SIKICH

STATE OF ILLINOIS
DEPARTMENT OF HEALTHCARE
AND FAMILY SERVICES

FINANCIAL AUDIT

Performed as Special Assistant Auditors
for the Auditor General, State of Illinois

For the Year Ended June 30, 2017

SIKICH.COM

STATE OF ILLINOIS
DEPARTMENT OF HEALTHCARE AND FAMILY SERVICES

FINANCIAL AUDIT
For the Year Ended June 30, 2017

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STATE OF ILLINOIS
DEPARTMENT OF HEALTHCARE AND FAMILY SERVICES

FINANCIAL AUDIT
For the Year Ended June 30, 2017

AGENCY OFFICIALS

Director	Felicia Norwood
Assistant Director	Vacant
Chief of Staff	Ray Marchiori (through 8/18/2017) Vacant (8/17/2017 to 12/15/2017) Shawn McGady (12/16/2017 to current)
Deputy Directors	
Community Outreach	Vacant
Administrative Operations	Richard Foxman (through 12/18/2017) Vacant (12/19/2017 to current)
Human Resources	Vacant
Strategic Planning	Michael Taylor (through 7/15/2016) Douglas O'Brien (8/1/2016 to 8/11/2017) Vacant (8/12/2017 to current)
General Counsel	Mollie Zito (through 1/31/2018) Vacant (2/1/2018 to 2/22/2018) Christopher Gange, Acting (2/23/2018 to current)
Inspector General	Bradley Hart
Administrators	
Division of Child Support Services	Pamela Lowry
Division of Finance	Michael Casey
Division of Medical Programs	Teresa Hursey, Acting
Division of Personnel and Administrative Services	Terri Shawgo
Chiefs	
Office of Legislative Affairs	Shawn McGady (through 12/15/2017) Vacant (12/16/2017 to current)
Office of Fiscal Management	Jack Dodds
Office of Information Services	Julie Hagele (through 2/27/2017) Vacant (2/28/2017) Graham Osmonson (3/1/2017 to current)

Department administrative offices are located at:

201 South Grand Avenue East
Springfield, IL 62763

2200 Churchill Road
Springfield, IL 62702

401 South Clinton
Chicago, IL 60607

FINANCIAL STATEMENT REPORT

SUMMARY

The audit of the accompanying financial statements of the State of Illinois, Department of Healthcare and Family Services (Department) was performed by Sikich LLP.

Based on their audit, the auditors expressed an unmodified opinion on the Department's basic financial statements.

SUMMARY OF FINDINGS

The auditors identified matters involving the Department's internal control over financial reporting they considered to be material weaknesses or significant deficiencies. The material weaknesses are described in the accompanying Schedule of Findings on pages 46-62 and 65-74 of this report as items:

- 2017-001 (Inadequate controls over fiscally monitoring Managed Care Organizations)
- 2017-002 (Department did not seek potential refunds from Managed Care Organizations)
- 2017-003 (Financial statement preparation)
- 2017-004 (Inaccurate rate used to pay Managed Care Organizations)
- 2017-005 (Incorrect claim payments made to medical providers and Managed Care Organizations)
- 2017-006 (Backlog of applications for human service programs)
- 2017-007 (Untimely redetermination of eligibility)
- 2017-009 (Lack of controls over changes to the Integrated Eligibility System)
- 2017-010 (Lack of security controls over the IES computing environment)
- 2017-011 (Lack of adequate controls over the review of internal controls over service providers)
- 2017-012 (Inadequate controls over drug rate changes)
- 2017-013 (Inadequate project management over the Pharmacy Benefits Management System)

The significant deficiency is described in the accompanying Schedule of Findings on pages 63-64 of this report as item 2017-008 (Inaccurate determination of eligibility for human service programs).

EXIT CONFERENCE

The findings and recommendations appearing in this report were discussed with Department personnel at an exit conference on February 23, 2018.

Attending were:

Department of Healthcare and Family Services
Felicia Norwood, Director
Keith Burklow, Bureau Chief – Bureau of Federal Finance
Amy Lyons, Audit Liaison
Shawn McGady, Chief of Staff
Christopher Gange, Acting General Counsel
Renee Perry, Bureau of Technical Services – PBMS Project Manager
Mark Huston, Bureau Chief – Bureau of Professional and Ancillary Services
Lynne Thomas, Deputy Administrator – Medical Eligibility Policy
Michael Casey, Finance Administrator

Department of Healthcare and Family Services – Continued
Jamie Nardulli, Chief Internal Auditor
Katey Staley, Manager – Bureau of Rate Development and Analysis
Dan Jenkins, Bureau Chief – Bureau of Rate Development and Analysis
Kelly Cunningham, Deputy Administrator – Long Term Care
Teresa Hursey, Acting Administrator – Division of Medical Programs

Office of the Auditor General
Janis VanDurme, Manager
Kathy Lovejoy, Manager

Sikich LLP
Thomas Leach, Partner
Meredith Angel, Senior Manager

The responses to the recommendations were provided by Felicia Norwood, Director, in correspondence dated March 2, 2018.

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Decatur, IL 62523
217.423.6000

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INDEPENDENT AUDITOR'S REPORT

Honorable Frank J. Mautino
Auditor General
State of Illinois

Report on the Financial Statements

As Special Assistant Auditors for the Auditor General, we have audited the accompanying financial statements of the governmental activities, the major fund, and the aggregate remaining fund information of the State of Illinois, Department of Healthcare and Family Services (Department), as of and for the year ended June 30, 2017, and the related notes to the financial statements, which collectively comprise the Department's basic financial statements as listed in the table of contents.

Management's Responsibility for the Financial Statements

Management is responsible for the preparation and fair presentation of these financial statements in accordance with accounting principles generally accepted in the United States of America; this includes the design, implementation, and maintenance of internal control relevant to the preparation and fair presentation of financial statements that are free from material misstatement, whether due to fraud or error.

Auditor's Responsibility

Our responsibility is to express opinions on these financial statements based on our audit. We conducted our audit in accordance with 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. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and fair presentation of the financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. Accordingly, we express no such opinion. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of significant accounting estimates made by management, as well as evaluating the overall presentation of the financial statements.

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinions.

Opinions

In our opinion, the financial statements referred to above present fairly, in all material respects, the respective financial position of the governmental activities, the major fund, and the aggregate remaining fund information for the Department, as of June 30, 2017, and the respective changes in financial position thereof for the year then ended in accordance with accounting principles generally accepted in the United States of America.

Emphasis of Matters

As discussed in Note 2, the financial statements of the Department are intended to present the financial position and the changes in financial position of only that portion of the governmental activities, the major fund, and the aggregate remaining fund information of the State that is attributable to the transactions of the Department. They do not purport to, and do not, present fairly the financial position of the State of Illinois as of June 30, 2017, and the changes in its financial position for the year then ended in conformity with accounting principles generally accepted in the United States of America. Our opinion is not modified with respect to this matter.

As discussed in Note 15, the Department's financial statements have been restated, as of July 1, 2016, to correct prior year misstatements. Our opinion is not modified with respect to this matter.

As discussed in Note 2 and above, the Department is not legally separate from the State of Illinois, and it relies heavily on the State's ability to appropriate resources for the continuation of the Department's health and social services programs. For the year ended June 30, 2017, approximately 28% of the Department's expenditures were funded with appropriations from the State of Illinois rather than from grants, fees and other revenues of the Department. Our opinion is not modified with respect to this matter.

Other Matters

Required Supplementary Information

Management has omitted management's discussion and analysis and budgetary comparison information for any of its funds and related pension and other postemployment benefit information for its Department-wide financial statements that accounting principles generally accepted in the United States of America require to be presented to supplement the basic financial statements. Such missing information, although not a part of the basic financial statements, is required by the Governmental Accounting Standards Board who considers it to be an essential part of financial reporting for placing the basic financial statements in an appropriate operational, economic, or historical context. Our opinion on the basic financial statements is not affected by this missing information.

Other Information

Our audit was conducted for the purpose of forming opinions on the financial statements that collectively comprise the Department's basic financial statements. The combining General Fund schedules and nonmajor governmental and agency funds financial statements are presented for purposes of additional analysis and are not a required part of the basic financial statements.

The combining General Fund schedules and nonmajor governmental and agency funds financial statements are the responsibility of management and were derived from and relate directly to the underlying accounting and other records used to prepare the basic financial statements. Such information 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 combining General Fund schedules and nonmajor governmental and agency funds financial statements are fairly stated, in all material respects, in relation to the basic financial statements as a whole.

Other Reporting Required by *Government Auditing Standards*

In accordance with *Government Auditing Standards*, we have also issued our report dated March 6, 2018 on our consideration of the Department's internal control over financial reporting and on our tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements and other matters. The purpose of that report is solely to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing, and not to provide an opinion on the effectiveness of the Department's internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* in considering the Department's internal control over financial reporting and compliance.

Restricted Use of this Auditor's Report

This report is intended solely for the information and use of the Auditor General, the General Assembly, the Legislative Audit Commission, the Governor, the Comptroller, and Department management and is not intended to be and should not be used by anyone other than these specified parties.

SIGNED ORIGINAL ON FILE

Decatur, Illinois
March 6, 2018

Statement of Net Position and Governmental Funds Balance Sheet

June 30, 2017 (Expressed in Thousands)

	General Fund	Other Nonmajor Funds	Total Governmental Funds	Adjustments	Statement of Net Position
ASSETS AND DEFERRED OUTFLOWS OF RESOURCES					
Unexpended appropriations	$ 2,291,314	$ 162	$ 2,291,476	$ -	$ 2,291,476
Cash equity with State Treasurer	1,019,724	15,595	1,035,319	-	1,035,319
Cash and cash equivalents	7,118	-	7,118	-	7,118
Securities lending collateral equity with State Treasurer	72,406	1,776	74,182	-	74,182
Due from other government - federal	3,959,288	23,199	3,982,487	-	3,982,487
Due from other government - local	52,407	-	52,407	-	52,407
Taxes receivable, net	74,930	-	74,930	-	74,930
Other receivables, net	556,302	9,165	565,467	-	565,467
Due from other Department funds	-	16,000	16,000	(16,000)	-
Due from other State funds	8,584	146	8,730	-	8,730
Due from State of Illinois component units	4,570	28	4,598	-	4,598
Prepaid expenses	-	-	-	384	384
Capital assets not being depreciated	-	-	-	123,538	123,538
Capital assets being depreciated, net	-	-	-	1,349	1,349
Total assets	8,046,643	66,071	8,112,714	109,271	8,221,985
Deferred outflows of resources - SERS pensions	-	-	-	262,476	262,476
Total assets and deferred outflows of resources	$ 8,046,643	$ 66,071	$ 8,112,714	371,747	8,484,461
LIABILITIES AND DEFERRED INFLOWS OF RESOURCES					
Accounts payable and accrued liabilities	$ 5,562,831	$ 7,884	$ 5,570,715	-	5,570,715
Due to other government - federal	974,047	5,548	979,595	-	979,595
Due to other government - local	127,228	10,364	137,592	-	137,592
Due to other State fiduciary funds	447	975	1,422	-	1,422
Due to other Department funds	16,000	-	16,000	(16,000)	-
Due to other State funds	62,387	11,301	73,688	-	73,688
Due to State of Illinois component units	35,549	256	35,805	-	35,805
Unearned Revenue	11,521	-	11,521	-	11,521
Obligations under securities lending of State Treasurer	72,406	1,776	74,182	-	74,182
Long-term obligations:					
Due within one year	-	-	-	1,084	1,084
Due subsequent to one year	-	-	-	8,469	8,469
Net pension liability - SERS	-	-	-	1,192,597	1,192,597
Total liabilities	6,862,416	38,104	6,900,520	1,186,150	8,086,670

Statement of Net Position and Governmental Funds Balance Sheet

June 30, 2017 (Expressed in Thousands)

	General Fund	Other Nonmajor Funds	Total Governmental Funds	Adjustments	Statement of Net Position
Unavailable revenue - Federal operating grants	$ 2,545,429	$ 18,962	$ 2,564,391	$ (2,564,391)	$ -
Unavailable revenue - License and fees	662	191	853	(853)	-
Unavailable revenue - Medical provider assessment tax	24,233	-	24,233	(24,233)	-
Unavailable revenue - Other taxes	441	-	441	(441)	-
Unavailable revenue - Other operating grants	48,863	-	48,863	(48,863)	-
Unavailable revenue - Other revenues	41,155	-	41,155	(41,155)	-
Deferred inflows of resources - SERS pensions	-	-	-	83,298	83,298
Total deferred inflows of resources	2,660,783	19,153	2,679,936	(2,596,638)	83,298
Total liabilities and deferred inflows of resources	9,523,199	57,257	9,580,456	(1,410,488)	8,169,968
FUND BALANCES (DEFICITS)/NET POSITION					
Committed for health and social services	756,147	8,814	764,961	(764,961)	-
Unassigned	(2,232,703)	-	(2,232,703)	2,232,703	-
Net investment in capital assets	-	-	-	124,887	124,887
Unrestricted net position	-	-	-	189,606	189,606
Total fund balances (deficits)/net position	(1,476,556)	8,814	(1,467,742)	$ 1,782,235	$ 314,493
Total liabilities, deferred inflows of resources and fund balances (deficits)	$ 8,046,643	$ 66,071	$ 8,112,714		

The accompanying notes to the financial statements are an integral part of this statement.

State of Illinois
Department of Healthcare and Family Services
Reconciliation of Governmental Funds Balance Sheet
to Statement of Net Position
June 30, 2017
(Expressed in Thousands)

Total fund balances (deficits)-governmental funds	$	(1,467,742)
Amounts reported for governmental activities in the Statement of Net Position are different because:		
Capital assets used in governmental activities are not financial resources and therefore are not reported in the funds.		124,887
Prepaid expenses for governmental activities are current uses of financial resources for funds.		384
Revenues in the Statement of Activities that do not provide current financial resources are deferred in the funds.		2,679,936
Deferred outflows of resources related to pension liability are not reported in the governmental funds since they do not provide current financial resources.		262,476
Deferred inflows of resources related to pension liability are not reported in the governmental funds since they do not use current financial resources.		(83,298)
Some liabilities reported in the Statement of Net Position do not require the use of current financial resources and, therefore, are not reported as liabilities in governmental funds. These activities consist of:		
Compensated absences		(9,553)
Net pension liability - SERS		(1,192,597)
Net position of governmental activities	$	314,493

The accompanying notes to the financial statements are an integral part of this statement.

Statement of Activities and Governmental Revenues, Expenditures, and Changes in Fund Balances

For the Year Ended June 30, 2017 (Expressed in Thousands)

	General Fund	Other Nonmajor Funds	Total Governmental Funds	Adjustments	Statement of Activities
Expenditures/expenses:					
Health and social services	$ 17,418,017	$ 311,098	$ 17,729,115	$ 73,115	$ 17,802,230
Debt service principal	10	1	11	(11)	-
Debt service interest	1	-	1	-	1
Capital outlays	31,853	4	31,857	(31,857)	-
Total expenditures/expenses	17,449,881	311,103	17,760,984	41,247	17,802,231
Program revenues:					
Charges for services:					
Licenses and fees	30,629	1,121	31,750	(279)	31,471
Other, net	-	11,960	11,960	-	11,960
Total charges for services	30,629	13,081	43,710	(279)	43,431
Operating grant revenue:					
Federal, net	10,807,020	195,206	11,002,226	1,765,139	12,767,365
Other	978,556	-	978,556	(32,316)	946,240
Total operating grant revenue	11,785,576	195,206	11,980,782	1,732,823	13,713,605
Net program revenues (expenses)	(5,633,676)	(102,816)	(5,736,492)	1,691,297	(4,045,195)
General revenues:					
Interest and investment income	2,508	43	2,551	-	2,551
Medical provider assesment tax	1,545,511	-	1,545,511	20,334	1,565,845
Other taxes, net	423,523	-	423,523	(696)	422,827
Other	10,157	-	10,157	25,100	35,257
Total general revenues	1,981,699	43	1,981,742	44,738	2,026,480
Other sources (uses):					
Appropriations from State resources	7,213,914	200,600	7,414,514	-	7,414,514
Lapsed appropriations	(2,294,588)	(18,024)	(2,312,612)	-	(2,312,612)
Receipts collected and transmitted to State Treasury	(2,602,327)	(149,811)	(2,752,138)	-	(2,752,138)
Capital transfers from other State agencies	-	-	-	5,935	5,935
Amount of SAMS transfers-in	(80,000)	-	(80,000)	-	(80,000)
Amount of SAMS transfers-out	45,000	-	45,000	-	45,000
Transfers-in	7,092	43,000	50,092	(43,000)	7,092
Transfers-out	(83,000)	-	(83,000)	43,000	(40,000)
Total other sources (uses)	2,206,091	75,765	2,281,856	5,935	2,287,791
Change in fund balances/net position	(1,445,886)	(27,008)	(1,472,894)	1,741,970	269,076
Fund balances (deficits)/net position, July 1, 2016, as restated	(30,670)	35,822	5,152	40,265	45,417
Fund balances (deficits)/net position, June 30, 2017	$ (1,476,556)	$ 8,814	$ (1,467,742)	$ 1,782,235	$ 314,493

The accompanying notes to the financial statements are an integral part of this statement.

State of Illinois
Department of Healthcare and Family Services
Reconciliation of Statement of Revenues, Expenditures and Changes in Fund Balances of Governmental Funds to Statement of Activities
For the Year Ended June 30, 2017
(Expressed in Thousands)

Net change in fund balances - governmental funds	$(1,472,894)
Amounts reported for governmental activities in the Statement of Activities are different because:	
Governmental funds report capital outlays as expenditures while governmental activities report depreciation expense to allocate those expenditures over the life of the assets. This is the amount by which capital outlays exceeded depreciation in the current period.	30,895
Some capital assets were transferred in from other State agencies and, therefore, were transferred at no cost.	5,935
Prepaid expenses in the Statement of Activities are not reported as expenses in governmental funds.	5
Revenues in the Statement of Activities that do not provide current financial resources are not reported as revenues in the funds. This amount represents the increase in unavailable revenue over the prior year.	1,777,282
Deferred inflows of resources related to pension liability in the Statement of Activities that do not use current financial resources are not reported in the governmental funds. This amount represents the increase in deferred inflows over the prior year.	(14,801)
Deferred outflows of resources related to pension liability in the Statement of Activities that do not provide current financial resources are not reported in the governmental funds. This amount represents the increase in deferred outflows over the prior year.	122,270
Some expenses reported in the Statement of Activities do not require the use of current financial resources and therefore are not reported as expenditures in governmental funds. Also, some expenditures reported in governmental funds decrease the amount of certain long-term liabilities reported on the Statement of Net Position and are therefore reported as expenses in the Statement of Activities. These include:	
Decrease in compensated absences obligation	1,055
Decrease in capital lease obligation	11
Increase in net pension liability - SERS	(180,682)
Change in net position of governmental activities	$ 269,076

The accompanying notes to the financial statements are an integral part of this statement.

Statement of Fiduciary Net Position

June 30, 2017 (Expressed in Thousands)

		Agency Funds
ASSETS		
Cash equity with State Treasurer	$	18,590
Cash and cash equivalents		1,878
Other receivables, net		202,383
Total assets	$	222,851
LIABILITIES		
Accounts payable and accrued liabilities	$	20,871
Other liabilities		201,980
Total liabilities	$	222,851

The accompanying notes to the financial statements are an integral part of this statement.

(1) Organization

The Department of Healthcare and Family Services (Department) is a part of the executive branch of government of the State of Illinois (State) and operates under the authority of and review by the Illinois General Assembly. The Department generally operates under a budget approved by the General Assembly in which resources primarily from the State's General Revenue Fund are appropriated for the use of the Department. Activities of the Department are subject to the authority of the Office of the Governor, the State's chief executive officer, and other departments of the executive and legislative branches of government (such as the Department of Central Management Services, the Governor's Office of Management and Budget, the State Treasurer's Office, and the State Comptroller's Office) as defined by the Illinois General Assembly. All funds appropriated to the Department and all other cash received are under the custody and control of the State Treasurer, with the exception of the Child Support Enforcement Trust Fund – SDU.

The Department is organized to provide for the improvement of the lives of Illinois' families through healthcare coverage and child support enforcement.

(2) Summary of Significant Accounting Policies

The financial statements of the Department have been prepared in accordance with accounting principles generally accepted in the United States of America (GAAP), as prescribed by the Governmental Accounting Standards Board (GASB). To facilitate the understanding of data included in the financial statements, summarized below are the more significant accounting policies.

(a) Financial Reporting Entity

As defined by GAAP, the financial reporting entity consists of a primary government, as well as its component units, which are legally separate organizations for which the elected officials of the primary government are financially accountable. Financial accountability is defined as:

1) Appointment of a voting majority of the component unit's board and either (a) the primary government's ability to impose its will, or (b) the possibility that the component unit will provide a financial benefit to or impose a financial burden on the primary government; or

2) Fiscal dependence on the primary government and the possibility that the component unit will provide a financial benefit to or impose a financial burden on the primary government.

Based upon the required criteria, the Department has no component units and is not a component unit of any other entity. However, because the Department is not legally separate from the State of Illinois, the financial statements of the Department are included in the financial statements of the State of Illinois. The State of Illinois' Comprehensive Annual Financial Report may be obtained by writing to the State Comptroller's Office, Division of Financial Reporting, 325 West Adams Street, Springfield, Illinois, 62704-1871.

(b) Basis of Presentation

The financial statements of the State of Illinois, Department of Healthcare and Family Services, are intended to present the financial position and the changes in financial position of only that portion of the governmental activities, major fund, and the aggregate remaining fund information of the State of Illinois that is attributable to the transactions of the Department. They do not purport to, and do not, present fairly the financial position of the State of Illinois as of June 30, 2017, and the changes in financial position for the year then ended in conformity with accounting principles generally accepted in the United States of America.

The financial activities of the Department, which consist only of governmental activities, are reported under the health and social services function in the State of Illinois' Comprehensive Annual Financial Report. For reporting purposes, the Department has combined the fund and government-wide financial statements using a columnar format that reconciles individual line items of the fund financial data to government-wide data in a separate column. A brief description of the Department's government-wide and fund financial statements is as follows:

Government-wide Statements. The government-wide statement of net position and statement of activities report the overall financial activity of the Department, excluding fiduciary activities. Eliminations have been made to minimize the double-counting of internal activities of the Department. The financial activities of the Department consist of governmental activities, which are generally financed through taxes and intergovernmental revenues.

The statement of net position presents the assets, deferred outflows of resources, liabilities and deferred inflows of resources of the Department's governmental activities with the difference being reported as net position. The assets and liabilities are presented in order of their relative liquidity by class of asset or liability with liabilities whose average maturities are greater than one year reported in two components – the amount due within one year and the amount due in more than one year.

The statement of activities presents a comparison between direct expenses and program revenues for the functions of the Department's governmental activities. Direct expenses are those that are clearly identifiable with a specific function. Program revenues include (a) charges paid by the recipients of goods or services offered by the programs and (b) grants and contributions that are restricted to meeting the operational or capital requirements of a particular program. Revenues that are not classified as program revenues, including all taxes, are presented as general revenues.

Fund Financial Statements. The fund financial statements provide information about the Department's funds, including fiduciary funds. Separate statements for each fund category – governmental and fiduciary – are presented. The emphasis on fund financial statements is the major governmental fund, which is displayed in a separate column. All remaining governmental funds are aggregated and reported as nonmajor funds.

The Department administers the following major governmental fund (or portions thereof in the case of shared funds – see note 2 (d)) of the State:

> **General** – This is the State's primary operating fund. It accounts for all financial resources of the general government, except those required to be accounted for in another fund. The services which are administered by the Department and accounted for in the General Fund include, among others, promoting access to quality healthcare and child support. Certain resources obtained from federal grants and used to support general governmental activities are accounted for in the General Fund consistent with applicable legal requirements. The Department's portion of the General Fund is composed of eight primary sub-accounts (General Revenue, U of I Hospital Services, County Provider Trust, Long-Term Care Provider, Hospital Provider, Budget Stabilization, Drug Rebate and Healthcare Provider Relief) and nine secondary sub-accounts.

Additionally, the Department reports the following fund types:

Governmental Fund Types:

> **Special Revenue** – These funds account for transactions related to resources obtained from specific revenue sources that are restricted or committed to expenditures for specific purposes other than debt service or capital projects.

Fiduciary Fund Types:

Agency – These funds account for transactions related to assets collected by the Department, acting in the capacity of an agent, for distribution to other governmental units or designated beneficiaries.

(c) Measurement Focus and Basis of Accounting

The government-wide and fiduciary fund financial statements are reported using the economic resources measurement focus (except for agency funds which do not have a measurement focus) and the accrual basis of accounting. Revenues are recorded when earned and expenses are recorded at the time liabilities are incurred, regardless of when the related cash flow takes place. Non-exchange transactions, in which the Department gives (or receives) value without directly receiving (or giving) equal value in exchange, include nursing home assessments, hospital assessments and intergovernmental grants. On an accrual basis, revenues from the nursing home assessments are recognized in the fiscal year in which the underlying exchange transaction occurs. Revenue from grants, entitlements, and similar items are recognized in the fiscal year in which all eligibility requirements imposed by the provider have been met.

Governmental funds are reported using the current financial resources measurement focus and the modified accrual basis of accounting. Revenues are recognized as soon as they are both measurable and available. Revenues are considered to be available when they are collected within the current period or soon enough thereafter to pay liabilities of the current period. For this purpose, the State considers revenues to be available if they are collected within 60 days of the end of the current fiscal year. Expenditures generally are recorded when the liability is incurred, as under accrual accounting. However, principal and interest on formal debt issues, claims and judgments, and compensated absences are recorded only when the payment is due. Capital asset acquisitions are reported as expenditures in governmental funds. Proceeds of general long-term debt and acquisitions under capital leases are reported as other financing sources.

Significant revenue sources which are susceptible to accrual include the nursing home assessment, hospital assessments, federal matching revenues, drug rebates, intergovernmental transfer agreement revenues, and child support. Other miscellaneous revenue sources are considered to be measurable and available only when cash is received.

(d) Shared Fund Presentation

The financial statement presentation for the General Revenue, Care Provider for Persons with Developmental Disabilities, the Trauma Center, and the Budget Stabilization Accounts of the General Fund, the Department of Corrections Reimbursement and Education Fund, and the Tobacco Settlement Recovery Fund, nonmajor governmental funds, represent only the portion of the shared fund that can be directly attributed to the operations of the Department. Financial statements for total fund operations of the shared State funds are presented in the State of Illinois' Comprehensive Annual Financial Report.

In presenting these financial statements, certain unique accounts are used for the presentation of shared funds. The following accounts are used in these financial statements to present the Department's portion of shared funds:

<u>Unexpended Appropriations</u>

This "asset" account represents lapse period warrants issued between July and September for fiscal year 2017, in accordance with the Statewide Accounting Management System (SAMS) records, plus any liabilities relating to obligations re-appropriated to the subsequent fiscal year.

Appropriations from State Resources

The "other financing source" account represents the final legally adopted appropriation according to SAMS records. The State of Illinois adopted a six-month budget for fiscal year 2017. The partial year "stopgap" budget was signed into law on June 30, 2016 and provided funding for six months through December 2016. Payments to Department employees for work performed and medical assistance payments through December 2016 were paid from the six month budget. On July 6, 2017 the State of Illinois passed a full operating budget for fiscal year 2018 (P.A. 100-0023) and a supplemental bill (P.A. 100-0021) to be used for fiscal year 2017 expenditures. The supplemental bill provided additional appropriations to be used for expenditures incurred through June 30, 2017.

Lapsed Appropriations

Lapsed appropriations are the legally adopted appropriations less net warrants issued for the 15 month period from July to September of the following year and re-appropriations to subsequent years according to SAMS records. Lapsed appropriations for certain Medicaid expenditures are the legally adopted appropriations less net warrants issued for the 16 month period from July to October of the following year.

Receipts Collected and Transmitted to State Treasury

This "other financing use" account represents all cash receipts received during the fiscal year from SAMS records.

Amount of SAMS Transfers-In

This "other financing use" account represents cash transfers made by the Office of the Comptroller in accordance with statutory provisions to the corresponding fund during the fiscal year per SAMS records in which the Department did not make a deposit into the State Treasury.

Amount of SAMS Transfers-Out

This "other financing source" account represents cash transfers made by the Office of the Comptroller in accordance with statutory provision from the corresponding fund during the fiscal year per SAMS records in which a legally adopted appropriation was not charged.

(e) Eliminations

Eliminations have been made in the government-wide statement of net position to minimize the "grossing-up" effect on assets and liabilities within the governmental activities column of the Department. As a result, amounts reported in the governmental funds balance sheet as interdepartmental interfund receivables and payables have been eliminated in the government-wide statement of net position. Amounts reported in the governmental funds balance sheet as receivable from or payable to fiduciary funds have been included in the government-wide statement of net position as receivable from and payable to external parties, rather than as internal balances.

(f) Cash and Cash Equivalents

Cash equivalents are defined as short-term, highly liquid investments readily convertible to cash with maturities of less than 90 days at the time of purchase. Cash and cash equivalents include cash on hand and cash in banks for locally held funds.

(g) Investments

Most investments are reported at fair value. The Illinois Funds, a 2a7-like pool is reported at amortized cost.

(h) Interfund Transactions and Transactions with State of Illinois Component Units

The Department has the following types of interfund transactions between Department funds and funds of other State Agencies:

Services provided and used – sales and purchases of goods and services between funds for a price approximating their external exchange value. Interfund services provided and used are reported as revenues in seller funds and expenditures or expenses in purchaser funds. Unpaid amounts are reported as interfund receivables and payables in the governmental funds balance sheet and the government-wide statement of net position.

Reimbursements – repayments from the funds responsible for particular expenditures or expenses to the funds that initially paid for them. Reimbursements are reported as expenditures in the reimbursing fund and as a reduction of expenditures in the reimbursed fund.

Transfers **–** flows of assets (such as cash or goods) without equivalent flows of assets in return and without a requirement for repayment. In governmental funds, transfers are reported as other financing uses in the funds making transfers and as other financing sources in the funds receiving transfers.

The Department also has activity with various component units of the State of Illinois for medical programs, intergovernmental transfer agreements and payments for services.

(i) Capital Assets

Capital assets, which includes property, plant, and equipment and intangible assets, are reported at cost or estimated historical cost based on appraisals. Contributed assets are reported at acquisition value at the time received. Capital assets are depreciated and amortized using the straight-line method. Intangible assets (purchased computer software and internally generated computer software) are assets that do not have a physical existence, are nonfinancial in nature, are not in a monetary form, and have a useful life of over one year.

Capitalization thresholds and the estimated useful lives are as follows:

Capital Asset Category	Capitalization Threshold	Estimated Useful Life (in Years)
Equipment	$ 5,000	3-10
Purchased Computer Software	$ 25,000	3-5
Internally Generated Computer Software	$1,000,000	5-20

(j) Deferred Outflows/Inflows of Resources

In addition to assets, the statement of net position will sometimes report a separate section for deferred outflows of resources. This separate financial statement element, deferred outflows of resources, represents a consumption of net assets that applies to a future period(s) and so will not be recognized as an outflow of resources (expense) until then. In addition to liabilities, the statement of net position will sometimes report a separate section for deferred inflows of resources. This separate financial statement element, deferred inflows of resources, represents an acquisition of net assets that applies to a future period(s) and so will not be recognized as an inflow of resources (revenue) until that time. The Department has recorded deferred outflows and inflows of resources in the government-wide financial statements in connection with the net pension liability reported and explained in Note 8. Unavailable revenues in governmental funds include receivables not “available” to finance the current period.

(k) Compensated Absences

The liability for compensated absences reported in the government-wide statement of net position consists of unpaid, accumulated vacation and sick leave balances for Department employees. A liability for these amounts is reported in governmental funds only if they have matured, for example, as a result of employee resignations and retirements. The liability has been calculated using the vesting method, in which leave amounts for both employees who currently are eligible to receive termination payments and other employees who are expected to become eligible in the future to receive such payments upon termination are included. The liability has been calculated based on the employees’ current salary level and includes salary related cost (e.g., Social Security and Medicare taxes).

Legislation that became effective January 1, 1998 capped the paid sick leave for all State Employees’ Retirement System members at December 31, 1997. Employees continue to accrue twelve sick days per year, but will not receive monetary compensation for any additional time earned after December 31, 1997. Sick days earned between 1984 and December 31, 1997 (with a 50% cash value) would only be used after all days with no cash value are depleted. Any sick days earned and unused after December 31, 1997 will be converted to service time for purposes of calculating employee pension benefits.

(l) Pensions

In accordance with the Department’s adoption of GASB Statement No. 68, *Accounting and Financial Reporting for Pensions – an amendment of GASB Statement No. 27*, and GASB Statement No. 71, *Pension Transition for Contributions Made Subsequent to the Measurement Date – an amendment of GASB Statement No. 68*, the net pension liability, deferred outflows of resources, deferred inflows of resources and pension expense have been recognized in the government-wide financial statements.

The net pension liability is calculated as the difference between the actuarially calculated value of the projected benefit payments attributed to past periods of service and the plan’s fiduciary net position. The total pension expense is comprised of the service cost or actuarial present value of projected benefit payments attributed to the valuation year, interest on the total pension liability, plan administrative expenses, current year benefit changes, and other changes in plan fiduciary net position less employee contributions and projected earnings on plan investments. Additionally, the total pension expense includes the annual recognition of outflows and inflows of resources due to pension assets and liabilities.

For purposes of measuring the net pension liability, deferred outflows of resources, deferred inflows of resources, pension expense and expenditures associated with the Department’s contribution requirements, information about the fiduciary net position of the plan and additions to/deductions from the plan’s fiduciary net position have been determined on the same basis as they are reported within the separately issued plan financial statements. For this purpose, benefit payments (including refunds of employee contributions) are recognized when due and payable in accordance with terms of the plan. Investments are reported at fair value.

(m) Fund Balances

In the fund financial statements, governmental funds report fund balances in the following categories:

Nonspendable- This consists of amounts that cannot be spent because they are either a) not in spendable form or b) legally or contractually required to be maintained intact.

Restricted- This consists of amounts that are restricted to specific purposes, that is, when constraints placed on the use of resources are either: a) externally imposed by creditors, grantors, contributors, or laws or regulations of other governments or b) imposed by law through constitutional provisions or enabling legislation.

Committed- This consists of amounts that can only be used for specific purposes pursuant to constraints imposed by formal action of the Department's highest level of decision-making authority. Committed amounts cannot be used for any other purpose unless the Department removes or changes the specified use by taking the same type of action it employed to previously commit those amounts. The Department's highest level of decision-making authority rests with the Illinois State legislature and the Governor. The State passes "Public Acts" to commit their fund balances.

Assigned- This consists of net amounts that are constrained by the Department's intent to be used for specific purposes, but that are neither restricted nor committed.

Unassigned- This consists of residual fund balance that has not been restricted, committed, or assigned within the General Fund and deficit fund balances of other governmental funds.

In the General Fund, it is the Department's policy to consider restricted resources to have been spent first when an expenditure is incurred for which both restricted and unrestricted (i.e. committed, assigned or unassigned) fund balances are available, followed by committed and then assigned fund balances. Unassigned amounts are used only after the other resources have been used.

In other governmental funds (special revenue), it is the Department's policy to consider restricted resources to have been spent last. When an expenditure is incurred for purposes for which both restricted and unrestricted fund balances are available, the Department first utilizes any assigned amounts, followed by committed and then restricted amounts.

(n) Net Position

In the government-wide statement of net position, net position is displayed in three components as follows:

Net investment in capital assets – This consists of capital assets, net of accumulated depreciation less the outstanding balances of any bonds, mortgages, notes or other borrowings that are attributable to the acquisition, construction, or improvement of those assets.

Restricted – This consists of net position that is legally restricted by outside parties or by law through constitutional provisions or enabling legislation. When both restricted and unrestricted resources are available for use, generally it is the State's policy to use restricted resources first, then unrestricted resources when they are needed.

Unrestricted – This consists of net position that does not meet the definition of "restricted" or "net investment in capital assets".

(o) Use of Estimates

The preparation of financial statements in conformity with GAAP requires management to make estimates and assumptions that affect the reported amounts of assets, deferred outflows of resources, liabilities, deferred inflows of resources, and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.

(p) Adoption of New Accounting Pronouncements

Effective for the year ending June 30, 2017, the Department adopted the following GASB statements:

GASB Statement No. 73, *Accounting and Financial Reporting for Pensions and Related Assets That Are Not within the Scope of GASB Statement 68, and Amendments to Certain Provisions of GASB Statements No. 67 and 68*, which addresses accounting and financial reporting by employers and governmental nonemployer contributing entities for pensions that are not within the scope of GASB Statement No. 68. The implementation of this statement had no financial impact on the Department's net position or results of operations.

GASB Statement No. 74, *Financial Reporting for Postemployment Benefit Plans Other Than Pension Plans*, which replaces GASB Statement No. 43 and addresses the financial reports of defined other postemployment benefit (OPEB) plans that are administered through trusts that meet specified criteria. This statement follows the framework for financial reporting of defined benefit OPEB plans in GASB Statement No. 45 by requiring a statement of fiduciary net position and a statement of changes in fiduciary net position. This statement requires more extensive note disclosures and Required Supplementary Information (RSI) related to the measurement of the OPEB liabilities for which assets have been accumulated, including information about the annual money-weighted rates of return on plan investments. This statement also sets forth note disclosure requirements for defined contribution OPEB plans. The implementation of this statement had no financial impact on the Department's net position or results of operations.

GASB Statement No. 77, *Tax Abatement Disclosures*, which is intended to improve financial reporting by requiring disclosure of tax abatement information about a reporting government's own tax abatement agreements and those that are entered into by other governments and that reduce the reporting government's tax revenues. The implementation of this statement had no financial impact on the Department's net position or results of operations.

GASB Statement No. 78, *Pensions Provided through Certain Multiple-Employer Defined Benefit Pension Plans*, which addresses a practice issue regarding the scope and applicability of GASB Statement No. 68. This issue is associated with pensions provided through certain multiple-employer defined benefit pension plans and to state or local government employers whose employees are provided with such pensions. This statement amends the scope and applicability of GASB Statement No. 68 to exclude pensions provided to employees of state or local governmental employers through a cost-sharing multiple-employer defined benefit pension plan that is not a state or local governmental pension plan, is used to provide defined benefit pensions both to employees of state or local governmental employers and to employees of employers that are not state or local governmental employers, and has no predominant state or local governmental employer (either individually or collectively with other state or local governmental employers that provide pensions through the pension plan). This statement establishes requirements for recognition and measurement of pension expense, expenditures, and liabilities; note disclosures; and required supplementary information for pensions that have the characteristics described above. The implementation of this statement had no financial impact on the Department's net position or results of operations.

GASB Statement No. 79, *Certain External Investment Pools and Pool Participants*, which establishes criteria for an external investment pool to qualify for making the election to measure all of its investments at amortized cost for financial reporting purposes. Only the portion of this statement related to certain provisions on portfolio quality, custodial credit risk and shadow pricing was implemented effective for the year ending June 30, 2017. The implementation of this statement had no financial impact on the Department's net position or results of operations.

GASB Statement No. 80, *Blending Requirements for Certain Component Units - an amendment of GASB Statement No. 14*, which amends the blending requirements for the financial statement presentation of component units of all state and local governments. The additional criterion requires blending of a component unit incorporated as a not-for-profit corporation in which the primary government is the sole corporate member. The implementation of this statement had no financial impact on the Department's net position or results of operations.

GASB Statement No. 82, *Pension Issues - an amendment of GASB Statements No. 67, No. 68, and No. 73*, which addresses issues regarding (1) the presentation of payroll-related measures in required supplementary information, (2) the selection of assumptions and the treatment of deviations from the guidance in an Actuarial Standard of Practice for financial reporting purposes, and (3) the classification of payments made by employers to satisfy employee (plan member) contribution requirements. The implementation of this statement had no financial impact on the Department's net position or results of operations.

(q) Future Adoption of GASB Statements

Effective for the year ending June 30, 2018, the Department will adopt the following GASB statements:

GASB Statement No. 75, *Accounting and Financial Reporting for Postemployment Benefits Other Than Pensions*, which replaces the requirements of GASB Statement No. 45 and requires governments to report a liability on the face of the financial statements for the OPEB they provide. This statement requires governments in all types of OPEB plans to present more extensive note disclosures and RSI about their OPEB liabilities. Among the new note disclosures is a description of the effect on the reported OPEB liability of using a discount rate and a healthcare cost trend rate that are one percentage point higher and one percentage point lower than assumed by the government. The new RSI includes a schedule showing the causes of increases and decreases in the OPEB liability and a schedule comparing a government's actual OPEB contributions to its contribution requirements.

GASB Statement No. 81, *Irrevocable Split-Interest Agreements*, which improves accounting and financial reporting guidance for irrevocable split-interest agreements by providing recognition and measurement guidance for situations in which a government is a beneficiary of the agreement.

GASB Statement No. 85, *Omnibus 2017*, which is intended to address practice issues that have been identified during implementation and application of certain GASB statements. This statement addresses a variety of topics including issues related to blending component units, goodwill, fair value measurement and application, and postemployment benefits.

GASB Statement No. 86, *Certain Debt Extinguishment Issues*, which is intended to improve consistency in accounting and financial reporting for in-substance defeasance of debt by providing guidance for transactions in which cash and other monetary assets acquired with only existing resources (resources other than the proceeds of refunding debt) are placed in an irrevocable trust for the sole purpose of extinguishing debt. In addition, this statement improves accounting and financial reporting for prepaid insurance on debt that is extinguished and notes to financial statements for debt that is defeased in substance.

Effective for the year ending June 30, 2019, the Department will adopt the following GASB statement:

GASB Statement No. 83, *Certain Asset Retirement Obligations*, which addresses accounting and financial reporting for certain asset retirement obligations (AROs) and establishes criteria for determining the timing and pattern of recognition of a liability and a corresponding deferred outflow of resources for AROs.

Effective for the year ending June 30, 2020, the Department will adopt the following GASB statement:

GASB Statement No. 84, *Fiduciary Activities*, which is intended to improve guidance regarding the identification of fiduciary activities for accounting and financial reporting purposes and how those activities should be reported. In addition, this Statement establishes criteria for identifying fiduciary activities of all state and local governments. The focus of the criteria generally is on (1) whether a government is controlling the assets of the fiduciary activity and (2) the beneficiaries with whom a fiduciary relationship exists. Separate criteria are included to identify fiduciary component units and postemployments benefit arrangements that are fiduciary activities.

Effective for the year ending June 30, 2021, the Department will adopt the following GASB statement:

GASB Statement No. 87, *Leases*, which is intended to better meet the information needs of financial statement users by improving accounting and financial reporting for leases by governments. This statement increases the usefulness of governments' financial statements by requiring recognition of certain lease assets and liabilities for leases that previously were classified as operating leases and recognized as inflows of resources or outflows of resources based on the payment provisions of the contract. It establishes a single model for lease accounting based on the foundational principle that leases are financings of the right to use an underlying asset.

The Department has not yet determined the impact of adopting these statements on its financial statements.

(3) Deposits and Investments

(a) Deposits

The State Treasurer is the custodian of the State's cash and cash equivalents for funds maintained in the State Treasury. Deposits in the custody of the State Treasurer are pooled and invested with other State funds in accordance with the Deposit of State Moneys Act of the Illinois Compiled Statutes (15 ILCS 520/11). Funds held by the State Treasurer have not been categorized as to credit risk because the Department does not own individual securities. Detail on the nature of these deposits and investments are available within the State of Illinois' Comprehensive Annual Financial Report.

Cash on deposit for locally held funds of fiduciary activities had carrying amounts and bank balances of $1.878 million and $13.212 million, respectively, at June 30, 2017. Balances in excess of FDIC depository insurance were covered by collateral held by an agent in the Department's name.

(b) Investments

Section 2 of the Public Funds Investment Act limits the State's investments outside the State Treasury to securities of the U.S. government or its agencies, short-term obligations of domestic corporations exceeding $500 million in assets that are rated in the three highest categories by at least two nationally recognized statistical ratings organizations not to exceed ten percent of the domestic corporations outstanding obligations, money market mutual funds invested in the U.S. government and/or its agencies, and repurchase agreements securities of the U.S. government or its agencies or money market mutual funds invested in the U.S. government or its agencies. Investments of public funds in a Public Treasurers' Investment Pool created under Section 17 of the State Treasurer Act are also permitted.

As of June 30, 2017, the Department had $7.118 million invested with the Illinois Funds. The Illinois Funds is an investment pool managed by the State of Illinois, Office of the Treasurer, which allows governments within the State to pool their funds for investment purposes. The Illinois Funds is a GASB Statement No. 79 qualified external investment pool that measures, for financial reporting purposes, all its investments at amortized cost. There are no limitations or restrictions on withdrawals from the pool.

Interest Rate Risk: The Department does not have a formal investment policy that limits investment maturities as a means of managing its exposure to fair value losses arising from increasing interest rates.

Credit Risk: The Department does not have a formal investment policy that limits investment choices. The Illinois Public Treasurers' Investment Pool were rated AAAm by Standard & Poor's.

(c) Reconciliation to Statement of Net Position and Statement of Fiduciary Net Position

The Statement of Net Position and the Statement of Fiduciary Net Position account cash and cash equivalents contains certain short-term investments (included as investments above) to reflect their liquidity. A reconciliation (amounts expressed in thousands) follows:

	Deposits	**Investments**
Governmental Activities		
Amount per note	$ -	$ 7,118
Cash equivalents	7,118	(7,118)
Amounts per Statement of Net Position	$ 7,118	$ -
Fiduciary Funds		
Cash on deposit	$ 13,212	$ -
Outstanding checks	(11,334)	-
Amounts per Statement of Fiduciary Net Position	$ 1,878	$ -

(4) Accounts Receivable

(a) Taxes Receivable

Taxes receivable (amounts expressed in thousands) at June 30, 2017 are as follows:

	General Fund
Taxes receivable	$ 93,568
Less: allowance for uncollectible taxes	(18,638)
Taxes receivable, net	$ 74,930

(b) Other Receivables

Other receivables (amounts expressed in thousands) at June 30, 2017 are as follows:

	General Fund	Nonmajor Governmental Funds	Fiduciary Funds
Other receivables	$ 668,416	$ 749,855	$5,217,936
Less: allowance for uncollectible accounts	(112,114)	(740,690)	(5,015,553)
Other receivables, net	$ 556,302	$ 9,165	$ 202,383

(5) Interfund Balances and Activity

(a) Balances due to/from Other Funds

The following balances (amounts expressed in thousands) at June 30, 2017 represent amounts due from Department Funds and other State Funds.

	Due from		
Fund	**Other Department Funds**	**Other State Funds**	**Description/Purpose**
General	$ -	$ 8,584	Due from other State Funds for subgrants received and for unapplied credits.
Nonmajor governmental funds	16,000	146	Due from other Department and other State Funds for subgrants received and for unapplied credits.
	$ 16,000	$ 8,730	

The following balances (amounts expressed in thousands) at June 30, 2017 represent amounts due to Department Funds, other State Funds and other State fiduciary Funds for purchases of services.

	Due to		
Fund	**Other Department Funds**	**Other State Funds**	**Other State Fiduciary Funds**
General	$ 16,000	$ 62,387	$ 447
Nonmajor governmental funds	-	11,301	975
	$ 16,000	$ 73,688	$ 1,422

(b) Transfers to/from Other Funds

Interfund transfers in (amounts expressed in thousands) for the year ended June 30, 2017 were as follows:

Fund	Transfers in from: Other Department Funds	Transfers in from: Other State Funds	Description/Purpose
General	$ -	$ 7,092	Transfer from other State agencies' General Fund.
Nonmajor governmental funds	43,000	-	Transfer from General Fund per State appropriation.
	$ 43,000	$ 7,092	

Interfund transfers out (amounts expressed in thousands) for the year ended June 30, 2017 were as follows:

Fund	Transfers out to: Other Department Funds	Transfers out to: Other State Funds	Description/Purpose
General	$ 43,000	$ 40,000	Transfers to Department nonmajor governmental funds and other State agencies' funds per State appropriation.
	$ 43,000	$ 40,000	

(c) *Balances Due to/from State of Illinois Component Units*

The following balances (amounts expressed in thousands) at June 30, 2017 represent amounts due from State of Illinois Component Units to the General Fund for intergovernmental agreement reimbursements.

Component Unit	Due From: General Funds	Due From: Nonmajor Governmental Funds
Southern Illinois University	$ 2,033	$ -
Illinois Housing Development Authority	-	28
University of Illinois	2,537	-
	$ 4,570	$ 28

The following balances (amounts expressed in thousands) at June 30, 2017 represent amounts due to State of Illinois Component Units for medical reimbursements.

Component Unit	Due To: General Funds	Due To: Nonmajor Governmental Funds
Illinois State University	$ 96	$ -
Northern Illinois University	414	-
Southern Illinois University	7,199	-
University of Illinois	27,840	256
	$ 35,549	$ 256

(6) Capital Assets

Capital asset activity (amounts expressed in thousands) for the year ended June 30, 2017 is as follows:

	Balance July 1, 2016	Additions	Deletions	Net Transfers	Balance June 30, 2017
Governmental Activities:					
Capital assets not being depreciated/amortized:					
Internally generated intangible assets in development	$ 85,878	$ 31,725	$ -	$ 5,935	$ 123,538
Total capital assets not being depreciated/amortized:	85,878	31,725	-	5,935	123,538
Capital assets being depreciated:					
Equipment	5,495	132	386	-	5,241
Non-internally generated software	2,878	-	-	-	2,878
Less accumulated depreciation:					
Equipment	4,389	391	386	-	4,394
Non-internally generated software	1,805	571	-	-	2,376
Total capital assets being depreciated, net	2,179	(830)	-	-	1,349
Governmental activity capital assets, net	$ 88,057	$ 30,895	$ -	$ 5,935	$ 124,887

Depreciation expense for governmental activities (amounts expressed in thousands) for the year ended June 30, 2017 was charged as follows:

Health and social services	$ 962

(7) Long-Term Obligations

Changes in Long-Term Obligations

Changes in long-term obligations (amounts expressed in thousands) for the year ended June 30, 2017 was as follows:

	Balance July 1, 2016	Additions	Deletions	Balance June 30, 2017	Amounts Due Within One Year
Governmental Activities:					
Compensated absences	$ 10,608	$ 10,609	$ 11,664	$ 9,553	$ 1,084
Capital Leases	11	-	11	-	-
Net Pension Liability	1,011,915	180,682	-	1,192,597	-
Total governmental Activities	$ 1,022,534	$ 191,291	$ 11,675	$ 1,202,150	$ 1,084

Compensated absences will be liquidated by the applicable governmental funds that account for the salaries and wages of the related employees. Net pension liabilities will be liquidated through the General Revenue Fund, and the special revenue funds that report wages.

(8) Defined Benefit Pension Plan

Plan Description. Substantially all of the Department's full-time employees who are not eligible for participation in another state-sponsored retirement plan participate in the State Employees' Retirement System (SERS), which is a single-employer defined benefit pension trust fund in the State of Illinois reporting entity. SERS is governed by article 14 of the Illinois Pension Code (40 ILCS 5/1, et al.). The plan consists of two tiers of contribution requirements and benefit levels based on when an employee was hired. Members who first become an employee and participate under any of the State's retirement plans on or after January 1, 2011 are members of Tier 2, while Tier 1 consists of employees hired before January 1, 2011 or those who have service credit prior to January 1, 2011. The provisions below apply to both Tier 1 and 2 members, except where noted. The SERS issues a separate CAFR available at www.srs.illinois.gov or that may be obtained by writing to the SERS, 2101 South Veterans Parkway, Springfield, Illinois, 62794-9255.

Benefit Provisions. SERS provides retirement benefits based on the member's final average compensation and the number of years of credited service that have been established. The retirement benefit formula available to general State employees is 1.67% for each year of covered service and 2.2% for each year of non-covered service. The maximum retirement annuity payable is 75% of final average compensation as calculated under the regular formula. The minimum monthly retirement annuity payable is $15.00 for each year of covered employment and $25 for each year of non-covered employment.

Participants in SERS under the regular formula Tier 1 and Tier 2 receive the following levels of benefits based on the respective age and years of service credits.

Regular Formula Tier 1	Regular Formula Tier 2
A member must have a minimum of eight years of service credit and may retire at: • Age 60, with 8 years of service credit. • Any age, when the member's age (years & whole months) plus years of service credit (years & whole months) equal 85 years (1,020 months) (Rule of 85) with eight years of credited service.	A member must have a minimum of 10 years of credited service and may retire at: • Age 67, with 10 years of credited service. • Between ages 62-67 with 10 years of credited service (reduced 1/2 of 1% for each month under age 67).

Regular Formula Tier 1	Regular Formula Tier 2
• Between ages 55-60 with 25-30 years of service credit (reduced 1/2 of 1% for each month under age 60). The retirement benefit is based on final average compensation and credited service. Final average compensation is the 48 highest consecutive months of service within the last 120 months of service. Under the Rule of 85, a member is eligible for the first 3% increase on January 1 following the first full year of retirement, even if the member is not age 60. If the member retires at age 60 or older, he/she will receive a 3% pension increase every year on January 1, following the first full year of retirement. If the member retires before age 60 with a reduced retirement benefit, he/she will receive a 3% pension increase every January 1 after the member turns age 60 and has been retired at least one full year. These pension increases are not limited by the 75% maximum.	The retirement benefit is based on final average compensation and credited service. For regular formula employees, final average compensation is the average of the 96 highest consecutive months of service within the last 120 months of service. The retirement benefit is calculated on a maximum salary of $106,800. This amount increases annually by 3% or one-half of the Consumer Price Index, whichever is less. If the member retires at age 67 or older, he/she will receive a pension increase of 3% or one-half of the Consumer Price Index for the preceding calendar year, whichever is less, every year on January 1, following the first full year of retirement. The calendar year 2016 rate is $111,572. If the member retires before age 67 with a reduced retirement benefit, he/she will receive a pension increase of 3% or one-half of the Consumer Price Index for the preceding calendar year, whichever is less, every January 1 after the member turns age 67 and has been retired at least one full year. These pension increases are not limited by the 75% maximum.

Additionally, the Plan provides an alternative retirement formula for State employees in high-risk jobs, such as State policemen, fire fighters, and security employees. Employees qualifying for benefits under the alternative formula may retire at an earlier age depending on membership in Tier 1 or Tier 2. The retirement formula is 2.5% for each year of covered service and 3.0% for each year of non-covered service. The maximum retirement annuity payable is 80% of final average compensation as calculated under the alternative formula.

SERS also provides occupational and non-occupational (including temporary) disability benefits. To be eligible for non-occupational (including temporary) disability benefits, an employee must have at least eighteen months of credited service to the System. The non-occupational (including temporary) disability benefit is equal to 50% of the monthly rate of compensation of the employee on the date of removal from the payroll. Occupational disability benefits are provided when the member becomes disabled as a direct result of injuries or diseases arising out of and in the course of State employment. The monthly benefit is equal to 75% of the monthly rate of compensation on the date of removal from the payroll. This benefit amount is reduced by Workers' Compensation or payments under the Occupational Diseases Act.
Occupational and non-occupational death benefits are also available through the System. Certain non-occupational death benefits vest after eighteen months of credited service. Occupational death benefits are provided from the date of employment.

Contributions. Contribution requirements of active employees and the State are established in accordance with Chapter 40, section 5/14-133 of the Illinois Compiled Statutes. Member contributions are based on fixed percentages of covered payroll ranging between 4.00% and 12.50%. Employee contributions are fully refundable, without interest, upon withdrawal from State employment. Tier 1 members contribute based on total annual compensation. Tier 2 members contribute based on an annual compensation rate not to exceed $106,800 with limitations for future years increased by the lessor of 3% or one-half of the annual percentage increase in the Consumer Price Index. For 2017, this amount was $112,408.

The State is required to make payment for the required departmental employer contributions, all allowances, annuities, any benefits granted under Chapter 40, Article 5/14 of the ILCS and all administrative expenses of the System to the extent specified in the ILCS. State law provides that the employer contribution rate be determined based upon the results of each annual actuarial valuation.

For fiscal year 2017, the required employer contributions were computed in accordance with the State's funding plan. This funding legislation provides for a systematic 50-year funding plan with an ultimate goal to achieve 90% funding of the plan's liabilities. In addition, the funding plan provided for a 15-year phase-in period to allow the State to adapt to the increased financial commitment. Since the 15-year phase-in period ended June 30, 2010, the State's contribution will remain at a level percentage of payroll for the next 35 years until the 90% funded level is achieved. For fiscal year 2017, the employer contribution rate was 44.568%. The Department's contribution amount for fiscal year 2017 was $34.876 million. In addition, the Department recorded $28.781 million as on-behalf revenue and expenditures in the General Revenue Fund (GRF) to account for payments made by SERS for GRF funded positions of the Department.

Pension liability, deferred outflows of resources, deferred inflows of resources and expense related to pensions. At June 30, 2017, the Department reported a liability of $1,192.597 million for its proportionate share of the State's net pension liability for SERS on the statement of net position. The net pension liability was measured as of June 30, 2016 (current year measurement date), and the total pension liability used to calculate the net pension liability was determined by an actuarial valuation as of that date. The Department's portion of the net pension liability was based on the Department's proportion of employer contributions relative to all employer contributions made to the plan during the year ended June 30, 2016. As of the current year measurement date of June 30, 2016, the Department's proportion was 3.4927%, which was a decrease of .120% from its proportion measured as of the prior year measurement date of June 30, 2015.

For the year ended June 30, 2017, the Department recognized pension expense of $136.870 million. At June 30, 2017, the Department reported deferred outflows and deferred inflows of resources related to the pension liability, as of the measurement date of June 30, 2016, from the following sources (amounts expressed in thousands):

	Deferred Outflows of Resources	Deferred Inflows of Resources
Differences between expected and actual experience	$ 1,826	$ 29,165
Changes of assumptions	183,316	-
Net difference between projected and actual investment earnings on pension plan investments	25,318	-
Changes in proportion	17,140	54,133
Department contributions subsequent to the measurement date	34,876	-
Total	$ 262,476	$ 83,298

$34.876 million reported as deferred outflows of resources related to pensions resulting from Department contributions subsequent to the measurement date will be recognized as a reduction of the net pension liability in the year ended June 30, 2018. Other amounts reported as deferred outflows and deferred inflows of resources related to pensions will be recognized as pension expense as follows (amounts expressed in thousands):

Year ended June 30,		
2018	$	50,584
2019		37,647
2020		31,398
2021		24,674
Total	$	144,303

Actuarial Methods and Assumptions. The total pension liability was determined by an actuarial valuation as of June 30, 2016, using the following actuarial assumptions, applied to all periods included in the measurement:

Mortality: 105 percent of the RP2014 Healthy Annuitant mortality table, sex distinct, with rates projected to 2015; generational mortality improvement factors were added.

Inflation: 2.75%

Investment Rate of Return: 7.00%, net of pension plan investment expense, including inflation.

Salary increases: Salary increase rates based on age related productivity and merit rates plus inflation.

Post-retirement benefit increases of 3.00%, compounded, for Tier 1 and the lessor of 3.00% or one-half of the annual increase in the Consumer Price Index for Tier 2.

Retirement Age: Experience-based table of rates specific to the type of eligibility condition. Table was last updated for the June 30, 2014, valuation pursuant to an experience study of the period July 1, 2009 to June 30, 2013.

The long-term expected real rate of return on pension plan investments was determined based on the simulated average 10-year annualized geometric return for each major asset class. These returns are combined to produce the long-term expected rate of return by weighting the expected future real rates of return by the target asset allocation percentage. For each major asset class that is included in the pension plan's target asset allocation, calculated as of the measurement date of June 30, 2016, the best estimates of the geometric real rates of return as summarized in the following table:

Asset Class	Target Allocation	Long-Term Expected Real Rate of Return
U.S. Equity	23%	5.80%
Developed Foreign Equity	13%	6.10%
Emerging Market Equity	7%	8.50%
Private Equity	9%	7.40%
Hedge Funds	3%	3.60%
Intermediate Investment Grade Bonds	11%	1.60%
Long-term Government Bonds	3%	1.60%
TIPS	5%	1.30%
High Yield and Bank Loans	5%	4.80%
Opportunistic Debt	4%	4.80%
Emerging Market Debt	2%	4.10%
Real Estate	10%	4.50%
Infrastructure	5%	5.90%
Total	**100%**	**5.04%**

Discount Rate. A discount rate of 6.64% was used to measure the total pension liability as of the measurement date of June 30, 2016 as compared to a discount rate of 7.02% used to measure the total pension liability as of the prior year measurement date. The June 30, 2016 single blended discount rate was based on the expected rate of return on pension plan investments of 7.00% and a municipal bond rate of 2.85%, based on an index of 20 year general obligation bonds with an average AA credit rating as published by the Federal Reserve. The projection of cash flows used to determine this single discount rate assumed that plan member contributions will be made at the current contribution rate and that contributions will be made based on the statutorily required rates under Illinois law. Based on these assumptions, the pension plan's fiduciary net position and future contributions will be sufficient to finance the benefit payments through the year 2072. As a result, the long-term expected rate of return on pension plan investments was applied to projected benefit payments through the year 2072, and the municipal bond rate was applied to all benefit payments after that date.

Sensitivity of the Net Pension Liability to Changes in the Discount Rate. The net pension liability for the plan was calculated using the stated discount rate, as well as what the net pension liability would be if it were calculated using a discount rate that is 1-percentage point lower or 1-percentage point higher than the current rate as shown below (amounts expressed in thousands):

	1% Decrease 5.64%	Discount Rate 6.64%	1% Increase 7.64%
Department's Proportionate Share of the Net Pension Liability	$ 1,439,352	$ 1,192,597	$ 991,238

Payables to the pension plan. At June 30, 2017, the Department reported a payable of $1.422 million to SERS for the outstanding amount of contributions to the pension plans required for the year ended June 30, 2017.

(9) Postemployment Benefits

The State provides health, dental, vision, and life insurance benefits for retirees and their dependents in a program administered by the Department of Central Management Services. Substantially all State employees become eligible for these other postemployment benefits ("OPEB") if they eventually become annuitants of one of the State sponsored pension plans.

The health, dental, and vision benefits provided to and contribution amounts required from annuitants are the result of collective bargaining between the State and the various unions representing the State's and the university component units' employees in accordance with the limitations established in the Act. Therefore, the benefits provided and contribution amounts are subject to periodic change. Annuitants may be required to contribute towards health, dental and vision benefits with the amount based on factors such as date of retirement, years of credited service with the State, whether the annuitant is covered by Medicare, and whether the annuitant has chosen a managed health care plan. Annuitants who retired prior to January 1, 1998, and who are vested in the State Employees Retirement System do not contribute towards health, dental and vision benefits. For annuitants who retired on or after January 1, 1998, the annuitant's contribution amount is reduced five percent for each year of credited service with the State allowing those annuitants with twenty or more years of credited service to not have to contribute towards health, dental and vision benefits. The State also provides life insurance benefits for annuitants equal to their annual salary as of the last day of employment until age 60, at which time the benefit amount becomes $5,000.

The total cost of the State's portion of health, dental, vision, and life insurance benefits of all members, including post-employment health, dental, vision, and life insurance benefits, is recognized as expenditure by the State in the Illinois Comprehensive Annual Financial Report. The State finances the costs on a pay-as-you-go basis. The total costs incurred for health, dental, vision, and life insurance benefits are not separated by department or component unit for annuitants and their dependents nor active employees and their dependents.

A summary of post-employment benefits provisions, changes in benefit provisions, employee eligibility requirements including eligibility for vesting, and the authority under which benefit provisions are established are included as an integral part of the financial statements of the Department of Central Management Services. A copy of the financial statements of the Department of Central Management Services may be obtained by writing to the Department of Central Management Services, 715 Stratton Building, 401 South Spring Street, Springfield, Illinois, 62606-4100.

(10) Fund Deficits

The following fund had a deficit balance at June 30, 2017 (amount expressed in thousands):

Major Governmental Funds:	Fund Deficit
General Fund	$ 1,476,556

The deficit is expected to be recovered from future years' State appropriations and federal funds.

(11) Risk Management

The Department is exposed to various risks of loss related to torts; theft of, damage to, and destruction of assets; errors and omissions; workers compensation and natural disasters. The State retains the risk of loss (i.e., self-insured) for these risks except computer equipment insurance purchased by the Department.

Liabilities are reported when it is probable that a loss has occurred and the amount of that loss can be reasonably estimated. Liabilities include an amount for claims that have been incurred but not reported (IBNR). Claims liabilities are based upon the estimated ultimate cost of settling the claims including specific, incremental claim adjustment expenses, salvage, and subrogation and considering the effects of inflation and recent claim settlement trends including frequency and amount of payouts and other economic and social factors.

The Department's risk management activities for self-insurance, unemployment insurance and workers' compensation are financed through appropriations to the Illinois Department of Central Management Services and are accounted for in the General Fund of the State. The claims are not considered to be a liability of the

Department, and accordingly, have not been reported in the Department's financial statements for the year ended June 30, 2017.

(12) Commitments and Contingencies

(a) Operating Leases

The Department leases equipment, buildings and office space under terms of noncancelable operating lease agreements not extending past the end of the fiscal year, that require the Department to make minimum lease payments plus pay a pro rata share of certain operating costs. Rent expense under operating leases was $3.8 million for the year ended June 30, 2017.

(b) Federal Funding

In October 2004, the U.S. Department of Health and Human Services Office of Inspector General (OIG) issued its reports, "Review of Illinois Medicaid Disproportionate Share Hospital Payments to the University of Illinois at Chicago Hospital" and "Review of Illinois Medicaid Disproportionate Share Hospital Payments to Mount Sinai Hospital of Chicago". The reports recommended that the State refund $140.282 million and $4.516 million respectively, in FFP to the federal government because of alleged overpayment to the hospitals of $280.6 million and $9.032 million above the hospital-specific limitation on Disproportionate Share Hospital (DSH) payments to the hospitals during State fiscal year 1997-2000. The State has strongly disagreed with the OIG's findings. The Centers for Medicare and Medicaid Services (CMS) concurred with the audit findings but stated "we interpret this recommendation as a prospective resolution and not a requirement to recoup any Federal payments associated with these findings". After approximately 12 years of no official action, in July 2016, the State received a formal disallowance from CMS for these two audits. It is the State's position that it has followed CMS published guidelines, and its methodology for calculating the hospital-specific limitation has been consistently been approved by CMS. The State is in the process of appealing the matter.

The Department receives other federal grants which are subject to review and audit by federal grantor agencies. Certain costs could be questioned as not being an eligible expenditure under the terms of the grants. At June 30, 2017, other than identified above, there were no material questioned costs that have not been resolved with the federal awarding agencies. However, questioned costs could still be identified during audits to be conducted in the future. Management of the Department believes there will be no material adjustments to the federal grants and, accordingly, has not recorded a provision for possible repayment.

(c) Litigation

A class action lawsuit existed at June 30, 2017 consisting of all past, present, and future participants in the Medically Fragile and Technology Dependent (MFTD) Medicaid Waiver for Children. The suit seeks to not have the individual's services reduced solely because the individual "ages-out" of the waiver at twenty-one upon being referred to a program with different service levels than the MFTD. An estimate of the possible loss cannot be made.

A class action lawsuit existed at June 30, 2017. This is a class action brought on behalf of children who receive home-based skilled nursing services through the Department's Nursing and Personal Care Services (NPCS) program. The suit argues the Department has engaged in a systematic effort to unfairly reduce or deny their approved services of affected NPCS participants. An estimate of the possible loss cannot be made.

A class action lawsuit existed at June 30, 2017. This is a putative class action on behalf of individuals who have applied for Medicaid long-term care benefits but have not had their eligibility for Medicaid and/or long term care benefits determined within a reasonably prompt period of time. The delayed eligibility determinations are also allegedly causing delays in payments for long term care services contingent on eligibility. The Plaintiffs seek injunctive relief that requires the State to take affirmative steps to make determinations within certain regulatory timelines, automatically treat individuals as eligible if the determination exceeds the time for making eligibility determinations, and pay claims of long term care providers once an individual is determined eligible for long term care. In addition to this case, several other federal lawsuits have been filed on behalf of other nursing facilities and more than 100 individuals seeking similar relief. An estimate of the possible loss cannot be made.

A class action lawsuit existed at June 30, 2017. This is a class action consisting of “all Medicaid eligible children under the age of 21 who have been diagnosed with a mental health or behavior disorder; and for whom a licensed practitioner of the healing arts has recommended intensive home and community based services to correct or ameliorate their disorders”. The Plaintiffs seek to require the provision of appropriate services and support to qualified persons in the community, including community based services and residential treatment of children in Psychiatric Residential Treatment Facilities (PRTF’s), under Early and Periodic Screening, Diagnosis & Treatment (EPSDT). An estimate of the possible loss cannot be made.

(d) Integrated Eligibility System

Backlog of Applications in Integrated Eligibility System (IES)

The State of Illinois has implemented a new Integrated Eligibility System (IES) for the intake and processing of applications in order to determine eligibility for various health and human services programs since March 2014. The State has experienced delays in processing applications due to an increase in the number of applications for the expanded Medicaid programs and open enrollment periods, insufficient caseworker resources and other factors. These delays resulted in applications not being reviewed and approved or denied within the mandated 45 day timeframe. As of June 30, 2017, the Department, along with the Department of Human Services, had 74,649 unprocessed applications. A portion of the unprocessed applications would seek Medicaid long-term care benefits for which a class action lawsuit existed at June 30, 2017. An estimate of the liability associated with backlogged applications has historically been included in the calculation of the Department’s overall medical accrual liability estimate recorded in the financial statements.

(13) Securities Lending Transactions

The State Treasurer lends securities to broker-dealers and other entities for collateral that will be returned for the same securities in the future. The State Treasurer has, through a Securities Lending Agreement, authorized Deutsche Bank AG to lend the State Treasurer’s securities to broker-dealers and banks pursuant to a form of loan agreement.

During fiscal year 2017, Deutsche Bank AG lent U.S. Agency securities and U.S. Treasury securities and received as collateral U.S. dollar denominated cash. Borrowers were required to deliver collateral for each loan equal to at least 100% of the aggregate fair value of the loaned securities. Loans are marked to market daily. If the fair value of collateral falls below 100%, the borrower must provide additional collateral to raise the fair value to 100%.

The State Treasurer did not impose any restrictions during fiscal year 2017 on the amount of the loans of available, eligible securities. In the event of borrower default, Deutsche Bank AG provides the State Treasurer with counterparty default indemnification. In addition, Deutsche Bank AG is obligated to indemnify the State Treasurer if Deutsche Bank AG loses any securities, collateral or investments of the State Treasurer in Deutsche Bank AG’s custody. There were no losses during fiscal year 2017 resulting from a default of the borrowers or Deutsche Bank AG.

During fiscal year 2017, the State Treasurer and the borrowers maintained the right to terminate all securities lending transactions on demand. The cash collateral received on each loan was invested in repurchase agreements with approved counterparties collateralized with securities approved by Deutsche Bank AG and marked to market daily at no less than 102%. Because the loans are terminable at will, their duration did not generally match the duration of the investments made with cash collateral. The State Treasurer had no credit risk as a result of its securities lending program as the collateral held exceeded the fair value of the securities lent. The securities lending collateral received that was invested in repurchase agreements and the fair value of securities on loan for the State Treasurer as of June 30, 2017 were $3,522,922,500 and $3,475,790,990, respectively.

In accordance with GASB Statement No. 28, paragraph 9, the Office of the State Treasurer has allocated the assets and obligations at June 30, 2017 arising from securities lending agreements to the various funds of the State. The total allocated to the Department at June 30, 2017 was $74.182 million.

(14) Subsequent Event

The Department is part of the executive branch of government and operates under a budget where resources are generally appropriated for the use of the Department (court orders directed certain spending in fiscal year's 2016 and 2017). On July 6, 2017 the State of Illinois passed a full operating budget for fiscal year 2018 (P.A. 100-0023) and a supplemental bill (P.A. 100-0021) to be used for certain fiscal year 2017 expenditures. The supplemental bill provided additional appropriations for certain Department expenses.

The Department implemented Phase 2 of the Integrated Eligibility System (IES) on October 24, 2017. IES Phase 1 functionality consisted of the initial benefit determination and Phase 2 functionality includes the annual re-determination of benefits and all other benefit eligibility changes. With this implementation, IES is now the book of record for benefits determination.

(15) Prior Period Adjustment

The Department's financial statements have been restated as of July 1, 2016. Amounts due to and from the Managed Care Organizations (MCOs) related to the medical loss ratio (MLR) recoupment for 2013-2016 and performance goals for the 2015 coverage period were not previously included in the financial statements. The MCO activity occurred in the General Revenue Account (0001) and the County Provider Trust Account (0329), of the General Fund. In addition, unapplied credits and disputes related to drug manufacturer receivables for prior fiscal years were not included in the prior year financial statements. These credits and disputes reduce the receivables owed to the Department from the drug manufacturers, resulting in an overstatement in fund balance and net position at June 30, 2016. The activity occurred in the Drug Rebate Account (0728), an account of the General Fund. As a result, the financial statements have been restated as of July 1, 2016, as shown in the table below.

	General Fund (Thousands)	Governmental Activities (Thousands)
Fund balance (deficit)/net position July 1, 2016 as previously reported	$ (28,014)	$ 40,604
Adjustment to the MCOs	14,922	22,391
Adjustment to unapplied credits and disputes related to drug manufacturers	(17,578)	(17,578)
Fund balance (deficit)/net position July 1, 2016, as restated	$ (30,670)	$ 45,417

Combining Schedule of Accounts - General Fund

June 30, 2017 (Expressed in Thousands)

	General Revenue 0001	U of I Hospital Services 0136	County Provider Trust 0329	Care Provider for Persons with DD 0344	Long-Term Care Provider 0345	Hospital Provider 0346	Special Education Medicaid Matching 0355	Trauma Center 0397	Public Aid Recoveries Trust 0421
ASSETS									
Unexpended appropriations	$ 2,287,425	$ -	$ -	$ 8	$ -	$ -	$ -	$ 3,881	$ -
Cash equity with State Treasurer	1,048	14,994	10,843	-	20,869	119,555	-	-	811,332
Cash and cash equivalents	7,118	-	-	-	-	-	-	-	-
Securities lending collateral equity with State Treasurer	-	5,202	5,684	-	5,266	39,821	-	-	-
Due from other government - federal	2,755,544	8,179	-	8,232	86,324	119,524	32,930	2,704	11,157
Due from other government - local	-	-	52,393	-	-	-	14	-	-
Taxes receivable, net	-	-	-	362	60,598	11,768	-	-	-
Other receivables, net	56,983	16	35,936	-	16	122	-	-	396,866
Due from other Department funds	21	37,500	-	-	-	-	-	-	-
Due from other State funds	39	-	-	-	-	-	-	-	-
Due from State of Illinois component units	-	2,537	-	-	-	-	-	-	-
Total assets	$ 5,108,178	$ 68,428	$ 104,856	$ 8,602	$ 173,073	$ 290,790	$ 32,944	$ 6,585	$ 1,219,355
LIABILITIES AND DEFERRED INFLOWS OF RESOURCES									
Accounts payable and accrued liabilities	$ 4,408,795	$ -	$ 62	$ 4	$ 165,441	$ -	$ -	$ 3,584	$ 12,479
Due to other government - federal	656,891	-	22,532	-	1	-	-	-	68
Due to other government - local	33,738	-	51,787	-	2,351	-	32,944	297	1,955
Due to other State fiduciary funds	-	-	28	2	9	-	-	-	402
Due to other Department funds	53,975	-	-	-	-	-	-	-	1,146,906
Due to other State funds	58,558	-	21	1	5	-	-	-	1,393
Due to State of Illinois component units	13,462	11,355	-	-	-	-	-	-	2,273
Unearned revenue	-	-	11,351	-	-	-	-	-	-
Obligations under securities lending of State Treasurer	-	5,202	5,684	-	5,266	39,821	-	-	-
Total liabilities	5,225,419	16,557	91,465	7	173,073	39,821	32,944	3,881	1,165,476
Unavailable revenue - Federal operating grants	2,140,615	3,111	-	2,738	151	114,018	22,952	770	5,555
Unavailable revenue - License and fees	650	-	-	-	-	-	-	-	-
Unavailable revenue - Medical provider assessment tax	-	-	-	9	24,224	-	-	-	-
Unavailable revenue - Other taxes	-	-	-	-	99	-	-	-	-
Unavailable revenue - Other operating grants	-	336	47,958	-	-	-	-	-	-
Unavailable revenue - Other revenues	46	-	-	-	-	-	-	-	-
Total deferred inflows of resources	2,141,311	3,447	47,958	2,747	24,474	114,018	22,952	770	5,555
Total liabilities and deferred inflows of resources	7,366,730	20,004	139,423	2,754	197,547	153,839	55,896	4,651	1,171,031
FUND BALANCES (DEFICITS)									
Committed for health and social services	-	48,424	-	5,848	-	-	-	1,934	48,324
Unassigned	(2,258,552)	-	(34,567)	-	(24,474)	136,951	(22,952)	-	-
Total fund balances (deficits)	(2,258,552)	48,424	(34,567)	5,848	(24,474)	136,951	(22,952)	1,934	48,324
Total liabilities, deferred inflows of resources and fund balances (deficits)	$ 5,108,178	$ 68,428	$ 104,856	$ 8,602	$ 173,073	$ 290,790	$ 32,944	$ 6,585	$ 1,219,355

Combining Schedule of Accounts -
General Fund

June 30, 2017 (Expressed in Thousands)

	Electronic Health Record Incentive 0503	Juvenile Rehab Services Medicaid Matching 0575	Budget Stabilization 0686	Medical Interagency Program 0720	Drug Rebate 0728	Medicaid Buy-in Program Revolving 0740	Healthcare Provider Relief 0793	Medical Special Purposes Trust 0808	Eliminations	Total
ASSETS										
Unexpended appropriations	$ -	$ -	$ -	$ -	$ -	$ -	$ -	$ -	$ -	$ 2,291,314
Cash equity with State Treasurer	21	-	-	257	13,437	927	21,467	4,974	-	1,019,724
Cash and cash equivalents	-	-	-	-	-	-	-	-	-	7,118
Securities lending collateral equity with State Treasurer	-	-	-	152	4,337	288	11,656	-	-	72,406
Due from other government - federal	-	42	-	11,239	470,932	-	451,889	592	-	3,959,288
Due from other government - local	-	-	-	-	-	-	-	-	-	52,407
Taxes receivable, net	-	-	-	-	-	-	2,202	-	-	74,930
Other receivables, net	128	-	-	-	13	64	66,158	-	-	556,302
Due from other Department funds	-	-	-	6,916	1,146,906	-		-	(1,191,343)	-
Due from other State funds	-	-	-	5,466	-	-	3,079	-	-	8,584
Due from State of Illinois component units	-	-	-	2,033	-	-	-	-	-	4,570
Total assets	$ 149	$ 42	$ -	$ 26,063	$ 1,635,625	$ 1,279	$ 556,451	$ 5,566	$ (1,191,343)	$ 8,046,643
LIABILITIES AND DEFERRED INFLOWS OF RESOURCES										
Accounts payable and accrued liabilities	$ -	$ -	$ -	$ 18,457	$ 740,025	$ 13	$ 213,958	$ 13	$ -	$ 5,562,831
Due to other government - federal	149	-	-	-	245,628	1	48,777	-	-	974,047
Due to other government - local	-	42	-	647	-	-	3,467	-	-	127,228
Due to other State fiduciary funds	-	-	-	-	-	6	-	-	-	447
Due to other Department funds	-	-	-	-	-	-	6,462	-	(1,191,343)	16,000
Due to other State funds	-	-	-	-	-	4	2,405	-	-	62,387
Due to State of Illinois component units	-	-	-	6,807	-	-	1,466	186	-	35,549
Unearned revenue	-	-	-	-	-	-	-	170	-	11,521
Obligations under securities lending of State Treasurer	-	-	-	152	4,337	288	11,656	-	-	72,406
Total liabilities	149	42	-	26,063	989,990	312	288,191	369	(1,191,343)	6,862,416
Unavailable revenue - Federal operating grants	-	37	-	8,784	-	-	246,528	170	-	2,545,429
Unavailable revenue - License and fees	-	-	-	-	-	12	-	-	-	662
Unavailable revenue - Medical provider assessment tax	-	-	-	-	-	-	-	-	-	24,233
Unavailable revenue - Other taxes	-	-	-	-	-	-	342	-	-	441
Unavailable revenue - Other operating grants	-	-	-	569	-	-	-	-	-	48,863
Unavailable revenue - Other revenues	-	-	-	-	-	-	41,109	-	-	41,155
Total deferred inflows of resources	-	37	-	9,353	-	12	287,979	170	-	2,660,783
Total liabilities and deferred inflows of resources	149	79	-	35,416	989,990	324	576,170	539	(1,191,343)	9,523,199
FUND BALANCES (DEFICITS)										
Committed for health and social services	-	-	-	-	645,635	955	-	5,027	-	756,147
Unassigned	-	(37)	-	(9,353)	-	-	(19,719)	-	-	(2,232,703)
Total fund balances (deficits)	-	(37)	-	(9,353)	645,635	955	(19,719)	5,027	-	(1,476,556)
Total liabilities, deferred inflows of resources and fund balances (deficits)	$ 149	$ 42	$ -	$ 26,063	$ 1,635,625	$ 1,279	$ 556,451	$ 5,566	$ (1,191,343)	$ 8,046,643

Combining Schedule of Revenues, Expenditures and Changes in Fund Balance - General Fund

For the Year Ended June 30, 2017 (Expressed in Thousands)

	General Revenue 0001	U of I Hospital Services 0136	County Provider Trust 0329	Care Provider for Persons with DD 0344	Long-Term Care Provider 0345	Hospital Provider 0346	Special Education Medicaid Matching 0355	Trauma Center 0397	Public Aid Recoveries Trust 0421
REVENUES									
Operating grants - federal, net	$ 2,825,295	$ 77,638	$ 1,279,794	$ 22,975	$ 285,625	$ 2,065,791	$ 137,919	$ 5,080	$ 73,466
Other operating grants	243,700	25,007	706,898	-	-	-	-	-	-
Licenses and fees	29,979	-	-	-	-	-	-	-	-
Other charges for services, net	-	-	-	-	-	-	-	-	442,711
Interest and other investment income	-	173	157	-	334	1,152	-	-	-
Medical provider assessment tax	-	-	-	16,705	158,587	1,370,219	-	-	-
Other taxes, net	-	-	-	-	19,005	-	-	-	-
Other	1,716	-	-	-	-	-	-	-	-
Total revenues	3,100,690	102,818	1,986,849	39,680	463,551	3,437,162	137,919	5,080	516,177
EXPENDITURES									
Health and social services	7,014,940	106,184	1,940,591	180	442,170	2,896,886	153,992	8,433	536,455
Debt service principal	7	-	-	-	-	-	-	-	-
Debt service interest	1	-	-	-	-	-	-	-	-
Capital outlays	1,609	-	-	-	-	-	-	-	75
Total expenditures	7,016,557	106,184	1,940,591	180	442,170	2,896,886	153,992	8,433	536,530
Excess (deficiency) of revenues over (under) expenditures	(3,915,867)	(3,366)	46,258	39,500	21,381	540,276	(16,073)	(3,353)	(20,353)
OTHER SOURCES (USES) OF FINANCIAL RESOURCES									
Appropriations from State resources	7,179,722	-	-	1,192	-	-	-	15,000	-
Lapsed appropriations	(2,287,010)	-	-	(1,011)	-	-	-	(6,567)	-
Receipts collected and transmitted to State Treasury	(2,563,732)	-	-	(34,219)	-	-	-	(4,376)	-
Amount of SAMS transfers-in	(80,000)	-	-	-	-	-	-	-	-
Amount of SAMS transfers-out	45,000	-	-	-	-	-	-	-	-
Transfers-in	80,000	45,000	-	-	30,000	-	-	-	-
Transfers-out	(69,923)	-	-	-	(20,000)	(362,805)	-	-	-
Net other sources (uses) of financial resources	2,304,057	45,000	-	(34,038)	10,000	(362,805)	-	4,057	-
Net change in fund balances	(1,611,810)	41,634	46,258	5,462	31,381	177,471	(16,073)	704	(20,353)
Fund balances (deficits), July 1, 2016, as restated	(646,742)	6,790	(80,825)	386	(55,855)	(40,520)	(6,879)	1,230	68,677
FUND BALANCES (DEFICITS), JUNE 30, 2017	$ (2,258,552)	$ 48,424	$ (34,567)	$ 5,848	$ (24,474)	$ 136,951	$ (22,952)	$ 1,934	$ 48,324

Combining Schedule of Revenues, Expenditures and Changes in Fund Balance - General Fund

For the Year Ended June 30, 2017 (Expressed in Thousands)

	Electronic Health Record Incentive 0503	Juvenile Rehab Services Medicaid Matching 0575	Budget Stabilization 0686	Medical Interagency Program 0720	Drug Rebate 0728	Medicaid Buy-in Program Revolving 0740	Healthcare Provider Relief 0793	Medical Special Purposes Trust 0808	Eliminations	Total
REVENUES										
Operating grants - federal, net	$ 42,967	$ 42	$ -	$ 14,681	$ 470,932	$ -	$ 3,501,974	$ 2,841	$ -	$ 10,807,020
Other operating grants	-	-	-	2,946	-	-	-	5	-	978,556
Licenses and fees	-	-	-	-	-	650	-	-	-	30,629
Other charges for services, net	-	-	-	-	-	-	-	-	(442,711)	-
Interest and other investment income	-	-	-	10	270	8	404	-	-	2,508
Medical provider assessment tax	-	-	-	-	-	-	-	-	-	1,545,511
Other taxes, net	-	-	-	-	-	-	404,518	-	-	423,523
Other	-	-	-	-	-	-	8,441	-	-	10,157
Total revenues	42,967	42	-	17,637	471,202	658	3,915,337	2,846	(442,711)	13,797,904
EXPENDITURES										
Health and social services	42,967	(11)	-	37,069	193,835	335	4,484,861	1,841	(442,711)	17,418,017
Debt service principal	-	-	-	-	-	-	3	-	-	10
Debt service interest	-	-	-	-	-	-	-	-	-	1
Capital outlays	-	-	-	-	-	240	29,839	90	-	31,853
Total expenditures	42,967	(11)	-	37,069	193,835	575	4,514,703	1,931	(442,711)	17,449,881
Excess (deficiency) of revenues over (under) expenditures	-	53	-	(19,432)	277,367	83	(599,366)	915	-	(3,651,977)
OTHER SOURCES (USES) OF FINANCIAL RESOURCES										
Appropriations from State resources	-	-	18,000	-	-	-	-	-	-	7,213,914
Lapsed appropriations	-	-	-	-	-	-	-	-	-	(2,294,588)
Receipts collected and transmitted to State Treasury	-	-	-	-	-	-	-	-	-	(2,602,327)
Amount of SAMS transfers-in	-	-	-	-	-	-	-	-	-	(80,000)
Amount of SAMS transfers-out	-	-	-	-	-	-	-	-	-	45,000
Transfers-in	-	-	-	16,679	-	-	232,805	-	(397,392)	7,092
Transfers-out	-	-	(18,000)	-	-	-	(9,664)	-	397,392	(83,000)
Net other sources (uses) of financial resources	-	-	-	16,679	-	-	223,141	-	-	2,206,091
Net change in fund balances	-	53	-	(2,753)	277,367	83	(376,225)	915	-	(1,445,886)
Fund balances (deficits), July 1, 2016, as restated	-	(90)	-	(6,600)	368,268	872	356,506	4,112	-	(30,670)
FUND BALANCES (DEFICITS), JUNE 30, 2017	$ -	$ (37)	$ -	$ (9,353)	$ 645,635	$ 955	$ (19,719)	$ 5,027	$ -	$ (1,476,556)

Combining Balance Sheet -
Nonmajor Governmental Funds

June 30, 2017 (Expressed in Thousands)

	Special Revenue					
	Provider Inquiry Trust 0341	**Money Follows the Person Budget Transfer 0522**	**Department of Corrections Reimbursement and Education 0523**	**Tobacco Settlement Recovery 0733**	**Child Support Administrative 0757**	**Total**
ASSETS						
Unexpended appropriations	$ -	$ -	$ -	$ 162	$ -	$ 162
Cash equity with State Treasurer	1,517	5,512	-	-	8,566	15,595
Securities lending collateral equity with State Treasurer	-	1,776	-	-	-	1,776
Due from other government - federal	-	532	38	110	22,519	23,199
Other receivables, net	312	5	-	-	8,848	9,165
Due from other Department funds	-	-	-	-	16,000	16,000
Due from other State funds	146	-	-	-	-	146
Due from State of Illinois component units	-	28	-	-	-	28
Total assets	$ 1,975	$ 7,853	$ 38	$ 272	$ 55,933	$ 66,071
LIABILITIES AND DEFERRED INFLOWS OF RESOURCES						
Accounts payable and accrued liabilities	$ -	$ -	$ -	$ 215	$ 7,669	$ 7,884
Due to other government - federal	-	-	-	-	5,548	5,548
Due to other government - local	-	-	-	-	10,364	10,364
Due to other State fiduciary funds	-	-	-	-	975	975
Due to other Department funds	-	-	-	-	-	-
Due to other State funds	-	-	-	-	11,301	11,301
Due to State of Illinois component units	-	256	-	-	-	256
Obligations under securities lending of State Treasurer	-	1,776	-	-	-	1,776
Total liabilities	-	2,032	-	215	35,857	38,104
Unavailable revenue - Federal operating grants	-	256	38	-	18,668	18,962
Unavailable revenue - License and fees	191	-	-	-	-	191
Total deferred inflows of resources	191	256	38	-	18,668	19,153
Total liabilities and deferred inflows of resources	191	2,288	38	215	54,525	57,257
FUND BALANCES						
Committed for health and social services	1,784	5,565	-	57	1,408	8,814
Total fund balances	1,784	5,565	-	57	1,408	8,814
Total liabilities, deferred inflows of resources and fund balances	$ 1,975	$ 7,853	$ 38	$ 272	$ 55,933	$ 66,071

Combining Statement of Revenues, Expenditures and Changes in Fund Balances - Nonmajor Governmental Funds

For the Year Ended June 30, 2017 (Expressed in Thousands)

	Special Revenue					
	Provider Inquiry Trust 0341	**Money Follows the Person Budget Transfer 0522**	**Department of Corrections Reimbursement and Education 0523**	**Tobacco Settlement Recovery 0733**	**Child Support Administrative 0757**	**Total**
REVENUES						
Operating grants - federal, net	$ -	$ 2,252	$ 7,111	$ 85,539	$ 100,304	$ 195,206
License and fees	1,121	-	-	-	-	1,121
Other charges for services, net	-	-	-	-	11,960	11,960
Interest and other investment income	-	43	-	-	-	43
Total revenues	1,121	2,295	7,111	85,539	112,264	208,330
EXPENDITURES						
Health and social services	590	1,100	-	162,933	146,475	311,098
Debt service principal	-	-	-	-	1	1
Capital outlays	-	-	-	-	4	4
Total expenditures	590	1,100	-	162,933	146,480	311,103
Excess (deficiency) of revenues over (under) expenditures	531	1,195	7,111	(77,394)	(34,216)	(102,773)
OTHER SOURCES (USES) OF FINANCIAL RESOURCES						
Appropriations from State resources	-	-	-	200,600	-	200,600
Lapsed appropriations	-	-	-	(18,024)	-	(18,024)
Receipts collected and transmitted to State Treasury	-	-	(7,111)	(142,700)	-	(149,811)
Transfers-in	-	-	-	-	43,000	43,000
Net other sources (uses) of financial resources	-	-	(7,111)	39,876	43,000	75,765
Net change in fund balances	531	1,195	-	(37,518)	8,784	(27,008)
Fund balances (deficits), July 1, 2016	1,253	4,370	-	37,575	(7,376)	35,822
FUND BALANCES, JUNE 30, 2017	$ 1,784	$ 5,565	$ -	$ 57	$ 1,408	$ 8,814

State of Illinois

Department of Healthcare and Family Services

Combining Statement of Fiduciary Net Position - Agency Funds

June 30, 2017 (Expressed in Thousands)

	Child Support Enforcement Trust 0957	Child Support Enforcement Trust - SDU 2957	Total
ASSETS			
Cash equity with State Treasurer	$ 18,590	$ -	$ 18,590
Cash and cash equivalents	265	1,613	1,878
Other receivables, net	202,364	19	202,383
Total assets	$ 221,219	$ 1,632	$ 222,851
LIABILITIES			
Accounts payable and accrued liabilities	$ 19,239	$ 1,632	$ 20,871
Other liabilities	201,980	-	201,980
Total liabilities	$ 221,219	$ 1,632	$ 222,851

Combining Statement of Changes in Assets and Liabilities - Agency Funds

For the Year Ended June 30, 2017 (Expressed in Thousands)

	Balance at July 1, 2016	Additions	Deletions	Balance at June 30, 2017
Child Support Enforcement Trust (0957)				
ASSETS				
Cash equity with State Treasurer	$ 16,697	$ 143,019	$ 141,126	$ 18,590
Cash and cash equivalents	186	81,544	81,465	265
Other receivables, net	207,043	138,339	143,018	202,364
Due from other Department funds	1	-	1	-
Total assets	$ 223,927	$ 362,902	$ 365,610	$ 221,219
LIABILITIES				
Accounts payable and accrued liabilities	$ 17,958	$ 8,750	$ 7,469	$ 19,239
Other liabilities	205,969	211,133	215,122	201,980
Total liabilities	$ 223,927	$ 219,883	$ 222,591	$ 221,219
Child Support Enforcement Trust - SDU (2957)				
ASSETS				
Cash and cash equivalents	$ 1,502	$ 1,223,475	$ 1,223,364	$ 1,613
Other receivables, net	36	216	233	19
Total assets	$ 1,538	$ 1,223,691	$ 1,223,597	$ 1,632
LIABILITIES				
Accounts payable and accrued liabilities	$ 1,538	$ 1,223,458	$ 1,223,364	$ 1,632
Total liabilities	$ 1,538	$ 1,223,458	$ 1,223,364	$ 1,632
Total				
ASSETS				
Cash equity with State Treasurer	$ 16,697	$ 143,019	$ 141,126	$ 18,590
Cash and cash equivalents	1,688	1,305,019	1,304,829	1,878
Other receivables, net	207,079	138,555	143,251	202,383
Due from other Department funds	1	-	1	-
Total assets	$ 225,465	$ 1,586,593	$ 1,589,207	$ 222,851
LIABILITIES				
Accounts payable and accrued liabilities	$ 19,496	$ 1,232,208	$ 1,230,833	$ 20,871
Other liabilities	205,969	211,133	215,122	201,980
Total liabilities	$ 225,465	$ 1,443,341	$ 1,445,955	$ 222,851

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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
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 governmental activities, the major fund, and the aggregate remaining fund information of the State of Illinois, Department of Healthcare and Family Services, as of and for the year ended June 30, 2017, and the related notes to the financial statements, which collectively comprise the State of Illinois, Department of Healthcare and Family Services' basic financial statements, and have issued our report thereon dated March 6, 2018.

Internal Control Over Financial Reporting

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

Our consideration of internal control was for the limited purpose described in the preceding paragraph and was not designed to identify all deficiencies in internal control that might be material weaknesses or significant deficiencies and therefore, material weaknesses or significant deficiencies may exist that were not identified. However, as described in the accompanying schedule of findings, we identified certain deficiencies in internal control that we consider to be material weaknesses and significant deficiencies.

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. We consider the deficiencies described in the accompanying schedule of findings as items 2017-001 through 2017-007 and 2017-009 through 2017-013 to be material weaknesses.

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. We consider the deficiency described in the accompanying schedule of findings as item 2017-008 to be a significant deficiency.

Compliance and Other Matters

As part of obtaining reasonable assurance about whether the State of Illinois, Department of Healthcare and Family Services' 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 instances of noncompliance or other matters that are required to be reported under *Government Auditing Standards* and which are described in the accompanying schedule of findings as items 2017-001, 2017-002, 2017-004 through 2017-010, 2017-12 and 2017-013.

State of Illinois, Department of Healthcare and Family Services' Responses to Findings

The State of Illinois, Department of Healthcare and Family Services' responses to findings identified in our audit are described in the accompanying schedule of findings. The State of Illinois, Department of Healthcare and Family Services' responses were not subjected to the auditing procedures applied in the audit of the financial statements and, accordingly, we express no opinion on the responses.

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 State of Illinois, Department of Healthcare and Family Services' internal control or on compliance. This report is an integral part of an audit performed in accordance with *Government Auditing Standards* in considering the State of Illinois, Department of Healthcare and Family Services' internal control and compliance. Accordingly, this communication is not suitable for any other purpose.

SIGNED ORIGINAL ON FILE

Decatur, Illinois
March 6, 2018

2017-001 **<u>FINDING</u>** (Inadequate controls over fiscally monitoring Managed Care Organizations)

The Department of Healthcare and Family Services (Department) failed to implement adequate fiscal-related monitoring controls over Managed Care Organization (MCO) contracts. In addition, the Department failed to exercise or enforce fiscal-related monitoring controls as provided for in the various MCO contracts.

The Department is the State's designated agency responsible for providing healthcare coverage for adults and children who qualify for Medicaid. In conjunction with the federal government, the Department ensures medical services are provided to approximately 25 percent of the State's population.

In 2011, the Department began implementing statutory changes to reform Medicaid which emphasized service delivery reforms (access to care), cost containment strategies (structure and operations), program integrity enhancements, and agency efficiencies (quality measurement improvement). In connection with this emphasis, the State began shifting its method of providing for medical services from fee-for-service arrangements to managed care and other care coordination services. Between 2011 and 2012, the Department began slowly implementing mandatory enrollment of certain Medicaid beneficiaries into healthcare plans with 12 MCOs. Since 2013, the Department has paid the 12 MCOs approximately $22.5 billion.

While testing the contracts the Department entered into with the 12 MCOs, we noted the Department **<u>did not</u>**:

- **<u>Have a review process</u>** in place to ensure MCO capitation payments were accurate. As a result, we noted instances totaling $619,455 for which the Department had a net underpayment to the MCOs for services paid during fiscal year 2017 (see Findings 2017-004 and 2017-005).
- **<u>Have a review process</u>** in place to ensure the correct percentage of the MCO incentive payments, manually calculated, were withheld in accordance with the MCO contracts. As a result, we noted instances totaling $10,991,086 for which the Department overpaid the MCOs during fiscal year 2017 by failing to withhold at the rate established by the contract (see Finding 2017-004).
- **<u>Review or audit</u>** self-reported encounter data (valid claims of services rendered by medical providers) submitted to the Department by the MCOs as required by the MCO contracts and the federally-approved State Plan was correct.
- **<u>Receive</u>** all healthcare program encounter data. As of June 30, 2017, the Department was unable to receive encounter data for the Division of Alcoholism and Substance Abuse (DASA), Long Term Care, Home and Community Based Waivers, Medicare-Medicaid Alignment Initiative, and Managed Long-Term Services and Supports.
- **<u>Review or audit</u>** the MCOs denial of claims data.
- **<u>Review</u>** MCO actual administrative costs or other non-benefit costs.
- **<u>Calculate and finalize</u>** the MCOs' annual Medical Loss Ratio calculations for mandatory enrollment for Coverage Years 2013, 2014, and 2015. This provision of the MCO contracts is included to determine whether the MCOs met established benefit levels for the coverage year and provides a mechanism for the State to recoup payments that fail to meet the target (see Finding 2017-002).
- **<u>Conduct internal audits</u>** over the Managed Care Program for mandatory enrollment since 2013.

Auditing standards applicable to financial audits contained in *Government Auditing Standards* issued by the Comptroller General of the United States Sections 1.01-1.02 state:

> The concept of accountability for use of public resources and government authority is key to our nation's governing processes. Management and officials entrusted with public resources are responsible for carrying out public functions and providing service to the public effectively, efficiently, economically, ethically, and equitably within the context of the statutory boundaries of the specific government program. As reflected in applicable laws, regulations, agreements, and standards, management and officials of government programs are responsible for providing reliable, useful, and timely information for transparency and accountability of these programs and their operations. Legislators, oversight bodies, those charged with governance, and the public need to know whether (1) management and officials manage government resources and use their authority properly and in compliance with laws and regulations; (2) government programs are achieving their objectives and desired outcomes; and (3) government services are provided effectively, efficiently, economically, ethically, and equitably.

The Fiscal Control and Internal Auditing Act (30 ILCS 10/3001) requires the Department to establish and maintain a system, or systems, of internal fiscal and administrative controls to provide assurance funds, property, and other assets and resources are safeguarded against waste, loss, unauthorized use, and misappropriation and 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.

Further, the Fiscal Control and Internal Auditing Act (30 ILCS 10/2003) requires the Department's Director ensure the Department's internal auditing program includes audits of its major systems of internal accounting and administrative control, including the obligation and expenditure of the State's funds and to determine whether those activities comply with applicable laws, and regulations, at least every two years.

Department management stated manual entry of the capitation rates into the Department's payment systems resulted in errors in the rates used for a limited number of rate cells. System limitations required an after-the-fact reconciliation of revenue prior to calculating the Medical Loss Ratios (MLRs), which delayed the calculations. System limitations and limited human resources to complete the required programming caused a delay in the Department's ability to accept encounter data for the DASA, Long-Term Care, Home and Community Based Waivers, Medicare-Medicaid Alignment Initiative, and Managed Long-Term Services and Supports during the period audited.

Failure to implement adequate fiscal internal controls or circumventing internal controls previously established could expose the State to unnecessary and avoidable litigation, excessive expenditures, over-reliance on contractors, and could result in a system that does not meet the needs of the Department and the individuals dependent on the State for medical services. (Finding Code No. 2017-001)

RECOMMENDATION

We recommend the Department take immediate action to exercise and enforce monitoring and accountability provisions established in the contracts with the MCOs. We also recommend the Department establish and implement additional internal controls, internal audits, and on-site reviews to fiscally monitor the MCOs to ensure the State's Medicaid program is carried out in an effective, efficient, and economical manner.

DEPARTMENT RESPONSE

The Department accepts the recommendation.

The Department continues to implement actions to enhance MCO operational quality and accountability. While a review process is in place with respect to MCO capitation payments, in the time since the period audited, the Department has implemented an additional layer of review of the manual rate entry process in order to reduce the incidence of errors in the rate entries.

Extensive review already takes place with respect to encounter data that is received from MCOs. And, as of January 1, 2018, the Department can now accept all types of encounter data, including Long-Term Care, DASA and Waiver service encounters. While an audit of such data is not a requirement of the MCO contracts, we accept the recommendation to implement such a process as a way of enhancing the fiscal monitoring process. A comprehensive process has also been put in place to review and audit MCO claim denials, leveraging the expertise of an external CPA firm retained by the Department.

Beginning with calendar year 2016 capitation rates, the Department revised its capitation rate structure to eliminate the types of payments that required reconciliation after- the-fact, in order to expedite its ability to calculate the MLRs in a timely manner. In addition, the Department has begun requesting estimated MLR calculations from its actuaries for use in monitoring the plans' performance prior to the date the official calculations can be performed. The MLR calculations that were delayed are currently being calculated and any recoupment due will be collected from the MCOs.

Finally, new managed care contracts, effective January 1, 2018, will increase managed care accountability, provide additional internal controls and help to ensure that the State's Medicaid program is carried out in an effective, efficient and economical manner.

2017-002 **<u>FINDING</u>** (Department did not seek potential refunds from Managed Care Organizations)

The Department of Healthcare and Family Services (Department) did not calculate the annual Medical Loss Ratios (MLRs) of the State's Medicaid Managed Care Organizations (MCOs) for mandatory enrollment for Coverage Years (CY) 2013, 2014, and 2015. As a result, the Department did not seek and collect an estimated $65 million in potential refunds due back from the MCOs to the State.

The Department is the State's designated agency responsible for providing healthcare coverage for adults and children who qualify for Medicaid. In conjunction with the federal government, the Department ensures medical services are provided to approximately 25 percent of the State's population.

In 2011, the Department began implementing statutory changes to reform Medicaid which emphasized service delivery reforms (access to care), cost containment strategies (structure and operations), program integrity enhancements, and agency efficiencies (quality measurement improvement). In connection with this emphasis, the State began shifting its method of providing for medical services from fee-for-service arrangements to managed care and other care coordination services. Between 2011 and 2012, the Department began slowly implementing mandatory enrollment of certain Medicaid beneficiaries into healthcare plans with 12 MCOs. Since 2013, the Department has paid the 12 MCOs approximately $22.5 billion

The MLR is defined within the MCO contracts as total plan benefit expense divided by total capitation revenue. Each of the MCO contracts contain a provision requiring the Department to calculate the MLR within 90 days following the six month claims run-out period following the CY. The MCOs then have 60 days to review the Department's calculation. If the MCO did not meet the Targeted MLR set forth in the applicable contract, the MCO is required to refund to the State an amount equal to the difference between the calculated MLR and the Targeted MLR (expressed as a percentage) multiplied by the CY revenue. According to the MCO contracts, the State requires health plans to have a Targeted MLR of 85 percent for the Family Health Population (FHP), Affordable Care Act (ACA), Medicare-Medicaid Alignment Initiative (MMAI), and Managed Long-Term Services and Supports (MLTSS) plans. The Integrated Care Program (ICP) plan has a Targeted MLR of 88 percent.

As an example, assume an MCO was paid $100 million in revenue by the Department for its ICP plan during CY 2013. Since the ICP contracts have a Targeted MLR of 88 percent, the Department would expect the MCO to have spent, at least, $88 million on benefit expenses (i.e. not administrative costs or profit) during CY 2013. After the conclusion of the six month claims run-out period for CY 2013, the Department receives data from the MCO indicating that its actual benefit expense for CY 2013 was only $80 million. In this example, the MCO would refund the Department $8 million.

As estimated by the Department's actuary as of the end of fieldwork, if the Department had calculated the CY 2013, CY 2014, and CY 2015 MLRs within the required contractual timeframe, the Department <u>should have received</u> at least $65 million in refunds from the MCOs by June 30, 2017.

Finally, the Department receives reimbursement from the Federal government to offset the cost of Medicaid assistance at the applicable federal financial participation (FFP) rate. By not calculating the MLRs and receiving the estimated $65 million in refunds, the Department has also not calculated and paid the applicable FFP rate back to the Federal government; thus, resulting in a potential liability.

The Illinois State Collection Act of 1986 (Act) (30 ILCS 210/3) states it is the "public policy of this State to aggressively pursue the collection of accounts or claims due and payable to the State of Illinois through all reasonable means."

Further, the Fiscal Control and Internal Auditing Act (30 ILCS 10/3001) requires the Department to establish and maintain a system, or systems, of internal fiscal and administrative controls to provide assurance assets and resources are safeguarded against waste, loss, unauthorized use, and misappropriation and funds applicable to operations are properly recorded and accounted for to permit the preparation of accounts and reliable reports and to maintain accountability over the State's resources.

Department officials indicated MLR calculations were delayed while capitation payments were finalized. Due to system issues, some adjustments had to be made manually after the 18 month lookback period.

The MLR recapture provision within the MCO contracts was designed to aid the Department in determining whether the MCOs met established benefit levels for a given CY. Without the MLR calculations, the Department cannot reconcile what was paid to the MCOs to ensure a significant portion of the State's cost was spent on direct services to Medicaid recipients.

Failure to calculate and collect refunds from MCOs may have resulted in the State not realizing refunds due, a potential liability due back to the Federal government for reimbursements not previously sought, and represents noncompliance with State law and contractual provisions. (Finding Code No. 2017-002)

RECOMMENDATION

We recommend the Department take action to ensure all MLRs are timely calculated and any amount due back to the State are aggressively pursued.

DEPARTMENT RESPONSE

The Department accepts the recommendation and has taken steps to calculate the outstanding Medical Loss Ratios and recoup any refunds due. Beginning with calendar year 2016 capitation rates, the Department revised its capitation rate structure to eliminate the types of payments that required reconciliation after the fact, in order to expedite its ability to calculate the MLRs in a timely manner. In addition, the Department has begun requesting estimated MLR calculations from its actuaries for use in monitoring the plans' performance prior to the date the official calculations can be performed. In the new MCO contracts, effective January of 2018, the timeline has been extended to allow the claims run out and revenue adjustments time to process prior to MLR calculation. The MLR calculations that were delayed are currently being calculated and any recoupment due will be collected from the MCOs. Under the terms and conditions of its contracts, the State is made whole, notwithstanding any delays in the recoupment process.

2017-003 **<u>FINDING</u>** (Financial statement preparation)

The Department of Healthcare and Family Services (Department) did not ensure its annual financial reports were prepared in conformity with U.S. generally accepted accounting principles (GAAP).

During testing, we noted the Department did not perform a sufficient review of all accounts and amounts recorded within its financial statements, GAAP Package reports prepared for the Office of the State Comptroller to prepare the State's Comprehensive Annual Financial Report, and various additional supporting schedules. As a result, we noted the following errors in the Department's financial statements, GAAP packages prepared for the Illinois Office of the Comptroller, and additional supporting schedules and analysis:

<u>Errors Also Requiring Prior Period Restatements</u>

- As described in greater detail in Finding 2017-002, the Department did not calculate the annual Medical Loss Ratios (MLRs) for the State's Medicaid Managed Care Organizations (MCOs) with mandatory enrollment since 2013. Consequently, the Department had not ensured reasonable estimations of this activity, including amounts due to the federal government from its participation in the Medicaid program, had been prepared for its financial reports. As the Department had only estimated and reported accounts receivable from the MCOs for the 2013 coverage year, its financial statements for both fiscal year 2016 and fiscal year 2017 omitted these transactions for subsequent coverage periods. (In fact, the fiscal year 2017 financial statements did not even include the MLR estimate for the 2013 coverage period.) To correct the error for prior years, the Department restated its beginning net position by $29.2 million, including an increase in its accounts receivables related to the MCOs by $67.2 million and an increase in liabilities due to the federal government by $38 million. To correct the current year's errors, the Department recorded a reduction of its expenses and an increase in its accounts receivables related to the MCOs by $22.3 million and increased its liabilities due to the federal government by $13 million. These material adjustments were subsequently recorded by the Department in its final financial statements.

- The Department did not calculate and record its liability to the MCOs for certain incentive payments. In accordance with the Department's contracts with the MCOs, the Department withholds a percentage from each MCO's monthly capitation payment and holds these amounts within an incentive pool. At the end of the coverage period, the MCO is entitled to receive the withheld payments if the MCO met certain performance measures. The Department did not record an estimated liability for accounts payable to the MCOs where the Department and the MCO had not yet finalized the performance process at either June 30, 2017 or 2016. To correct this error for the prior year, the Department restated its beginning net position by ($14.3) million. To correct the current year's errors, the Department recorded an increase in its accounts payable and expenses by $37 million. These material adjustments were subsequently recorded by the Department in its final financial statements.

- The Department lacked adequate controls over its accounts receivable related to drug manufacturer rebates. Originally, the Department recorded rebates receivable of $295.3 million at June 30, 2016 and $262.2 million at June 30, 2017. During testing, we noted the following:

    - The Department had not applied credit balances of $46.5 million as of June 30, 2016, and $47.3 million as of June 30, 2017, to the manufacturers' accounts or taken this situation into consideration during the Department's financial reporting process. According to Department officials, the credit balances may have been the result of overpayments from the manufacturers, inaccurate rebate rates used, or invoicing problems, which were not readily determinable. To correct this error for prior years, the Department restated its beginning net position by ($46.5) million. To correct the current year's errors, the Department recorded an additional decrease in its accounts receivable and an increase in expenses of $800 thousand. These material adjustments were subsequently recorded by the Department in its final financial statements.

- The Department routinely has disputes with its drug manufacturers due to a variety of issues, including matters such as over (under) payments, incorrect billing rates, and the wrong number of units. Although the Department has a mechanism in place to catalog each dispute, it does not track the resolution of these disputes. As such, the Department does not have a process in place to ensure all disputes are resolved in a timely manner. The Department also lacked a process to make a reasonable estimate of the resolution of such disputes and determination of the impact on the Department's year end financial reporting. To correct this error for prior years, the Department restated its beginning net position by ($2.1) million. To correct the current year's errors, the Department recorded a decrease in its accounts receivable and an increase in expenses by $700 thousand. These material adjustments were subsequently recorded by the Department in its final financial statements.

Current Period Errors Only

- The Department did not record certain invoices/vouchers from the Department of Central Management Services (CMS) for services rendered to the Department, totaling approximately $10.7 million. Further, we noted the Department did not reflect associated unapplied credits of approximately $11.4 million from CMS. These errors netted to an approximate overstatement of the Department's due to other State funds and expense of approximately $700 thousand. This material adjustment was subsequently recorded by the Department in its final financial statements.

- During our review of the Department's medical accrual calculation, we noted the Department used an incorrect percentage to allocate federal reimbursements for the Children's Health Insurance Program (CHIP) to the General Revenue Fund (Fund 0001). As the CHIP has a higher Federal Financial Participation (FFP) percentage than the Medical Assistance Program, the Department understated its due from the federal government balance by $8.2 million and its unavailable revenue balance by $8.2 million. This material adjustment was subsequently recorded by the Department in its final financial statements.

- During testing of statutory transfers from the Public Aid Recoveries Trust Fund (Fund 0421) to the Drug Rebate Fund (Fund 0728) at June 30, 2017, we noted some transfers were omitted from the Department's GAAP Packages. This error resulted in an understatement in Fund 0421's due to other funds and transfers out and an understatement of Fund 0728's due from other funds and transfers in by $402.2 million. These material adjustments were subsequently recorded by the Department in its final financial statements.

- During receipt testing, we identified $42.1 million in receipts into the General Revenue Fund (Fund 0001) that should have been reported within the Department of Human Services' Community Development Disability Services Medicaid Trust Fund (Fund 0142). These receipts were incorrectly reported within Fund 0142 as due from the federal government, instead of due from Fund 0001. As a result, Fund 0001's amount due from the federal government was overstated and the due to other funds was understated by $42.1 million. This material adjustment was subsequently recorded by the Department in its final financial statements.

- The Department did not properly account for expenditures related to the Pharmacy

Benefits Management System (PBMS). As of June 30, 2017, the Department understated the amount of costs incurred in connection with the PBMS project, totaling $2.5 million. As such, the Department's health and social services expenditures were understated by $2.5 million and liabilities due to the vendor were understated by $2.5 million. These material adjustments were subsequently recorded by the Department in its final financial statements.

- While reviewing and recalculating the Department's aging schedules for its child support accounts receivable within the Child Support Enforcement Trust Fund (Fund 0957), an agency fund, we noted the Department omitted $23.4 million in accounts receivable. As a result of a $22 million allowance for doubtful accounts applied against this receivable, the net understatement of accounts receivable was $1.4 million. This error was not corrected by the Department in its financial statements, however it was deemed immaterial and did not result in a modification to the auditor's opinion on the Department's financial statements.

Material Adjustments Not Directly Related to Financial Reporting Errors

In addition to the financial reporting errors noted above, we identified other instances of material misstatements to the Department's draft financial statements that were not a direct result of the Department's financial reporting process. These errors were identified during our testing of the Department's underlying transactions and are described in the following findings:

- Finding 2017-001, regarding monitoring of MCOs;
- Finding 2017-004, regarding incorrect rates used to pay MCOs;
- Finding 2017-005, regarding incorrect claim payments; and,
- Finding 2017-006, regarding a backlog of applications for public aid.

The Department is required to report its financial information within both its financial statements and its GAAP Packages used by the State Comptroller to compile the State's Comprehensive Annual Financial Report in accordance with GAAP. Under GAAP, the Department must report government-wide and fiduciary transactions under the economic resources measurement focus and the accrual basis of accounting and report governmental funds using the current financial resources measurement focus and the modified accrual basis of accounting. In accordance with the Fiscal Control and Internal Auditing Act (30 ILCS 10/3001), the Department must establish and maintain a system, or systems, of internal fiscal and administrative controls to provide assurance revenues, expenditures, transfers, assets, resources, and funds applicable to operations are properly recorded and accounted for to permit the preparation of accounts and reliable financial reports. Further, the State Comptroller Act (15 ILCS 405/19.5(a)) requires the Department to provide all financial information deemed necessary by the Comptroller to compile and publish the State's Comprehensive Annual Financial Report on or before October 31. Good internal controls over financial reporting and compliance require the Department to ensure its GAAP Packages and other data reported to the State Comptroller is accurate and complete to enable the timely preparation and audit of the State's Comprehensive Annual Financial Report.

Department management stated these problems were due to system limitations, unavailability of certain information during GAAP development, the complexity of the Department's programs, and human error.

The Department's current financial reporting process is overly dependent on the post audit program identifying and proposing adjustments to remediate the Department's financial reporting weaknesses. The post audit process is not a substitute for the Department designing and implementing appropriate internal controls to compile accurate financial information in accordance with GAAP within a reasonable period of time.

Failure to ensure financial transactions are reported properly in accordance with GAAP resulted in material errors within the Department's draft financial statements, negatively impacted the information compiled within the State's financial statements, delayed the State's financial reporting process, and represents noncompliance with State law. (Finding Code No. 2017-003, 2016-004)

RECOMMENDATION

We recommend the Department take action to ensure all of its transactions are properly recorded and presented in its financial statements and GAAP Packages in accordance with GAAP. Further, the Department should ensure the accuracy and completeness of its financial and non-financial information used during the financial reporting process by reviewing the source for, and manual and electronic process of, its underlying transactions.

DEPARTMENT RESPONSE

The Department accepts the recommendation. The Department plans to implement changes to address the issues contained within the overall finding. This will include a review of the Department's GAAP preparation procedures and consultation with its contracted CPA firm to limit opportunities for oversight or human error.

While Medical Loss Ratio calculations were unavailable during GAAP development, the Department did not ignore the concept in its medical accrual calculation. Medical accrual supporting work-papers disclosed the unavailability of MLR values as of the FY17 GAAP reporting deadline.

With regard to the drug rebate transfer item, larger than normal drug rebate receipts remained in the Public Aid Recoveries Trust Fund (PARTF) as of June 30, 2017. In the spring of 2017, as part of the FY18 introduced budget package, the Department requested a statutory change (PA 100-0023 - Budget Implementation Act, effective July 6, 2017) and FY17 supplemental appropriation authorizing spending prior to transferring the resources to the Drug Rebate Fund for expenditure. Department accounting staff used traditional information sources to report the drug rebate amount due from PARTF to the Drug Rebate Fund. Those sources did not reflect the unique situation of the larger than normal drug rebate balance in PARTF. The Department accepts the recommendation and has implemented improved drug rebate revenue reporting within PARTF. While the amount may be material to the Fund financial statements, it is the Department's understanding the issue would not impact the accuracy of the State's Comprehensive Annual Financial Report since both PARTF and the Drug Rebate Fund are reported as General Funds and the activity offsets.

The finding also references reporting of certain federal revenues between the General Revenue Fund and the Department of Human Services' Community Development Disability Services Medicaid Trust Fund. The Department reported the pending transaction as how the movement of federal dollars would ultimately be reflected on the State's records once the transaction was effectuated. During the audit review, auditors for the Department and DHS agreed that regardless of the State mechanism used to effectuate the transaction, it should be reported as described in the finding for purposes of GAAP. The Department accepts that recommendation. While the amount may be material to the Fund financial statements, it is the Department's understanding the issue would not materially impact the accuracy of the State's Comprehensive Annual Financial Report since both funds are reported as General Funds.

The issue of expenditure reporting related to the Pharmacy Benefit Management System (PBMS) is due to vendor payments being subject to the Department's approval of project deliverables under terms of the contract. The finding states that the Department should have accrued liability for contractor work performed on or before June 30, 2017 even though the related deliverables were not approved until after that date (FY18). The Department GAAP preparers were unaware of the issue and did not receive accrued liabilities because the program area contract manager believed the requirement for State payment did not occur until the relevant deliverables were approved (generally, liabilities are not accrued on administrative contracts because services are normally billed as rendered). The Department accepts the recommendation on this issue and will improve the GAAP information gathering process by including a question to the various program areas regarding deliverables-based contracts.

2017-004 **<u>FINDING</u>** (Inaccurate rate used to pay Managed Care Organizations)

The Department of Healthcare and Family Services (Department) made payments to Managed Care Organizations (MCOs) using incorrect rates.

During fiscal year 2017, the Department made capitation payments totaling $5.68 billion to 12 MCOs for Medicaid recipients' healthcare services under four plans:

- <u>Integrated Care Program (ICP) MCOs:</u> The plans served individuals who were non-Medicare eligible disabled adults who were over the age of 18;
- <u>Family Health Plan (FHP) MCOs:</u> The plan served children and caretaker adults;
- <u>Affordable Care Act (ACA) MCOs:</u> The plan served the newly eligible adults who gained coverage under the Medicaid expansion provisions of the Affordable Care Act; and
- <u>Medicare-Medicaid Alignment Initiative (MMAI) MCOs:</u> The plan served individuals who were "dually" Medicare-Medicaid eligible. The plan operated in a limited number of counties.

The State of Illinois, State Plan under Title XIX of the Social Security Act, Medical Assistance Program, requires capitation payments and bonuses/incentive payments to meet all the federal requirements, as outlined in the Code of Federal Regulations (42 C.F.R § 438.6), and to be actuarial sound.

In order to determine if the capitation rates in effect <u>during the engagement period</u> were in accordance with the actuarially determined rates, we compared the capitation payment rate tables to the actuarial reports, noting:

- For ICP:
  - The Department withheld the incorrect percentage for the incentive pools; 1% was withheld, when 1.5% or 2% should have been withheld, resulting in an <u>overpayment</u> of $8,110,116 to the MCOs.
  - The incorrect risk adjustment factor was utilized for one MCO, resulting in an <u>underpayment</u> of $546,601 to the MCO. The Department had identified this error in October 2017, and subsequently corrected the error by manually adjusting the payments to the MCOs.
  - The incorrect base rate was utilized for one MCO, resulting in an <u>overpayment</u> of $667,940 to the MCO. The Department had identified this error in October 2017, and subsequently corrected the error by manually adjusting the payments to the MCOs.
- For FHP:
  - The Department paid the incorrect Health Insurers Fee to one MCO, resulting in an <u>underpayment</u> to the MCO of $430,717.
  - The Department withheld the incorrect percentage for the incentive pools; 1% was withheld, when 1.5% or 2% should have been, resulting in an <u>overpayment</u> of $2,880,970 to the MCOs.

The Fiscal Control and Internal Auditing Act (30 ILCS 10/3001) requires all State agencies establish and maintain a system, or systems, of internal fiscal and administrative controls to provide assurance that resources are utilized efficiently, effectively, and in compliance with applicable laws and obligations and costs are in compliance with applicable law.

Department management stated the rates are entered manually, and as such, the errors were the result of human error.

As a result of making incorrect payments, the Department has incurred expenditures which are not in compliance with federal and State laws. (Finding Code No. 2017-004)

RECOMMENDATION

We recommend the Department ensure the payments made to the MCOs are in accordance with the actuarially determined rates. Additionally, the Department should implement a secondary review of the input of rate components to ensure they are in agreement with the actuarially determined rates.

DEPARTMENT RESPONSE

The Department accepts the recommendation and has already implemented an additional layer of review of all rates being manually entered and the components of the calculation. All errors have been corrected in the Department's systems, and all overpayments or underpayments are being paid or recouped through adjustments to the payment records.

2017-005 **<u>FINDING</u>** (Incorrect claim payments made to medical providers and Managed Care Organizations)

The Department of Healthcare and Family Services (Department) made incorrect claim payments to medical providers and Managed Care Organizations (MCO).

In order to administer the State's Medicaid Program, the Department's Medicaid Management Information System (MMIS) processes Medicaid claims submitted by Medicaid providers and MCOs for services rendered to Medicaid-eligible recipients, and generates the related payments.

During the fiscal year, the Department processed approximately 219,485,284 claims totaling $15 billion.

The Department reimburses Medicaid providers using two methods: fee-for-service and managed care. Under managed care, the Department makes fixed payments called capitation payments to MCOs for recipients enrolled in the program. Long-term care (LTC) payments are paid to Medicaid providers for individuals requiring long-term assistance in nursing facilities, supportive living facilities, and intermediate care facilities. Pharmacy payments are paid to Medicaid providers for medications that are medically necessary for Medicaid recipients. The Medicaid program covers both prescription and over the counter products.

We selected a sample of all claim types (Capitation, LTC, and pharmacy) paid by the Department during fiscal year 2017 to determine that payments were consistent with the rate tables. **Note:** See Finding 2017-004 which addresses the use of incorrect rates used to generate payments to MCOs.

We tested all claims paid for the period July 1, 2016 through June 30, 2017 to determine if the Department properly paid claims. Specifically, we noted the following:

- Capitation Payments
  - Recipients are required to be actively enrolled with a MCO as of the date of service. However, 1,118 claims did not have the required information; therefore, the claim should have been voided. As a result, $623,356 was <u>overpaid</u> to the MCOs.
  - 67 claims did not have a corresponding rate in the rate information. Specifically, the rate information did not list the MCO that was paid in the region for which the claim was paid. Therefore, we could not determine if an <u>overpayment</u> was made to the MCO, totaling $230,454.
  - 804 claims were paid at a rate different than the defined rate. As a result, $933,433 was <u>overpaid</u> to the MCOs.
  - Due to the date of a recipient's date of birth changing on 73 claims, we could not determine if the correct rate was paid. Although an actual error could not be determined, the maximum <u>overpayment</u> to care coordination providers would not exceed $46.

- Long-Term Care Payments
  - 789 claims had a net liability amount which did not agree to our recalculated net liability, resulting in medical providers being <u>underpaid</u> by $15,754. The Department stated these claims had retroactive rate changes which had not been adjusted.
  - 639 claims had a net liability amount which did not agree to our recalculated net liability. Therefore, we could not determine if an <u>underpayment</u> was made to medical providers, totaling $59,998.

- Pharmacy
  - 50 claims had a net liability amount which did not agree to our recalculated net liability. The Department stated these claims were paid incorrectly due to a logic issue. The net error for these claims was an <u>underpayment</u> to medical providers of $6,284.

- 74 claims had a net liability amount which did not agree to our recalculation. The Department stated these claims were paid incorrectly due to a production issue. The net error for these claims was an <u>underpayment</u> to medical providers of $3,220.
- 30,471 claims had a net liability amount which did not agree to our recalculation of the net liability. Therefore, we could not determine if an <u>overpayment</u> was made to medical providers, totaling $303,815.
- 5,591 compound drug claims had a net liability amount which did not agree to our recalculated net liability. Therefore, we could not determine if an <u>overpayment</u> was made to medical providers, totaling $93,098.
- 3,525 Critical Care Provider claims had over-the-counter charges and non-drug charges, which were not paid at the federally approved rate. The error amount for these claims was an <u>overpayment</u> to medical providers of $1,166,653.

The Fiscal Control and Internal Auditing Act (30 ILCS 10/3001) requires the Department to establish and maintain a system, or systems, of internal fiscal and administrative controls, to provide assurance that resources are utilized efficiently, effectively, and in compliance with applicable laws and obligations and costs are in compliance with applicable laws.

Department management stated these errors were due to system issues and adjustments that had not been processed yet.

Failure to establish internal controls to ensure medical providers submit proper claims, MCO payments are generated correctly, and the Department furnishes proper reimbursements resulted in erroneous payments by the State. (Finding Code No. 2017-005)

<u>RECOMMENDATION</u>

We recommend the Department implement controls to confirm claims are properly processed at the federally approved rate. Specifically, the Department should:

- Ensure medical providers and MCOs provide complete and accurate information. In the event they do not, the claims should be properly voided.
- Ensure all claims are properly paid at the approved corresponding rate.
- Ensure claimant information (date of birth, etc.) is accurate and not changed. In the event a change is required, the Department should maintain a history of changes.

<u>DEPARTMENT RESPONSE</u>

The Department accepts the recommendation. All capitation records paid during FY 2017 were reviewed during the audit, **nearly 21 million records**. For each of the capitation records identified, the following actions were taken:

- 1,118 records (**0.0053%** of all capitations) were not voided when MCO enrollment was retroactively removed. Programming has been added to automatically void these records during the 18 month look-back period.
- 67 records (**0.0003%** of all capitations) were paid for maternity case rate payments at the rate for the region of the client's local office. In cases the local office county differs from the county of residency, programming has been added to pay at the county of residence rather than the local office county.
- 804 records (**0.0038%** of all capitations) were for rate changes made after the 18 month look-back period had passed. Adjustment files have been created and are being processed to adjust the payment amounts and correct the payment rates to pay or recoup funds as necessary.
- 73 records (**.0003%** of all capitations) had retroactive changes in the client's date of birth.

All Long-Term Care records paid during FY 2017 were reviewed during the audit, **over 463,000 records.** For each of the Long-Term Care records identified, the following actions were taken:

- 789 records (**0.17 %** of all Long-Term Care claims) had retroactive rate changes which had not been adjusted. A new adjustment process is being developed for the new direct billed Long-Term Care claims. The Department estimates the actual adjustments will be applied by the end of this month.
- 639 records (**0.138 %** of all Long-Term Care claims) with a potential underpayment need to be reviewed by the Department. The Department will complete the review and correct any invalid claims as necessary.

All Pharmacy records paid during FY 2017 were reviewed during the audit, **over 7.6 million records**. For each of the Pharmacy records identified, the following actions were taken:

- 50 records (**0.0007%** of all pharmacy claims) were paid incorrectly due to a logic issue that occurred when the Department implemented its new Pharmacy Benefit Management System. The issue was identified and corrected by the Department prior to the audit.
- 74 records (**0.0010%** of all pharmacy claims) were paid incorrectly due to a production issue that occurred when the Department implemented its new Pharmacy Benefit Management System. The issue was identified and corrected by the Department prior to the audit.
- 30,471 records (**0.4%** of all pharmacy claims) may be attributable to retroactive drug pricing changes. Pharmacy claims are adjudicated through a point-of-sale claims processing system using the price available at the time of processing; however, when drug prices change, the new price begin date can oftentimes be retroactive. Pharmacy claims are not adjusted for retroactive pricing changes and the payments are not considered inaccurate. The occurrence of retroactive price changes is an industry-wide occurrence. The practice of not adjusting claims for retroactive pricing changes is an acceptable practice in both the government and commercial environment.
- 5,591 compound drug records (**0.07%** of all pharmacy claims) may be attributable to retroactive drug pricing changes. Pharmacy claims are adjudicated through a point-of-sale claims processing system using the price available at the time of processing; however, when drug prices change, the new price begin date can oftentimes be retroactive. Pharmacy claims are not adjusted for retroactive pricing changes and the payments are not considered inaccurate. The occurrence of retroactive price changes is an industry-wide occurrence. The practice of not adjusting claims for retroactive pricing changes is an acceptable practice in both the government and commercial environment.
- 3,525 Critical Care Provider records (**0.05%** of all pharmacy claims) were due to an issue in the Department's legacy system that required additional programming to correct. The new Pharmacy Benefit Management System resolves the issue.

2017-006 **FINDING** (Backlog of applications for human service programs)

The Department of Healthcare and Family Services and the Department of Human Services (Departments) did not maintain adequate controls to ensure applications for human service programs were reviewed and approved or denied within the mandated 45 day timeframe.

The Department of Healthcare and Family Services and the Department of Human Services have shared responsibility for various human service programs in the State. This includes the intake, processing, and approval of applications for benefits. The Departments have shared responsibility for internal control over manual and automated processes relating to eligibility for these programs.

The Departments' Integrated Eligibility System (IES) takes in applications from individuals in order to determine eligibility and subsequent payments for the State's human service programs.

As of June 30, 2017, the Departments had incurred a backlog of 74,649 applications that were more than 45 days old, with the oldest application dating back to November 19, 2014. As of January 12, 2018,

- The Departments had worked 1,714 applications, which resulted in payments totaling $209,894 for medical services that were incurred during fiscal year 2017.
- The Departments had worked 676 applications, which resulted in payments totaling $47,568 for SNAP (Supplemental Nutrition Assistance Program) and TANF (Temporary Assistance for Needy Families) services that were incurred during fiscal year 2017.

The Code of Federal Regulations (42 CFR § 435.912) requires the Departments to determine eligibility within 45 days of receipt of the application for assistance.

Departments' management stated the delay in processing was due to increased numbers of applications from expanded Medicaid programs and open enrollment periods, delays in receiving some Federally Facilitated Marketplace applications (transfers from the Federal Marketplace), training of new caseworkers hired, and availability of caseworker staff to process applications due to training on the new IES processing system prior to Phase II implementation of IES.

Because the Departments may be required to retroactively pay for services determined, at a later date, to be eligible, not all expense and liabilities may be reported in the Departments' financial statements in the period incurred. Additionally, untimely eligibility determinations may cause hardships on the applicants. (Finding Code No. 2017-006)

RECOMMENDATION

We recommend the Department of Healthcare and Family Services work with the Department of Human Services to implement controls to comply with the requirement that applications are reviewed and approved or denied within 45 days.

DEPARTMENTS' RESPONSE

The Departments accept the recommendation. The Departments continue to strive to be in compliance with its mandated application disposition timelines. There are several factors that lead to the current backlog. During the audit period, the Departments were planning for the implementation of a new processing system, for which substantial training was needed for all casework staff. As the implementation of the system stabilizes, and staff become more efficient in the processing of applications, it is expected that any backlog of applications will be reduced considerably.

2017-007 **FINDING** (Untimely redetermination of eligibility)

The Department of Healthcare and Family Services and the Department of Human Services (Departments) did not conduct timely redeterminations of eligibility for Medicaid recipients. The Code of Federal Regulations (42 CFR § 435.916) requires states to conduct redeterminations of an individual's eligibility every 12 months.

The Department of Human Services and the Department of Healthcare and Family Services have shared responsibility for various human service programs in the State. This includes the intake, processing, and approval of applications for benefits, as well as redeterminations of eligibility where applicable. The Departments have shared responsibility for internal control over manual and automated processes relating to eligibility for these programs.

In order to determine if redeterminations were performed timely, we tested all individuals who received a capitation payment on their behalf to a managed care organization during the audit period and reviewed their redetermination dates. The testing results indicated 8,187 individuals' eligibility redeterminations were not performed within the required 12 month period.

The Departments made payments on behalf of these individuals, totaling $71,300,077, for medical services during fiscal year 2017.

The Fiscal Control and Internal Auditing Act (30 ILCS 10/3001) requires all agencies to establish and maintain a system of internal fiscal and administrative controls to provide assurance that resources are utilized efficiently, effectively, and in compliance with applicable laws and obligations and costs are in compliance with applicable laws.

Departments' management stated staff turnover and availability contributed to the delay in completing all of the redeterminations due each month.

By not conducting eligibility redeterminations as required by the Code of Federal Regulations, the Departments may have incurred expenditures for ineligible individuals. (Finding Code No. 2017-007)

RECOMMENDATION

We recommend the Department of Healthcare and Family Services work with the Department of Human Services to establish the appropriate controls to monitor eligibility redeterminations, and assign the resources necessary so that redeterminations of eligibility are performed annually as required by the Code of Federal Regulations.

DEPARTMENTS' RESPONSE

The Departments accept the recommendation. The redetermination process will be enhanced with the implementation of the newly updated processing system in IES Phase II, which went live on October 24, 2017. In Phase II, both new applications and case maintenance are completed within one system. The IES Phase II system will assist in tracking and auto initiating renewal notices to eligible customers using a three step process. Beginning with cases due for renewal effective February 2018, anyone who is required to return their redetermination notice but does not respond will have their benefits automatically canceled by IES. Previously, these cancelations had to be completed manually by casework staff. Online and classroom training venues are available to all staff using the new system.

2017-008 **<u>FINDING</u>** (Inaccurate determination of eligibility for human service programs)

The Department of Healthcare and Family Services and the Department of Human Services (Departments) lacked adequate controls over the operation of the State of Illinois' Integrated Eligibility System (IES) to sufficiently prevent the inaccurate determination of eligibility.

The Department of Healthcare and Family Services and the Department of Human Services have shared responsibility for various human service programs in the State. This includes the intake, processing, and approval of client applications for benefits. The Departments have shared responsibility for internal control over manual and automated processes (such as IES) relating to eligibility for these programs.

The Departments implemented IES for the intake and processing of applications in order to determine eligibility for the State's human service programs. During fiscal year 2017, the Departments processed:

Applications submitted via IES	677,753
Application approved via IES	496,154
Expenditures associated with applications approved via IES	$1,316,575,345

In order to obtain social services, individuals are evaluated on financial and non-financial criteria. To ensure the accuracy of the Departments' determination, through IES, of eligibility for social service programs, we selected the non-financial criteria (citizenship, residency, social security information) for detailed testing. We tested all individuals whose applications were approved via IES in order to determine if they were properly approved based on the eligibility criteria selected. Our testing noted 251 distinct applications which were approved even though the IES data indicated the eligibility criteria had not been met. Specifically, applications were approved:

- <u>Without meeting</u> immigration requirements,
- <u>Without verification</u> of citizenship,
- <u>Without verification</u> of residency, and/or
- <u>Without valid</u> Social Security Numbers (SSNs) or documentation of submitted application for SSNs.

As a result of the exceptions noted, the Departments incurred expenditures of $1,028,316 for individuals who may not have been eligible for benefits received.

It should be noted that the Departments and the auditors came to an agreement regarding the identified exceptions on December 7, 2017. Then on February 21, 2018, the Departments provided the auditors with additional information related to the testing of the non-financial criteria. The results of testing noted above take into consideration the additional information.

In addition, we selected a statistical sample of 138 distinct applications to determine if they were properly approved based on all eligibility criteria (financial and non-financial). In order to determine if the applications were properly approved, we reviewed each distinct application in IES. Our testing noted:

- 5 (3.6%) applications <u>did not contain</u> support related to residency.
- 3 (2.2%) applications <u>did not contain</u> support related to income.
- 7 (5%) applications <u>did not contain</u> the caseworker's verification of the budgeted income.
- 7 (5%) applications <u>did not contain</u> a copy of the application or the application was not signed.
- 6 (4.3%) applications <u>did not contain</u> evidence that citizenship was verified.

The Department of Human Services incurred expenditures of $18,571 for these individuals who may not have been eligible for benefits received.

The Illinois Public Aid Code (Code) (305 ILCS 5) requires individuals to provide information related to their citizenship, residencies and SSNs. The Code also requires the Departments to verify, via a third party, the information provided by the individuals.

The State Records Act (5 ILCS 160/8) requires the head of each agency to preserve records containing adequate and proper documentation of the organization, functions, policies, decisions, procedures, and essential transactions of the agency designed to furnish information to protect the legal and financial rights of the State and of persons directly affected by the agency's activities.

Finally, the Fiscal Control and Internal Auditing Act (30 ILCS 10/3001) requires all agencies to establish and maintain a system of internal fiscal and administrative controls to provide assurance that resources are utilized efficiently, effectively, and in compliance with applicable laws and obligations and costs are in compliance with applicable laws.

Departments' management stated the problems noted were a due to caseworker error.

Inadequate controls over the operation of IES have resulted in expenditures for which eligibility has not been adequately demonstrated or documented and may result in future expenditures for individuals who are ineligible to receive benefits from these human service programs. (Finding Code No. 2017-008, 2016-001, 2015-002)

RECOMMENDATION

We recommend the Department of Healthcare and Family Services work with the Department of Human Services to improve controls over caseworker involvement and system defects by refining supervisory oversight to confirm all applications are properly approved and caseworkers are properly obtaining and retaining documentation in IES to support eligibility

DEPARTMENTS' RESPONSE

The Departments accept the recommendation. The errors noted in the testing of the 138 cases are attributed to casework error. The current transition the Departments were undertaking from one system to another comes with an unfamiliarity of processing procedures and nuances that are still being learned and perfected. During the audit period, casework staff had been required to spend substantial time participating in training of the new system. The transition from paper case records to electronic case records required a massive change in the gathering and maintaining of documentation. Although the new system does allow for proper maintenance of documentation in an electronic format, the conversion to the new process is still being refined. It is expected that as the transition to the new system stabilizes, casework errors will be reduced.

2017-009 **FINDING** (Lack of controls over changes to the Integrated Eligibility System)

The Department of Healthcare and Family Services and the Department of Human Services (Departments) lacked controls over changes to the Integrated Eligibility System (IES).

The Department of Healthcare and Family Services and the Department of Human Services have shared responsibilities for various human service programs in the State. As such, the Departments have a shared responsibility for the adequacy of internal controls over the IT applications and data which is utilized in determining eligibility for the human service programs.

IES is utilized for the intake of applications and the determination of eligibility for the State's human service programs. During fiscal year 2017, IES determined eligibility for 677,753 applications, approved and denied.

In October 2013, the Departments contracted with a vendor for the development and maintenance of IES; however, the Departments were responsible for ensuring proper controls were in place. As noted in the past two audits, we determined the Departments still had not developed policies and procedures to control changes over IES. As such, we were unable to determine if changes were properly controlled.

In addition, we requested documentation to demonstrate programmers' access was restricted; however, the Departments were unable to provide complete and accurate documentation. During discussions with the Departments, it was also noted vendor programmers had access to the production environment. In fact, a programmer had moved a change into the production environment that caused problems with the use and processing of IES data.

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 to provide assurance that revenues, expenditures, and transfers of assets, resources, or 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.

Generally accepted information technology guidance endorses the implementation of suitable change management procedures to control changes to computer systems. Effective change management procedures reduce the risk of unauthorized, improper, or erroneous changes to computer systems. These procedures include restricting programmers from accessing the production environment.

Departments' management stated that control policies and procedures for IES have not been fully documented due to competing IES priorities.

The inability to determine and document that changes to IES are proper and approved increases the risk that IES will not have the required accuracy, integrity, availability, and security. (Finding Code No. 2017-009)

RECOMMENDATION

We recommend the Department of Healthcare and Family Services work with the Department of Human Services to implement controls over changes to IES. Specifically, the Departments should develop change control policies and procedures to control changes. The policies and procedures should include at a minimum:

- Procedures to generate a complete list of program changes,
- Formal documentation authorizing the change by the Departments,
- Testing and documentation requirements,
- Formal documentation authorizing the change prior to being moved to the production environment.

In addition, the Departments should require that programmers' access be properly restricted and an adequate segregation of duties exists.

DEPARTMENTS' RESPONSE

The Departments accept the recommendation and will work together_to implement an approval process for changes made to the IES. The Departments will develop formal change control policies and procedures for IES that encompass the recommendations listed and ensure that programmers do not have direct access to the production environment without proper approval.

2017-010 **<u>FINDING</u>** (Lack of security controls over the IES computing environment)

The Department of Healthcare and Family Services and the Department of Human Services (Departments) failed to implement adequate security controls over the computing environment supporting the Integrated Eligibility System (IES).

The Department of Human Services and the Department of Healthcare and Family Services have shared responsibilities for various human service programs in the State. As such, the Departments have a shared responsibility for the adequacy of internal controls over the IT applications and data which is utilized in determining eligibility for the human service programs.

IES is utilized for the intake of applications and the determination of eligibility for the State's human service programs. During fiscal year 2017, IES determined eligibility for 677,753 applications.

During our engagement, we requested the Departments provide the population of servers in which IES resides in order to determine the security over the servers. In response, the Departments provided a listing of servers; however, during testing, we noted servers which were not included on the listing.

Due to these conditions, we were unable to conclude the Departments' population of records were sufficiently precise and detailed under the Professional Standards promulgated by the American Institute of Certified Public Accountants (AU-C § 330, AU-C § 530, AT-C § 205).

Even given the population limitations noted above, we performed testing and noted:

- 209 of 346 servers were running operating systems that were no longer supported by the vendor.
- The IES Disaster Recovery Plan had not been updated to reflect the current environment.

In addition, the Departments' own review noted:

- Personal identifiable information (PII) and protected health information (PHI) is exposed in shared service areas.
- Lack of documentation or inaccurate documentation of users on infrastructure devices.
- Separation of duties not being exercised.
- Access privileges are not limited.
- Security functions assigned to personnel outside of security.
- Devices incorrectly configured and not working correctly.
- Server configuration setting maintained only by the vendor.
- Audit logs are not generated.
- Hardware/software contains out of date batches and fixes.
- Password reset questions are maintained in clear text.

Departments' management stated the IES Plan of Action and Milestones included all items identified during this audit. These items are in various stages of development and implementation; several of which require significant time and resources to resolve. The Departments determined that those items presenting the highest risk would be included with the Phase II Go-Live release in October 2017. The remaining items, moderate and low risk, were determined by the Departments as acceptable risks due to compensating or other implemented security controls. The remaining three high risk items are among those that require substantial code and infrastructure changes.

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 to provide assurance that revenues, expenditures, and transfers of assets, resources, or 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.

Generally accepted information technology guidance endorses the development of well-designed and well-managed controls to protect computer systems and data.

Failure to implement and maintain adequate controls over security could result in inaccurate data and availability issues. (Finding Code No. 2017-010)

RECOMMENDATION

We recommend the Department of Healthcare and Family Services work with the Department of Human Services to implement suitable security controls over the computing environment supporting IES.

DEPARTMENTS' RESPONSE

The Departments accept the recommendation. The security issues were previously identified by the Department and a Plan of Action and Milestones were developed to track each issue, with the exception of two items which are tracked in the weekly infrastructure technical meeting. In addition, corrective action plans are in progress for each.

2017-011 <u>**FINDING**</u> (Lack of adequate controls over the review of internal controls over service providers)

The Department of Healthcare and Family Services (Department) did not obtain or conduct timely independent internal control reviews over its external service providers.

We requested the Department provide the population of service providers utilized by the Department in order to determine if the Department had reviewed the internal controls over the service providers. In response to our request, the Department provided a listing of service providers utilized during the engagement period. However, during testing, we noted four additional service providers, which the Department had not included in their listing.

Due to these conditions, we were unable to conclude the Department's population records were sufficiently precise and detailed under the Professional Standards promulgated by the American Institute of Certified Public Accountants (AU-C § 330, AU-C § 530, AT-C § 205).

Even given the population limitations noted above, we performed testing of the ten service providers utilized by the Department from the listing provided by the Department and the service providers identified by us.

The Department utilized various service providers to provide:

- Software used in the data matching and verification, process management, and reporting of client's eligibility redeterminations. The vendor processed 674,475 client redeterminations during the engagement period.
- Administration and payment of claims for the enrollees of the State's Dental Program. The vendor processed claims totaling $86,566,937 during the engagement period.
- An externally developed and hosted application which processed Medicaid Incentive Payment Program (eMIPP). During the engagement period, $43,008,372 of eMIPP payments were processed.
- Software as a service and infrastructure as a service for the Department's Pharmacy Benefits Management System. During the engagement period, $1,057,184,554 in drug rebate invoices and $76,187,132 in pharmacy claims were processed.
- Management and operations of the State's Disbursement Unit for the collection and disbursement of payments under child support orders. During the engagement period, 7,027,509 transactions were processed, totaling $1,313,329,474.
- The establishment of rate and review of information related to the State's Managed Care Program.

During testing, we noted:

- The Department did not obtain System and Organization Control (SOC) reports or conduct independent internal control reviews for four external service providers.
- Although the Department had received a SOC report from five of the external service providers, an analysis of the all reports and the complementary user entity controls had not been conducted.
- Four external service providers utilized subcontractors in order to carry out their contractual duties. However, the Department had not performed an analysis to determine the need to obtain information as to the subservice organization's internal controls.
- Not all agreements between the Department and the external service providers contained a requirement for an independent review to be completed.

Department management stated some contract managers were unaware of the need for SOC reports from certain types of service providers and subcontractors.

The Department is responsible for the design, implementation, and maintenance of internal controls related to information systems and operations to assure its critical and confidential data are adequately safeguarded. This responsibility is not limited due to the processes being outsourced.

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 to provide assurance that revenues, expenditures, and transfers of assets, resources, or 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. In addition, generally accepted information technology guidance endorses the review and assessment of internal controls related to information systems and operations to assure the accurate processing and security of information.

Without having obtained and reviewed a SOC report or another form of independent internal controls review, the Department does not have assurance the external service providers' or subservice organizations' internal controls are adequate to ensure program payments and claims are accurate and secure. (Finding Code No. 2017-011, 2016-003, 2015-004)

RECOMMENDATION

We recommend the Department strengthen its controls in identifying and documenting all service providers utilized. Further, we recommend the Department obtain or perform independent reviews of internal controls associated with third party service providers at least annually.

The Department should perform a timely review of the reports, assess the effect of any noted deficiencies, and identify and implement any compensating controls. The Department's reviews and corrective actions taken by the service provider should be documented and maintained.

In addition, the Department should perform an analysis to determine the need to obtain information as to the subservice organization's internal controls and perform reviews as needed.

DEPARTMENT RESPONSE

The Department accepts the recommendation. The Department will acquire System and Organization Control (SOC) Reports from vendors as appropriate. The Department will implement procedures to review and respond to those SOC reports as necessary.

The variance of the four contracts cited as needing SOC reports that were not on the Department's listing was due to the Department's interpretation of which entities needed a SOC report.

2017-012 **FINDING** (Inadequate controls over drug rate changes)

The Department of Healthcare and Family Services (Department) did not have controls in place to ensure the drug rates paid to medical providers were in accordance with the State Plan and properly loaded into the Pharmacy Benefits Management System (PBMS).

The State of Illinois, State Plan under Title XIX of the Social Security Act, Medical Assistance Program, Methods and Standards for Establishing Payments Rates (State Plan), states "pharmacies will be reimbursed for prescribed drugs at the lower of:

- i. The pharmacy's usual and customary charges to the general public.
- ii. The applicable methodology from among the following plus the applicable dispensing fee:
    - a. Single source legend drugs
        - i. Effective July 21, 2012, the lower of:
            1. Wholesale acquisition cost of national drug code on claim.
            2. The State upper limit.

    - b. Multiple source legend drugs
        - i. Effective July 21, 2012, the lower of:
            1. Wholesale acquisition cost of national drug code on claim
            2. The federal upper limit.
            3. The State upper limit.

In addition, the drug rates are to be updated at least monthly utilizing data procured from a national drug database source.

During testing, we requested the Department provide documentation demonstrating their due diligence in ensuring the updated rates were reviewed and the load process was properly completed. However, the Department was unable to provide such documentation.

The Department stated they had contracted with a vendor to maintain the PBMS, which makes payments to the pharmacies. As such, the vendor was responsible for receiving the rate files from the Medi-Span data file and loading them into PBMS. Therefore, the Department did not feel it was necessary to ensure the controls over the process were sufficient.

On March 26, 2017, the Department implemented the point-of-sale module, which makes payments to medical providers. From March 26, 2017 through June 30, 2017, the Department's pharmacy system processed 1,068,744 pharmacy transactions totaling $76,187,132.

Department management stated they did not obtain information from the vendor to ensure the controls over the Medi-Span data file load process were sufficient.

Lack of controls over changes to the pharmacy rate files could result in incorrect payments to medical providers and is noncompliance with the State Plan. (Finding Code No. 2017-012)

RECOMMENDATION

We recommend the Department review the controls over the vendor to make certain the rates are in accordance with the State Plan and the load process is properly completed.

DEPARTMENT RESPONSE

The Department accepts the recommendation. The Department regularly monitors claims data for anomalies that could identify potential issues, such as possible discrepancies in the pricing file. When an anomaly is identified, the Department conducts further research to isolate the root cause. In addition, the Department has established a process requiring the vendor to provide documentation of the outcome of the load process on a weekly basis. Department staff will review the documentation and immediately escalate any concerns to the vendor for explanation and/or resolution.

2017-013 **<u>FINDING</u>** (Inadequate project management over the Pharmacy Benefits Management System)

The Department of Healthcare and Family Services (Department) did not establish adequate controls to conduct due diligence or to ensure project management over the Pharmacy Benefits Management System (PBMS).

On March 17, 2014, the Department entered into a $28.5 million contract for the development, implementation and hosting of PBMS. PBMS was to provide two main functions; billing and maintenance of the drug manufacture rebates and the processing of medical pharmacy transactions.

As of June 30, 2017, the Department had completed five implementations. During our review of each implementation, we noted:

- The contract required the vendor to provide reports on the various iterations of testing.
  - Final Unit Test Report,
  - Final System Integration Test Report,
  - Final User Acceptance Test Report and Master Test Tracking Matrix,
  - Final Pilot Test Report, and
  - Application Performance Testing Report.

  However, the Department was unable to provide all the various reports for each implementation. During our review of the reports provided, we could not determine if they were the final version.

  The Department provided documentation to support User Acceptance Testing; however, the documentation indicated testing steps had not been completed or resulted in a defect, with no indication of resolution.

- As part of the implementations, data was converted and we requested documentation to support the accuracy of converting data from the Department's legacy systems to PBMS. However, the Department did not provide documentation to demonstrate the data conversion was complete and accurate.

- The Department did not provide documentation demonstrating security controls over PBMS had been tested throughout all implementations.

- The Department did not provide documentation authorizing the vendor to apply two implementations into the production environment.

Department management stated some of the documentation for Phase I was not saved in the project repository and turnover of staff made it difficult to retrieve the documentation not maintained centrally.

The Fiscal Control and Internal Auditing Act (30 ILCS 10/3001) states all agencies are to establish and maintain a system of internal fiscal and administrative controls to provide assurance that resources are utilized efficiently, effectively, and in compliance with applicable laws and obligations and costs are in compliance with applicable laws. In addition, generally accepted information technology standards endorse the implementation of project management techniques to ensure computer system development activities meet management's objectives.

Due to the inadequate project management and due diligence, the Department did not obtain all documentation to support the implementations. (Finding Code No. 2017-013)

RECOMMENDATION

We recommend the Department establish adequate controls over project management and due diligence over major projects, such as PBMS.

DEPARTMENT RESPONSE

The Department accepts the recommendation. At all times throughout the project, the Department has had the support and autonomous review of the federally-required Independent Validation & Verification (IV&V) vendor. For Phase I, most deliverable sign-offs were handled informally via email rather than with formal documentation including signatures. A formal sign off process for deliverables was instituted for Phase II. The Phase II PBMS Project Team has worked closely with its IV&V vendor, meeting on a weekly basis to manage processes and to implement fiscal controls as well as administrative controls to monitor the spending and resources allocated for this project.

PRIOR FINDINGS NOT REPEATED

A. **FINDING** (Lack of control over the Integrated Eligibility System)

During the prior engagement, the Department of Healthcare and Family Services and the Department of Human Services (Departments) failed to implement adequate security, change management, and recovery controls over the State's Integrated Eligibility System (IES).

During the current engagement, we noted adequate controls still had not been implemented over security, change management, and recovery services. As such, we reported the issues separately in Finding 2017-009 and Finding 2017-010. (Finding Code No. 2016-002, 2015-003)