

**STATE OF ILLINOIS
DEPARTMENT OF HEALTHCARE AND FAMILY SERVICES
TEACHER HEALTH INSURANCE SECURITY FUND**

**FINANCIAL AUDIT
For the Year Ended June 30, 2008**

STATE OF ILLINOIS
DEPARTMENT OF HEALTHCARE AND FAMILY SERVICES
TEACHER HEALTH INSURANCE SECURITY FUND
FINANCIAL AUDIT
For the Year Ended June 30, 2008

AGENCY OFFICIALS

Director	Barry S. Maram
Assistant Director	Sharron Matthews
General Counsel	Nancy Shalowitz (7/1/07-12/28/07)
General Counsel	Kyong Lee (Acting) (12/31/07 – Current)
Inspector General	John C. Allen
State Purchasing Officer	Thomas Meirink (7/01/07 – 6/25/08)
State Purchasing Officer	Tom Sestak (Acting) (6/26/08 – Current)
Division of Finance, Administrator	Michael Moss
Office of Fiscal Management, Chief	Jack Dodds

Department of Healthcare and Family Services offices are located at:

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2200 Churchill Road
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STATE OF ILLINOIS
DEPARTMENT OF HEALTHCARE AND FAMILY SERVICES
TEACHER HEALTH INSURANCE SECURITY FUND
FINANCIAL AUDIT
For the Year Ended June 30, 2008

FINANCIAL STATEMENT REPORT

SUMMARY

The audit of the accompanying financial statements of the Illinois Department of Healthcare and Family Services' Teacher Health Insurance Security Fund was performed by the Office of the Auditor General.

Based on their audit, the auditors expressed an unqualified opinion on the Teacher Health Insurance Security Fund's financial statements.

SUMMARY OF FINDINGS

The auditors identified matters involving the Department's internal control over financial reporting that they considered to be significant deficiencies. The significant deficiencies are described in the accompanying Schedule of Findings on pages 17-22 of this report as finding 08-1, third party internal control reviews not obtained and 08-2, incorrect health insurance premium rates charged.

EXIT CONFERENCE

The financial audit findings and recommendations appearing in this report were discussed with Department personnel at an exit conference on May 22, 2009.

The responses to the recommendations were provided by Peggy Edwards, Audit Liaison for the Department, on June 1, 2009.

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OFFICE OF THE AUDITOR GENERAL
WILLIAM G. HOLLAND

INDEPENDENT AUDITORS' REPORT

Honorable William G. Holland
Auditor General
State of Illinois

We have audited the accompanying financial statements of the Teacher Health Insurance Security Fund of the State of Illinois, Department of Healthcare and Family Services, as of and for the year ended June 30, 2008, as listed in the table of contents. These financial statements are the responsibility of the State of Illinois, Department of Healthcare and Family Services' management. Our responsibility is to express an opinion 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 of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and the significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audit provides a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of the Teacher Health Insurance Security Fund of the State of Illinois, Department of Healthcare and Family Services, as of June 30, 2008, and the changes in financial position thereof for the year then ended in conformity with accounting principles generally accepted in the United States of America.

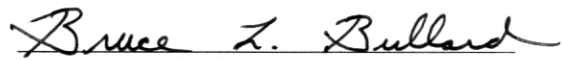
In accordance with *Government Auditing Standards*, we have also issued a report dated June 26, 2009 on our consideration of the State of Illinois, Department of Healthcare and Family Services' internal control over financial reporting of the Teacher Health Insurance Security Fund and on our tests of the State of Illinois, Department of Healthcare and Family Services' compliance with certain provisions of laws, regulations, contracts and grant agreements and other matters. The purpose of that report is 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 internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* and should be considered in assessing the results of our audit.

INTERNET ADDRESS: AUDITOR@MAIL.STATE.IL.US

RECYCLED PAPER • SOYBEAN INKS

The Schedule of Funding Progress for the year ended June 30, 2008 and the Schedule of Contributions from Employers and Other Contributing Entities for the year ended June 30, 2008 on pages 13-14 are not a required part of the financial statements of the Teacher Health Insurance Security Fund but is supplementary information required by accounting principles generally accepted in the United States of America. We have applied certain limited procedures which consisted principally of inquiries of management regarding the methods of measurement and presentation of the required supplementary information. However, we did not audit the information and express no opinion on it.

The State of Illinois, Department of Healthcare and Family Services has not presented a management's discussion and analysis for the Teacher Health Insurance Security Fund that accounting principles generally accepted in the United States of America has determined is necessary to supplement, although not required to be part of, the financial statements.



Bruce L. Bullard, CPA

Director of Financial and Compliance Audits

June 26, 2009

STATE OF ILLINOIS
DEPARTMENT OF HEALTHCARE AND FAMILY SERVICES
TEACHER HEALTH INSURANCE SECURITY FUND
STATEMENT OF PLAN NET ASSETS
June 30, 2008

(amounts expressed in thousands)

Assets	
Cash and short-term investments	\$ 79,628
Receivables	
Employer	3,449
Employee	4,598
Federal government	5,137
Interest	125
Other receivables	<u>5,756</u>
Total receivables	<u>19,065</u>
Total assets	<u>98,693</u>
 Liabilities	
Accounts payable and other	35,680
Intergovernmental payables	1
Due to other funds	697
Short-term compensated absences	<u>2</u>
Total current liabilities	36,380
Long-term compensated absences	<u>68</u>
Total liabilities	<u>36,448</u>
Net assets held in trust for other postemployment benefits	<u><u>\$ 62,245</u></u>

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

STATE OF ILLINOIS
DEPARTMENT OF HEALTHCARE AND FAMILY SERVICES
TEACHER HEALTH INSURANCE SECURITY FUND
STATEMENT OF CHANGES IN PLAN NET ASSETS
For the Year Ended June 30, 2008

(amounts expressed in thousands)

Additions

Contributions	
Employer	\$ 63,458
State	68,596
Plan member:	
Actives	84,611
Retirees	140,248
Federal government Medicare Part D	19,930
Consolidated Omnibus Budget Reconciliation Act	<u>209</u>
Total contributions	377,052
Interest income	<u>3,122</u>
Total additions	<u>380,174</u>

Deductions

Benefit payments	380,852
Administrative expense	<u>2,867</u>
Total deductions	<u>383,719</u>

Net increase/(decrease) (3,545)

**Net assets held in trust for other
postemployment benefits**

Beginning of year	<u>65,790</u>
End of year	<u>\$ 62,245</u>

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

STATE OF ILLINOIS
DEPARTMENT OF HEALTHCARE AND FAMILY SERVICES
TEACHER HEALTH INSURANCE SECURITY FUND
NOTES TO THE FINANCIAL STATEMENTS
June 30, 2008

The Teacher Health Insurance Security Fund (also known as The Teacher Retirement Insurance Program, "TRIP") is a non-appropriated trust fund held outside the State Treasury, with the State Treasurer as custodian. Revenues deposited into the Trust are for the sole purpose of providing the health benefits to retirees, as established under the plan, and associated administrative costs. TRIP is a cost-sharing multiple-employer defined benefit post-employment healthcare plan that covers retired employees of participating school districts throughout the State of Illinois, excluding the Chicago Public School System. TRIP health coverage includes provisions for medical, prescription, and behavioral health benefits, but does not provide vision, dental, or life insurance benefits. Annuitants may participate in the State administered Preferred Provider Organization plan or choose from several managed care options. The State Employees Group Insurance Act of 1971 (5 ILCS 375/6.5) establishes the eligibility and benefit provisions for the plan. The Illinois Departments of Healthcare and Family Services (HFS) and Central Management Services (CMS) administer the plan with the cooperation of the Teachers Retirement System (TRS).

In order to be eligible, retirees of public schools must have been certified educators or administrators during their time of employment. Eligibility to participate in the plan is currently limited to former full-time employees and their dependents.

A. Summary of Significant Accounting Principles

Basis of Accounting: TRIP's financial statements are prepared using the accrual basis of accounting. Plan member contributions are recognized in the period in which the contributions are due. Employer contributions to the plan are recognized when due and the employer has made a formal commitment to provide the contributions. Benefits and refunds are recognized when due and payable in accordance with the terms of the plan.

Cash and Cash Equivalents: Cash and cash equivalents include cash on hand and cash in banks for locally held funds. Cash equivalents are defined as short-term, highly liquid investments readily convertible to cash.

Investments/Deposits: The investments are in the State Treasury Investment Pool (Illinois Funds). Investments are reported at fair value.

Compensated Absences: The liability for compensated absences reported in the statement of plan net assets consists of unpaid, accumulated vacation and sick leave balances for Department employees. 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 costs (e.g., Social Security and Medicare tax).

STATE OF ILLINOIS
DEPARTMENT OF HEALTHCARE AND FAMILY SERVICES
TEACHER HEALTH INSURANCE SECURITY FUND
NOTES TO THE FINANCIAL STATEMENTS
June 30, 2008

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.

Use of Estimates: The preparation of financial statements in conformity with Generally Accepted Accounting Principles (GAAP) requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and to disclose 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.

B. Contribution Information

Membership of the plan consisted of the following at June 30, 2008:

Retirees and beneficiaries receiving benefits	62,936
Waived retirees who may elect healthcare coverage in the future	15,507
Terminated plan members entitled to but not yet receiving benefits thru TRIP	7,181
Terminated plan members entitled to but not yet receiving benefits thru other TRS plans	8,340
Active plan members	<u>165,572</u>
Total	<u>259,536</u>
 Number of participating employers	 1,005

The State Employees Group Insurance Act of 1971 (5 ILCS 375/6.6) requires that all active contributors of the Teachers' Retirement System (TRS), who are not employees of a department, make contributions to the plan at a rate of .84% of salary and for every employer of a teacher to contribute an amount equal to .63% of each teacher's salary. Beginning July 1, 2007, HFS will determine, by rule, the percentage required, which each year shall not exceed 105% of the percentage of salary actually required to be paid in the previous fiscal year.

STATE OF ILLINOIS
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NOTES TO THE FINANCIAL STATEMENTS
June 30, 2008

The State Employees Group Insurance Act of 1971 (5 ILCS 375/6.5) requires that the HFS Director determine the rates and premiums for annuitants and dependent beneficiaries and establish the cost-sharing parameters, as well as funding. Member premiums are set by this statute, which provides for a subsidy of either 50% or 75%, depending upon member benefit choices. Dependents are eligible for coverage, at a rate of 100% of the cost of coverage.

For the year ended June 30, 2008, member annuitants (including their dependent beneficiaries) contributed \$140.2 million, or approximately 39.26% of total premiums, through their required contributions. Member required contributions ranged from \$66.00 to \$171.85, per month per retiree, and from \$306.09 to \$515.55, per month per retiree and spouse (assuming Medicare eligibility). For non-Medicare eligible members, required contributions ranged from \$53.78 to \$592.31, per month per retiree, and from \$268.92 to \$1,776.93, per month per retiree plus dependents. The State Employees Group Insurance Act of 1971 (5 ILCS 375/6.6) requires active teachers contribute .84% of salaries; they contributed \$84.6 million, or approximately 23.69% of total premiums. The State Employees Group Insurance Act of 1971 (5 ILCS 375/6.6) also requires participating school districts contribute .63% of salaries; they contributed \$63.5 million, or approximately 17.78% of total premiums. In addition, the State Employees Group Insurance Act of 1971 (5 ILCS 375/6.6) requires the State contribute .8% of salaries; they contributed \$68.6 million, or approximately 19.21% of total premiums. The fund received \$19.9 million in Medicare Part D subsidy payments from the federal government.

C. Deposits and Investments

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 with the State Treasurer totaled \$68,634 thousand at June 30, 2008.

STATE OF ILLINOIS
DEPARTMENT OF HEALTHCARE AND FAMILY SERVICES
TEACHER HEALTH INSURANCE SECURITY FUND
NOTES TO THE FINANCIAL STATEMENTS
June 30, 2008

Investments

As of June 30, 2008, the Department had the following investments in the State Treasury Investment Pool (Illinois Funds):

	Fair Value <u>(Thousands)</u>	Book Value <u>(Thousands)</u>	Weighted Average Maturity <u>(Years)</u>
State Treasury Investment Pool (Illinois Funds)	\$ 10,994	\$ 10,994	0.068
Total fixed income investments	<u>\$ 10,994</u>	<u>\$ 10,994</u>	

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 State Treasury Investment Pool (Illinois Funds) were rated AAAM by Standard & Poor's.

D. Status and Funding Progress - OPEB Plans

The funded status of the plan as of the most recent actuarial valuation date available as of June 30, 2008, is as follows (amounts expressed in thousands):

Actuarial Date	Actuarial Value of Assets (a)	Actuarial Accrued Liability (AAL)-- Projected Unit (b)	Unfunded AAL (UAAL) (b-a)	Funded Ratio (a/b)	Covered Payroll (c)	UAAL as a Percentage of Covered Payroll ([b-a]/c)
6/30/07	\$65,790	\$14,284,678	\$14,218,888	.46%	\$7,785,458	182.63%

STATE OF ILLINOIS
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NOTES TO THE FINANCIAL STATEMENTS
June 30, 2008

Actuarial valuations of an ongoing plan involve estimates of the value of reported amounts and assumptions about the probability of occurrence of events far into the future. Examples include assumptions about future employment, mortality, and the healthcare cost trend. Actuarially determined amounts are subject to continual revision as actual results are compared with past expectations and new estimates are made about the future. The Schedule of Funding Progress, presented as required supplementary information following the notes to the financial statements, presents multi-year trend information about whether the actuarial values of plan assets are increasing or decreasing over time, relative to the actuarial accrued liabilities for benefits.

The accompanying Schedule of Contributions from Employers and Other Contributing Entities presents trend information about the amounts contributed to the plan by employers in comparison to the Annual Required Contribution (ARC), an amount that is actuarially determined in accordance with the parameters of GASB Statement 43. The ARC represents a level of funding that, if paid on an ongoing basis, is projected to cover normal cost for each year and amortize any unfunded actuarial liabilities (or funding excess) over a period not to exceed thirty years.

Projections of benefits for financial reporting purposes are based on the substantive plan (the plan as understood by the employer and plan members) and include the types of benefits provided at the time of each valuation and the historical pattern of sharing of benefit costs between the employer and plan members to that point. The actuarial methods and assumptions used include techniques that are designed to reduce the effects of short-term volatility in actuarial accrued liabilities and the actuarial value of assets, consistent with the long-term perspective of the calculations. Additional information as of the latest actuarial valuation follows:

Valuation Date	6/30/07
Actuarial Cost Methods	Projected Unit Credit
Amortization Method	Level Percentage of Pay
Remaining Amortization Period	30 years
Asset Valuation Method	Market Value
Actuarial Assumptions:	
Inflation Rate	3.5%
Amortization Period	Open
Investment Rate of Return*	4.5%*
Healthcare Cost Trend Rate	9% Initial 5% Ultimate

* Determined as a blended rate of the expected long-term investment returns on plan assets based upon the funded level of the plan as of the valuation date.

STATE OF ILLINOIS
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NOTES TO THE FINANCIAL STATEMENTS
June 30, 2008

E. Long-Term Obligations

Changes in long-term obligations (amounts expressed in thousands) for the year ended June 30, 2008, were as follows:

	Balance July 1, 2007	Additions	Deletions	Balance June 30, 2008	Amounts Due Within One Year
Compensated Absences	\$ 62	\$ 48	\$ 40	\$ 70	\$ 2
Total	\$ 62	\$ 48	\$ 40	\$ 70	\$ 2

F. Commitments and Contingencies

The Department is a party to numerous other legal proceedings, many of which normally occur in the course of operations. These proceedings are not, in the opinion of the Department's legal counsel, likely to have a material adverse impact on the Department's financial position. In the event a material action is settled against the Department, such amounts would be paid from future appropriations or by another State agency. Accordingly, no amounts have been provided in the accompanying financial statements related to outstanding litigation.

STATE OF ILLINOIS
DEPARTMENT OF HEALTHCARE AND FAMILY SERVICES
TEACHER HEALTH INSURANCE SECURITY FUND
REQUIRED SUPPLEMENTARY INFORMATION
SCHEDULE OF FUNDING PROGRESS
(amounts expressed in thousands)

Actuarial Valuation Date	Actuarial Value of Assets	Actuarial Liability (AAL)-- Projected Unit (b)	Unfunded AAL (UAAL) (b-a)	Funded Ratio (a/b)	Covered Payroll (c)	UAAL as a Percentage of Covered Payroll ([b-a]/c)
	(a)	(b)	(b-a)	(a/b)	(c)	([b-a]/c)
6/30/2007	\$ 65,790	\$ 14,284,678	\$ 14,218,888	0.46%	\$ 7,785,458	182.63%

STATE OF ILLINOIS
DEPARTMENT OF HEALTHCARE AND FAMILY SERVICES
TEACHER HEALTH INSURANCE SECURITY FUND
REQUIRED SUPPLEMENTARY INFORMATION
SCHEDULE OF CONTRIBUTIONS FROM EMPLOYERS
AND OTHER CONTRIBUTING ENTITIES

(amounts expressed in thousands)

<u>Year Ended June 30</u>	<u>Annual Required Contribution</u>	<u>State Contributions</u>	<u>State Percentage Contributed</u>	<u>Employer's Contributions</u>	<u>Employer's Percentage Contributed</u>	<u>Medicare Part D Contributions</u>	<u>Medicare Part D Percentage Contributed</u>
2007	\$ 1,013,794	\$ 75,839	7.48%	\$ 58,191	5.74%	\$ 17,026	1.68%
2008	\$ 1,059,415	\$ 68,596	6.47%	\$ 63,458	5.99%	\$ 19,930	1.88%

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OFFICE OF THE AUDITOR GENERAL
WILLIAM G. HOLLAND

INDEPENDENT ACCOUNTANTS' 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 William G. Holland
Auditor General
State of Illinois

We have audited the Teacher Health Insurance Security Fund of the State of Illinois, Department of Healthcare and Family Services, as of and for the year ended June 30, 2008, and have issued our report thereon dated June 26, 2009. 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.

Internal Control Over Financial Reporting

In planning and performing our audit, we considered the State of Illinois, Department of Healthcare and Family Services' internal control over financial reporting of the Teacher Health Insurance Security Fund as a basis for designing our auditing procedures for the purpose of expressing our opinion on the financial statements and not for the purpose of expressing an opinion on the effectiveness of the State of Illinois, Department of Healthcare and Family Services' internal control over financial reporting. Accordingly, we do not express an opinion on the effectiveness of the State of Illinois, Department of Healthcare and Family Services' internal control over financial reporting.

Our consideration of internal control over financial reporting was for the limited purpose described in the preceding paragraph and would not necessarily identify all deficiencies in the internal control over financial reporting that might be significant deficiencies or material weaknesses. However, as discussed below, we identified certain deficiencies in internal control over financial reporting that we consider to be significant deficiencies.

A control deficiency 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 misstatements on a timely basis. A significant deficiency is a control deficiency, or combination of control deficiencies, that adversely affects the entity's ability to initiate, authorize, record, process, or report financial data reliably in accordance with generally accepted accounting principles such that there is more than a remote likelihood that a misstatement of the entity's financial statements that is more than inconsequential will not be prevented or detected by the entity's internal control. We consider the deficiencies in the accompanying schedule of findings to be significant deficiencies in internal control over financial reporting as item 08-1 and 08-2.

A material weakness is a significant deficiency, or combination of significant deficiencies, that results in more than a remote likelihood that a material misstatement of the financial statements will not be prevented or detected by the entity's internal control.

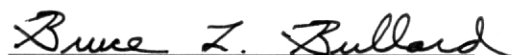
Our consideration of internal control over financial reporting was for the limited purpose described in the first paragraph of this section and would not necessarily identify all deficiencies in the internal control over financial reporting that might be significant deficiencies, and would not necessarily disclose all significant deficiencies that are also considered to be material weaknesses. However, we believe that none of the significant deficiencies described is a material weakness.

Compliance and Other Matters

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

We also noted certain matters which we have reported to management of the State of Illinois, Department of Healthcare and Family Services in a separate letter dated June 26, 2009.

The State of Illinois, Department of Healthcare and Family Services' responses to the findings identified in our audit are described in the accompanying schedule of findings. We did not audit the State of Illinois, Department of Healthcare and Family Services' responses and, accordingly, we express no opinion on it.



Bruce L. Bullard, CPA

Director of Financial and Compliance Audits

June 26, 2009

STATE OF ILLINOIS
DEPARTMENT OF HEALTHCARE AND FAMILY SERVICES
TEACHER HEALTH INSURANCE SECURITY FUND
SCHEDULE OF FINDINGS
For the Year Ended June 30, 2008

08-1. **FINDING** (Third party internal control reviews not obtained)

The Department of Healthcare and Family Services (Department) did not obtain an independent internal control review of its third parties involved with the processing of health insurance claims for the Teachers Retirement Insurance Program. Without a review, the Department did not have assurance that information system controls to prevent errors or irregularities were established.

The Department contracts with four different third-party health insurance service providers to process health insurance claims. Each of the health insurance service provider uses their own computer system to process these health insurance claims. During our review of third party health insurance service providers, we noted that the Department did not obtain an independent internal control review for one of the service providers during fiscal year 2008.

Of the health insurance payments made to the four third-party health insurance service providers totaling \$292,678,137 in fiscal year 2008, \$44,572,976 (15%) of the health insurance payments were processed under a third-party health insurance service provider that the Department did not obtain an independent internal control review.

Statement on Auditing Standards (AU 324.02) states that a service auditor's report on a service organization's description of its controls that may be relevant to a user organization's internal control as it relates to an audit of financial statements, on whether such controls were suitably designed to achieve specified control objectives, on whether they had been placed in operation as of a specific date, and on whether the controls that were tested were operating with sufficient effectiveness to provide reasonable, but not absolute, assurance that the related control objectives were achieved during the period specified. Statement on Auditing Standards (AU 324.06) also states when a user organization uses a service organization, transactions that affect the user organization's financial statements are subjected to controls that are, at least in part, physically and operationally separate from the user organization.

The Fiscal Control and Internal Auditing Act (30 ILCS 10/3001) requires all State agencies to establish and maintain a system of internal fiscal and administrative controls, which shall 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 reports and to maintain accountability over the State's resources.

Good internal controls require that third party service providers arrange to have a periodic independent review of internal controls placed in operation and issue a report on the results of this review commonly known as a SAS 70 report. The SAS 70 report should be obtained from the service organizations that process critical data for the Department.

STATE OF ILLINOIS
DEPARTMENT OF HEALTHCARE AND FAMILY SERVICES
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SCHEDULE OF FINDINGS
For the Year Ended June 30, 2008

The Department stated that they negotiate long term contracts with the parties involved in processing insurance claims for the health care plans. Typical healthcare contracts have five year initial periods and up to five one-year renewal periods. One contract cited was initially negotiated with a five-year contract in 2001, for fiscal year 2002 implementation, without a SAS 70 requirement. The contract is currently in a one-year renewal period without a SAS 70 requirement. The Department previously submitted the relevant portions of the Sarbanes Oxley audit pertaining to internal controls as they relate to the audited financial statements for this contract.

Due to the significance of the reliance placed by the Department on the procedures performed by the third party, it is critical that the Department obtains independent internal control reviews. In addition, it is essential to obtain and review an independent review of the third party service provider's information systems environment. An independent review provides a method of evaluating the systems in place at the service provider and helps the Department develop internal control processes that would complement those at the service provider. Based on the review, the Department would have additional assurance that the internal controls are appropriate to ensure the information received from the service provider is accurate and reliable. (Finding Code No. 08-1)

RECOMMENDATION

We recommend the Department require that each third-party health insurance service provider engage independent auditors to perform an annual independent internal control review on the controls placed in operation and the tests of their operating effectiveness.

DEPARTMENT RESPONSE

The Department respectfully disagrees with this finding. This contract was originally executed prior to industry acceptance of SAS 70.

The Fiscal Year 2010 contract and renewal for this vendor has already been negotiated and signed by the vendor. In order to implement this requirement for this vendor, the Department would have to renegotiate their contract. Renegotiating this contract at this date would jeopardize the contract beginning July 1, 2009. Negotiating an additional audit into this renewal would also increase the cost of the contract.

The Department will include a SAS 70 requirement to all future contracts bid with third parties involved with the processing of health insurance claims.

STATE OF ILLINOIS
DEPARTMENT OF HEALTHCARE AND FAMILY SERVICES
TEACHER HEALTH INSURANCE SECURITY FUND
SCHEDULE OF FINDINGS
For the Year Ended June 30, 2008

AUDITOR'S COMMENT

The auditors requested all third party internal control reviews from the Department and, for the contract noted above, the Department indicated that they relied on "equivalent" reviews.

With regard to the contract, the Department did provide the auditors with what they called a Sox Report. The documentation that the Department provided was an excel spreadsheet that documented computer controls. This spreadsheet was not accompanied by any type of cover letter or auditor's report. After the auditors questioned the Sox Report, the Department contacted the vendor and the Department was informed that the Sox Report is actually part of the vendor's SAS 70 Report.

The Department cannot state to the auditors that they are relying on these "equivalent" reports if they do not obtain them unless requested by the auditors. There is clearly no internal controls to obtain and review these reports.

STATE OF ILLINOIS
DEPARTMENT OF HEALTHCARE AND FAMILY SERVICES
TEACHER HEALTH INSURANCE SECURITY FUND
SCHEDULE OF FINDINGS
For the Year Ended June 30, 2008

08-2. **FINDING** (Incorrect health insurance premium rates charged)

The Illinois Department of Healthcare and Family Services did not charge the correct health insurance premium rates for the Teachers Retirement Insurance Program.

The Department set the fiscal year 2008 health insurance premium rates for Teachers Retirement System benefit recipient and dependent beneficiaries by increasing the prior year rate by 5%. The Department did not take into account the percentage that was to be paid by the Teacher Health Insurance Security Fund. As a result, we noted that the Department did not have an adequate rate-setting methodology used to determine the amount of the health care premiums to be charged. In addition, the Department did not present the rate-setting methodology (included but not limited to utilization levels and costs) used to determine health care premiums to the Teachers' Retirement System by April 15th as required.

The State Employees Group Insurance Act of 1971 (5 ILCS 375/6.5(e)) requires the Director of the Department of Central Management Services to determine the insurance rates and premiums for Teacher Retirement System benefit recipients and dependent beneficiaries, and present to the Teachers' Retirement System of the State of Illinois, by April 15th of each calendar year, the rate-setting methodology (including but not limited to utilization levels and costs) used to determine the amount of the health care premiums.

However, Executive Order 2005-3, *Executive Order to Reorganize Agencies by the Transfer of Certain Healthcare Procurement and Administrative Functions Primarily of the Department of Central Management Services to the Department of Healthcare and Family Services* issued by the Governor on April 1, 2005 transferred the respective powers, duties, rights and responsibilities related to State Healthcare Purchasing from various departments, including CMS, to the Department of Healthcare and Family Services. The Executive Order states the statutory powers, duties, rights and responsibilities of the various agencies, including CMS, derive from various statutes including 5 ILCS 375 et seq. The functions associated with State Healthcare Purchasing intended to be transferred included rate development.

We also noted the following 2008 premium rates of Teachers Retirement Insurance Program health insurance were not in compliance with parameters established in State statute.

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- The monthly health insurance premium rate charged for a Teachers Retirement System dependent beneficiary who is Medicare primary was \$240.09; however, the health insurance premium rate should have only been \$229.63. The State Employees Group Insurance Act of 1971 (5 ILCS 375/6.5(e) and (e)(3.1)) requires that the Teacher Health Insurance Security Fund pay 25% of the total insurance rate for this type of coverage. This means that the health insurance premium rate charged to a recipient should only be 75% of the insurance rate, however State statute also requires the premium charged may not exceed 105% of the premium actually charged in the previous fiscal year. The insurance rate determined by the Departments for this category was \$306.17. The health insurance premium rate charged in fiscal year 2007 to the Teachers Retirement System dependent beneficiary in this category was \$228.65. The dependent beneficiaries were overcharged a total of \$152,643 during fiscal year 2008.
- The monthly health insurance premium rate charged for a Teachers Retirement System benefit recipient for ages twenty three and under selecting the major medical coverage program was \$139.54; however, the health insurance premium rate should have only been \$117.17. The State Employees Group Insurance Act of 1971 (5 ILCS 375/6.5(e) and (e)(2)) requires that the Teacher Health Insurance Security Fund pay 50% of the total insurance rate for this type of coverage. This means that the health insurance premium rate charged to a recipient should only be 50% of the insurance rate, however State statute also requires the premium charged may not exceed 105% of the premium actually charged in the previous fiscal year. The insurance rate determined by the Departments for this category was \$234.33. The health insurance premium rate charged in fiscal year 2007 to the Teachers Retirement System benefit recipients in this category was \$132.90. The benefit recipients were overcharged a total of \$2,617 during fiscal year 2008.
- The monthly health insurance premium rate charged to a Teachers Retirement System benefit recipient for ages twenty three and under selecting the medical coverage program was \$69.77; however, the health insurance premium rate should have only been \$58.58. The State Employees Group Insurance Act of 1971 (5 ILCS 375/6.5(e) and (e)(1)) requires that the Teacher Health Insurance Security Fund pay 75% of the total insurance rate for this type of coverage. This means that the health insurance premium rate charged to a recipient should only be 25% of the insurance rate, however State statute also requires the premium charged may not exceed 105% of the premium actually charged in the previous fiscal year. The 2008 insurance rate determined by the Departments for this category was \$234.33. The health insurance premium rate charged in fiscal year 2007 to the Teachers Retirement System benefit recipients in this category was \$66.45. The benefit recipients were overcharged a total of \$269 during fiscal year 2008.

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Department management stated they did not interpret the statute as requiring premiums to be determined by both an increase of no more than 5% of the prior year and the amount to be paid by the Teacher Health Insurance Security Fund. (Finding Code No. 08-2)

RECOMMENDATION

We recommend the Department ensure health insurance premium rates are set for the Teachers Health Insurance Program as required by the State Employees Group Insurance Act of 1971. We also recommend the Department ensure adequate rate setting methodologies are established and make annual required reports to the Teachers Retirement System.

DEPARTMENT RESPONSE

The Department agrees with the finding. The Department has submitted draft legislative language to address the issue and clarify that the determination of premiums shall be limited solely to an increase of no more than 5% of the prior year.

AUDITOR'S COMMENT

The Department's corrective action plan noted in its response is an overly simple and unreasonable resolution to the issues addressed in the finding. A rate setting methodology should be developed annually and include but not be limited to utilization levels and costs as currently required by the State Employees Group Insurance Act of 1971.

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PRIOR YEAR FINDINGS NOT REPEATED
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A. **FINDING** (Financial statements not timely)

During the prior examination, the Illinois Department of Healthcare and Family Services did not provide the auditors with timely financial statements for the Teacher Health Insurance Security Fund.

During the current examination, the Department has taken the necessary steps to ensure that the financial statements for the Teacher Health Insurance Security Fund were completed and provided to the auditors on a timely basis. (Finding Code No. 07-1)