147,391,513	$10,743,815,883

** Includes member payments and accounts receivable under the Payroll Deduction Program.*

This publication is a summary of the Comprehensive Annual Financial Report *for the fiscal year ended June 30, 2005. The comprehensive report, which has more detailed information, is available at our Web site, trs.illinois.gov, or by calling (800) 877-7896.*

Cover photos left to right:
Jamie and Kayla of the Records Center retrieve member records to fill staff requests.
Catherine and Mark of the Member Services Department discuss a member issue.
Tim of Counseling Services greets a TRS member.

Terry and Donnie of Support Services sort incoming mail.

Jeremy of Information Systems troubleshoots a computer issue with Barb of Member Services.

Alice and Mable of Administrative Services review the progress of a special project.