

State of Illinois
DEPARTMENT OF
CENTRAL MANAGEMENT SERVICES
LOCAL GOVERNMENT HEALTH INSURANCE
RESERVE FUND
FINANCIAL AUDIT
For the Year Ended June 30, 2015

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

STATE OF ILLINOIS
DEPARTMENT OF CENTRAL MANAGEMENT SERVICES
LOCAL GOVERNMENT HEALTH INSURANCE RESERVE FUND
FINANCIAL AUDIT
For the Year Ended June 30, 2015

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STATE OF ILLINOIS
DEPARTMENT OF CENTRAL MANAGEMENT SERVICES
LOCAL GOVERNMENT HEALTH INSURANCE RESERVE FUND

AGENCY OFFICIALS

Director	Michael Hoffman, Acting (1/16/16 – present) Tom Tyrrell (4/30/15 – 1/15/16) Tom Tyrrell, Acting (1/25/15 - 4/29/15) Ngozi Okorafor, Acting (1/13/15 - 1/25/15) Simone McNeil, Acting (through 1/12/15)
Assistant Directors	Kimberly McCullough (3/23/15 - present) Marcus Veile (1/20/15 - present) Vacant (1/13/15 – 1/19/15) Israel Salazar (through 1/12/15)
Chief Administrative Officer	David Wu (1/12/15 - 6/30/15) Vacant (10/1/14 – 1/11/15) Roger Nondorf (through 9/30/14)
Chief Operating Officer	Jennifer Waldinger (6/30/15 - present) Vacant (2/9/15 – 6/29/15) Chimaobi Enyia (through 2/8/15)
Chief Fiscal Officer	Karen Pape (3/3/15 - present) Karen Pape, Acting (1/27/15 - 3/2/15) Chuck Morris (through 2/2/15)
General Counsel	Mike Basil (2/9/15 - present) Vacant (1/20/15 – 2/8/15) Thomas Mikrut (through 1/19/15)
Chief Internal Auditor	Deborah Abbott

Agency main offices are located at:

715 Stratton Office Building
401 South Spring Street
Springfield, IL 62706

STATE OF ILLINOIS
DEPARTMENT OF CENTRAL MANAGEMENT SERVICES
LOCAL GOVERNMENT HEALTH INSURANCE RESERVE FUND
FINANCIAL AUDIT
For the Year Ended June 30, 2015

FINANCIAL STATEMENT REPORT

SUMMARY

The audit of the accompanying financial statements of the Local Government Health Insurance Reserve Fund of the State of Illinois, Department of Central Management Services, was performed by Sikich LLP.

Based on their audit, the auditors expressed an unmodified opinion on the Local Government Health Insurance Reserve 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 a material weakness. The material weakness is described in the accompanying Schedule of Findings on pages 20-21 of this report as item:

2015-001 Failure to establish reasonable estimation methodology

EXIT CONFERENCE

The Department waived an exit conference. The response to the recommendation was provided by Mr. Michael Hoffman, Acting Director, on February 1, 2016.

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 Local Government Health Insurance Reserve Fund of the State of Illinois, Department of Central Management Services, as of and for the year ended June 30, 2015, and the related notes to the 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 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 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 opinion.

Opinion

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of the Local Government Health Insurance Reserve Fund of the State of Illinois, Department of Central Management Services, as of June 30, 2015, and the changes in financial position and cash flows thereof for the year then ended in accordance with accounting principles generally accepted in the United States of America.

Emphasis of Matter

As discussed in Note 2, the financial statements present only the Local Government Health Insurance Reserve Fund of the State of Illinois, Department of Central Management Services and do not purport to, and do not, present fairly the financial position of the State of Illinois of the State of Illinois, Department of Central Management Services, as of June 30, 2015, and the changes in its financial position or its cash flows 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.

Other Matters

Required Supplementary Information

Accounting principles generally accepted in the United States of America require that the Schedule of Claims for Active Employees for the Ten Years Ended June 30, 2015 on page 17 be presented to supplement the fund financial statements. Such information, although not a part of the financial statements, is required by the Governmental Accounting Standards Board who considers it to be an essential part of financial reporting for placing the financial statements in an appropriate operational, economic, or historical context. We have applied certain limited procedures to the required supplementary information in accordance with auditing standards generally accepted in the United States of America, which consisted of inquiries of management about the methods of preparing the information and comparing the information for consistency with management's responses to our inquiries, the financial statements, and other knowledge we obtained during our audit of the financial statements. We do not express an opinion or provide any assurance on the information because the limited procedures do not provide us with sufficient evidence to express an opinion or provide any assurance.

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

Other Reporting Required by *Government Auditing Standards*

In accordance with *Government Auditing Standards*, we have also issued our report dated February 1, 2016 on our consideration of the Local Government Health Insurance Reserve Fund of the State of Illinois, Department of Central Management Services' internal control over financial reporting of the Local Government Health Insurance Reserve Fund 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 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* in considering the State of Illinois, Department of Central Management Services' internal control over financial reporting of the Local Government Health Insurance Reserve Fund and its compliance.

Sikich LLP

Springfield, Illinois
February 1, 2016

STATE OF ILLINOIS
DEPARTMENT OF CENTRAL MANAGEMENT SERVICES
LOCAL GOVERNMENT HEALTH INSURANCE RESERVE FUND
STATEMENT OF NET POSITION

June 30, 2015

(Expressed in Thousands)

ASSETS

Cash equity with State Treasurer	\$	4,820
Cash and cash equivalents		1,356
Securities lending collateral equity with State Treasurer		1,964
Due from other government - federal		8
Due from other government - local		79
Other receivables, net		512
Total current assets		<u>8,739</u>
 Total assets		 <u>8,739</u>

LIABILITIES

Accounts payable and accrued liabilities		4,570
Due to other government - federal		2
Due to other Department funds		15
Due to other State funds		11
Unearned Revenue		41
Obligations under securities lending of State Treasurer		1,964
Total current liabilities		<u>6,603</u>
 Noncurrent portion of long-term obligations		 119
Total liabilities		 <u>6,722</u>

NET POSITION

Unrestricted		2,017
Total net position		<u><u>\$ 2,017</u></u>

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

STATE OF ILLINOIS
DEPARTMENT OF CENTRAL MANAGEMENT SERVICES
LOCAL GOVERNMENT HEALTH INSURANCE RESERVE FUND
**STATEMENT OF REVENUES, EXPENSES
AND CHANGES IN FUND NET POSITION**
For the Year Ended June 30, 2015

(Expressed in Thousands)

OPERATING REVENUES	
Charges for sales and services	\$ 37,341
Total operating revenues	37,341
 OPERATING EXPENSES	
Benefit payments and refunds	36,890
General and administrative	993
Total operating expenses	37,883
Operating income (loss)	(542)
 NONOPERATING REVENUES (EXPENSES)	
Interest and investment income	21
Interest expense	(12)
Other revenues	58
Change in net position	(475)
Net position, July 1, 2014	2,492
NET POSITION, JUNE 30, 2015	\$ 2,017

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

STATE OF ILLINOIS
DEPARTMENT OF CENTRAL MANAGEMENT SERVICES
LOCAL GOVERNMENT HEALTH INSURANCE RESERVE FUND
STATEMENT OF CASH FLOWS

For the Year Ended June 30, 2015

(Expressed in Thousands)

CASH FLOWS FROM OPERATING ACTIVITIES:

Cash received from sales and services	\$	37,427
Cash payments to suppliers for goods and services		(37,331)
Cash payments to employees for services		(1,192)
Cash receipts from other operating activities		984
Net cash provided (used) by operating activities		(112)

CASH FLOWS FROM NONCAPITAL FINANCING ACTIVITIES:

Interest paid on other borrowings		(12)
Operating grants received		62
Net cash provided (used) by noncapital financing activities		50

CASH FLOWS FROM INVESTING ACTIVITIES:

Interest and dividends on investments		21
Net cash provided (used) by investing activities		21

Net increase (decrease) in cash and cash equivalents (41)

Cash and cash equivalents, July 1, 2014 6,217

CASH AND CASH EQUIVALENTS, JUNE 30, 2015 \$ 6,176

Reconciliation of cash and cash equivalents to the Statement of Net Assets:

Total cash and cash equivalents per the Statement of Net Position	\$	1,356
Add: cash equity with State Treasurer		4,820

CASH AND CASH EQUIVALENTS, JUNE 30, 2015 \$ 6,176

Reconciliation of operating income (loss) to net cash provided (used) by operating activities:

OPERATING INCOME (LOSS) \$ (542)

Adjustments to reconcile operating income (loss) to net cash provided (used) by operating activities:

Depreciation		
Changes in assets and liabilities:		
(Increase) decrease in accounts receivable		(173)
(Increase) decrease in intergovernmental receivables		64
Increase (decrease) in accounts payable and accrued liabilities		537
Increase (decrease) in intergovernmental payables		(3)
Increase (decrease) in due to other funds		(11)
Increase (decrease) in unearned revenues		22
Increase (decrease) in other liabilities		(6)
Total adjustments		430

NET CASH PROVIDED (USED) BY OPERATING ACTIVITIES \$ (112)

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

STATE OF ILLINOIS
DEPARTMENT OF CENTRAL MANAGEMENT SERVICES
LOCAL GOVERNMENT HEALTH INSURANCE RESERVE FUND
NOTES TO THE FINANCIAL STATEMENTS
June 30, 2015

1) Organization

The Local Government Health Insurance Reserve Fund (LGHIRF) was established to provide health and dental insurance to participating local governmental entities. The fund is part of the primary government of the State of Illinois. As a result of the Governor's Executive Order 12-01, the responsibilities in relation to LGHIRF were transferred to the Department of Central Management Services (Department) as of July 1, 2013. The Department is responsible for the financial reporting of the fund.

As of June 30, 2015, there were 260 local governmental entities participating with approximately 2,798 employees, 1,847 dependents and 204 retirees covered. Each participating local governmental unit is required to enter into a written agreement with the Department. The agreement sets forth the responsibilities of both parties. The Department administers the Local Government Health Insurance Plan.

The responsibilities required of the Department are:

- Setting and adjusting premium rates
- Billing and collecting monthly premiums from local governmental units
- Enrollment and termination of members and dependents after notification by the local governmental unit
- Establishment of a Local Government Health Plan Advisory Board, consisting of seven advisors from the participating local governmental units
- Establishment of the Local Government Health Insurance Reserve Fund
- Processing and paying authorized claims

The responsibilities required of the local governmental units are:

- Enrollment of all employees and dependents that meet eligibility guidelines and who elect to participate
- Collection and transmission of monthly member and dependent premiums
- Designation of Health Plan Representative
- Participation in the program for a minimum of two years

2) Summary of Significant Accounting Policies

a) Financial Reporting Entity

As defined by Generally Accepted Accounting Principles (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 LGHIRF has no component units and is not a component unit of any other entity. However, because the LGHIRF is not legally separate from the State of Illinois, the financial statements of the LGHIRF are included in the financial statements of the

STATE OF ILLINOIS
DEPARTMENT OF CENTRAL MANAGEMENT SERVICES
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NOTES TO THE FINANCIAL STATEMENTS
June 30, 2015

State of Illinois as a non major enterprise fund. 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 present only the LGHIRF administered by the State of Illinois, Department of Central Management Services. They are intended to present the financial position, the changes in financial position, and the cash flows of only the LGHIRF. They do not purport to, and do not, present fairly, the financial position of the State of Illinois or the Department as of June 30, 2015 and the changes in financial position and cash flows for the year ended in conformity with accounting principles generally accepted in the United States of America.

c) Measurement Focus and Basis of Accounting

The LGHIRF prepares its financial statements in accordance with Government Accounting Standards Board (GASB) Statement Nos. 10, 29, 30 and 34.

GASB 10 and 30 provide accounting and reporting standards that apply to public entity risk pools and require public entity risk pools to account for their activities using proprietary fund accounting. Proprietary activities are accounted for using the economic resources measurement focus and the accrual basis of accounting.

Proprietary fund operating revenues, such as charges for services, result from exchange transactions associated with the principal activity of the fund. Exchange transactions are those in which each party receives and gives up essentially equal values. Non-operating revenues, such as subsidies and investment earnings, result from non-exchange transactions or ancillary activities.

d) 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 equity with State Treasurer and cash in banks for locally held funds.

d) Investments

Investments are reported at fair value.

e) Capital Assets

Capital assets, which includes property, plant, and equipment, are reported at cost or estimated historical cost based on appraisals. Contributed assets are reported at estimated fair value at the time received. Capital assets are depreciated using the straight-line method.

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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 years

f) Compensated Absences

The liability for compensated absences reported in the proprietary fund statement of net position 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).

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.

g) 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 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.

h) Health Benefits Claims Processing

The State Employees Group Insurance Act of 1971 (5 ILCS 375) establishes the Department's responsibility for administering the State's health benefit programs. The Department contracts with third-party administrators to process health, dental, and prescription claims submitted by healthcare service providers relating to the applicable self-insured portions of the health benefit programs accounted for in the Local Government Health Insurance Reserve Fund. It is the Department's policy to recognize claims expense and accrue any unpaid liability relating to claims incurred but not reported (IBNR) based on actuarial projections and reports of processed claims provided by the third-party administrators.

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

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categorized as to credit risk because the Department does not own individual securities. Detail on the nature of these deposits and investments, is available within the State of Illinois' Comprehensive Annual Financial Report.

Cash on deposit with the State Treasurer totaled \$4.820 million and cash on deposit for funds held outside the State Treasurer totaled \$0 at June 30, 2015.

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, 2015, the Department had the following investments outside of the State Treasury:

	Fair Value (Thousands)	Weighted Average Maturity (Years)
Illinois Public Treasurers' Investment Pool	<u>\$1,356</u>	0.120
Total fixed income investments	<u>\$1,356</u>	

Interest Rate Risk: Interest rate risk is the risk that changes in interest rates will adversely affect the fair value of an investment. 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: Credit risk is the risk that an issuer or other counterparty to an investment will not fulfill its obligations. The Department does not have a formal investment policy that limits investment choices. Investments in the Illinois Public Treasurers' Investment Pool were rated AAAM by Standard & Poor's.

Custodial Credit Risk: The Department does not have a formal investment policy which restricts investments to address custodial credit risk. Custodial credit risk is the risk that, in the event of failure of the counterparty to a transaction, the Department would not be able to recover the value of investments or collateral securities in the possession of an outside party.

c) Reconciliation to Statement of Net Position

	Deposits (Thousands)	Investments (Thousands)
Amounts per Note 3(a)(b)	\$4,820	\$1,356
Cash Equivalents	<u>1,356</u>	<u>(1,356)</u>
Total per Statement of Net Position	<u>\$6,176</u>	<u>\$ 0</u>

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d) Securities Lending Transactions

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 Group to lend the State Treasurer's securities to broker-dealers and banks pursuant to a form of loan agreement.

During fiscal year 2015 and 2014, Deutsche Bank Group 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 on loan amounts of available and eligible securities during fiscal years 2015 and 2014, respectively. In the event of borrower default, Deutsche Bank Group provides the State Treasurer with counterparty default indemnification. In addition, Deutsche Bank Group is obligated to indemnify the State Treasurer if Deutsche Bank Group loses any securities, collateral or investments of the State Treasurer in Deutsche Bank Group's custody. Moreover, there were no losses during fiscal years 2015 and 2014 resulting from a default of the borrowers or Deutsche Bank Group.

During fiscal years 2015 and 2014, 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 Group 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 invested in repurchase agreements and the fair value of securities on loan for the State Treasurer as of June 30, 2015 were \$4,007,450,623 and \$3,980,606,070, respectively. The securities lending collateral invested in repurchase agreements and the fair value of securities on loan for the State Treasurer as of June 30, 2014 were \$5,758,768,923 and \$5,727,657,697, respectively.

4) Long-Term Obligations

Changes in long-term obligations (amounts expressed in thousands) for the year ended June 30, 2015 were as follows:

	Balance July 1, 2014	Additions	Deletions	Balance June 30, 2015	Amounts Due Within One Year
Compensated Absences	\$ 125	\$ 48	\$ (54)	\$ 119	\$ 0
Total	\$ 125	\$ 48	\$ (54)	\$ 119	\$ 0

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5) Risk Pool Disclosure

The LGHIRF had previously contracted with third party reinsurers for reinsurance coverage. However, no such coverage was in place for the year ended June 30, 2015.

The basis used in calculating the estimated liability for future claims is based on claims reported but not paid during the fiscal year plus an estimate of claims incurred but not reported (IBNR). The estimate for claims incurred but not reported was calculated using a factor based on historical experience stated as a percentage of claims reported vs. total claims incurred during the policy cycle. The estimated ultimate cost of settling the claims includes the effect of inflation and other societal and economic factors. For the year ended June 30, 2015, all claims are paid on a two-year claim cycle.

Based on the above method, the liability for future claims (amounts expressed in thousands) at June 30, 2015 is as follows:

Claims incurred and reported but not paid as of June 30	\$3,019
Estimated liability for claims incurred but not reported	<u>1,473</u>
Total estimated liability for future claims	<u><u>\$4,492</u></u>

A reconciliation of total benefit claim payments and refunds including claims adjustment expense is as follows (amounts expressed in thousands):

Payments made for benefit claims	\$36,314
Less: liability for unpaid claims, beginning of year	<u>3,916</u>
Subtotal	32,398
Add: liability for unpaid claims, end of year	<u>4,492</u>
Total benefit claim payments and refunds	<u><u>\$36,890</u></u>

The following reconciliation represents changes in aggregate liabilities (amounts expressed in thousands) for the Fund during the past two years:

	Healthcare Claims	
	<u>2015</u>	<u>2014</u>
Unpaid claims and claim adjustment expense at beginning of year	<u>\$ 3,916</u>	<u>\$ 5,607</u>
Incurred claim and adjustment expenses:		
Provision for insured claims of the current year	39,520	35,935
Decrease in provisions for claims of prior year	<u>(2,630)</u>	<u>(3,524)</u>
Total incurred claims and claim adjustments	<u>36,890</u>	<u>32,411</u>
Payments:		
Claims and claim adjustment expense attributable to claims of the current year	35,028	32,019
Claims and claim adjustment expense attributable to claims of prior year	<u>1,286</u>	<u>2,083</u>
Total Payment	<u>36,314</u>	<u>34,102</u>
Total unpaid claims and claim adjustments expense at end of year	<u><u>\$ 4,492</u></u>	<u><u>\$ 3,916</u></u>

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DEPARTMENT OF CENTRAL MANAGEMENT SERVICES
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6) Pension Plan

The vested full-time employees paid from the LGHIRF may participate in the State Employees' Retirement System (SERS), which is a pension trust fund in the State of Illinois reporting entity. The SERS is a single-employer defined benefit public employee retirement system (PERS) in which State employees participate, except those covered by the State Universities, Teachers', General Assembly, and Judges' Retirement Systems. The financial position and results of operations of the SERS for fiscal year 2015 are included in the State of Illinois' Comprehensive Annual Financial Report (CAFR) for the year ended June 30, 2015. The SERS issues a separate CAFR that may be obtained by writing to the SERS, 2101 South Veterans Parkway, Springfield, Illinois, 62794-9255.

A summary of SERS benefit 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 SERS' CAFR. Also included is a discussion of employer and employee obligations to contribute and the authority under which those obligations are established.

The Department pays employer retirement contributions based upon an actuarially determined percentage of their payrolls. For fiscal year 2015, the employer contribution rate was 42.339%. Effective for pay periods beginning after December 31, 1991, the State opted to pay the employee portion of retirement for most State agencies (including the Department) with employees covered by the State Employees' and Teachers' Retirement Systems. However, effective with the fiscal year 2004 budget, the State opted to stop paying the portion or a part of the portion of retirement for many State agencies (including the Department) for certain classes of employees covered by the State Employees' and Teachers' Retirement Systems. The pickup, when applicable, is subject to sufficient annual appropriations and those employees covered may vary across employee groups and State agencies.

7) Post-employment Benefits

The State provides health, dental, vision, and life insurance benefits for retirees and their dependents in a program administered by the Department. Substantially all State employees become eligible for post-employment benefits if they eventually become annuitants of one of the State sponsored pension plans. Health, dental, and vision benefits include basic benefits for annuitants and dependents under the State's self-insurance plan and insurance contracts currently in force. 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 Employee's 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. Annuitants also receive life insurance coverage equal to the annual salary of the last day of employment until age 60, at which time the benefit becomes \$5,000.

However, Public Act 97-0695, effective, July 1, 2012, alters the contributions to be paid by the State, annuitants, survivors, and retired employees under the State Employees Group Insurance Act. This Act requires the Director of the Department to, on an annual basis, determine the amount that the State should contribute. The remainder of the cost of coverage shall be the responsibility of the annuitant, survivor, or retired employee. These costs will be assessed beginning July 1, 2013. However, four putative class actions were filed challenging the validity of this legislation under, among other things, the pension protection clause of the Illinois Constitution of 1970. The four class actions were consolidated in the circuit court of Sangamon County. The circuit court dismissed each

STATE OF ILLINOIS
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NOTES TO THE FINANCIAL STATEMENTS
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of them for failure to state a cause of action, without certifying any classes. The Illinois Supreme Court allowed direct appeal. On July 3, 2014, the Illinois Supreme Court issued an opinion in the retiree health insurance premium case. The Illinois Supreme Court disagreed with the circuit court and determined the circuit court should not have dismissed the case. The Supreme Court sent the case back to the circuit court for reconsideration. As a result, the Sangamon County Circuit Court has directed all retirement systems to discontinue withholding, as soon as possible, the retiree and survivor health insurance premiums that have been in effect since July 2013. The refunding of these premiums was repaid from an escrow account by June 15, 2015.

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 an expense 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 benefit 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. A copy of the financial statements of the Department may be obtained by writing to the Department of Central Management Services, 401 South Spring Street, Springfield, Illinois, 62706-4100.

8) Contingencies

The Department is a party to numerous 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
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LOCAL GOVERNMENT HEALTH INSURANCE RESERVE FUND
SCHEDULE OF CLAIMS FOR ACTIVE EMPLOYEES
For the Ten Years Ended June 30, 2015

DEVELOPMENT INFORMATION

The table below illustrates how the Fund's earned required contribution and investment income compared to related costs of loss and other expenses assumed by the Fund as of the following fiscal year ends (expressed in thousands).

The following information for the ten fiscal years ended June 30, 2015

	2015	2014	2013	2012	2011	2010	2009	2008	2007	2006
Net earned required contribution and investment revenue:										
Earned	\$ 37,362	\$ 35,340	\$ 38,870	\$ 45,795	\$ 52,612	\$ 53,060	\$ 54,999	\$ 60,924	\$ 64,261	\$ 67,074
Ceded	-	-	-	-	-	-	-	-	-	-
Net earned revenue	<u>37,362</u>	<u>35,340</u>	<u>38,870</u>	<u>45,795</u>	<u>52,612</u>	<u>53,060</u>	<u>54,999</u>	<u>60,924</u>	<u>64,261</u>	<u>67,074</u>
Unallocated expenses	<u>1,005</u>	<u>1,286</u>	<u>2,083</u>	<u>2,553</u>	<u>2,004</u>	<u>1,934</u>	<u>3,073</u>	<u>901</u>	<u>1,869</u>	<u>835</u>
Estimated incurred claims and expenses, end of the policy year:										
Incurred	39,520	35,935	40,742	46,768	54,050	57,236	56,615	61,044	61,423	68,778
Ceded	-	-	-	-	-	-	-	-	-	-
Net incurred claims	<u>39,520</u>	<u>35,935</u>	<u>40,742</u>	<u>46,768</u>	<u>54,050</u>	<u>57,236</u>	<u>56,615</u>	<u>61,044</u>	<u>61,423</u>	<u>68,778</u>
Paid (cumulative) as of:										
End of policy year	<u>35,028</u>	<u>32,019</u>	<u>35,135</u>	<u>40,009</u>	<u>46,900</u>	<u>53,801</u>	<u>53,450</u>	<u>56,830</u>	<u>57,021</u>	<u>63,274</u>
One year later		<u>33,305</u>	<u>37,218</u>	<u>42,562</u>	<u>48,471</u>	<u>55,975</u>	<u>55,042</u>	<u>58,980</u>	<u>60,692</u>	<u>67,002</u>
Two years later			<u>37,218</u>	<u>42,562</u>	<u>48,471</u>	<u>55,975</u>	<u>55,042</u>	<u>58,980</u>	<u>60,692</u>	<u>67,002</u>
Three years later				<u>42,562</u>	<u>48,471</u>	<u>55,975</u>	<u>55,042</u>	<u>58,980</u>	<u>60,692</u>	<u>67,002</u>
Four years later					<u>48,471</u>	<u>55,975</u>	<u>55,042</u>	<u>58,980</u>	<u>60,692</u>	<u>67,002</u>
Five years later						<u>55,975</u>	<u>55,042</u>	<u>58,980</u>	<u>60,692</u>	<u>67,002</u>
Six years later							<u>55,042</u>	<u>58,980</u>	<u>60,692</u>	<u>67,002</u>
Seven years later								<u>58,980</u>	<u>60,692</u>	<u>67,002</u>
Eight years later									<u>60,692</u>	<u>67,002</u>
Nine years later										<u>67,002</u>
Reestimated ceded losses and expenses	-	-	-	-	-	-	-	-	-	-
Reestimated incurred claims and expenses:										
End of policy year	<u>39,520</u>	<u>35,935</u>	<u>40,742</u>	<u>46,768</u>	<u>54,050</u>	<u>57,236</u>	<u>56,615</u>	<u>61,044</u>	<u>61,423</u>	<u>68,778</u>
One year later		<u>33,305</u>	<u>37,218</u>	<u>42,562</u>	<u>48,471</u>	<u>55,975</u>	<u>55,042</u>	<u>58,980</u>	<u>60,692</u>	<u>67,002</u>
Two years later			<u>37,218</u>	<u>42,562</u>	<u>48,471</u>	<u>55,975</u>	<u>55,042</u>	<u>58,980</u>	<u>60,692</u>	<u>67,002</u>
Three years later				<u>42,562</u>	<u>48,471</u>	<u>55,975</u>	<u>55,042</u>	<u>58,980</u>	<u>60,692</u>	<u>67,002</u>
Four years later					<u>48,471</u>	<u>55,975</u>	<u>55,042</u>	<u>58,980</u>	<u>60,692</u>	<u>67,002</u>
Five years later						<u>55,975</u>	<u>55,042</u>	<u>58,980</u>	<u>60,692</u>	<u>67,002</u>
Six years later							<u>55,042</u>	<u>58,980</u>	<u>60,692</u>	<u>67,002</u>
Seven years later								<u>58,980</u>	<u>60,692</u>	<u>67,002</u>
Eight years later									<u>60,692</u>	<u>67,002</u>
Nine years later										<u>67,002</u>
Increase (decrease) in estimated incurred claims and expenses from end of policy year	<u>\$ -</u>	<u>\$ (2,630)</u>	<u>\$ (3,524)</u>	<u>\$ (4,206)</u>	<u>\$ (5,579)</u>	<u>\$ (1,261)</u>	<u>\$ (1,573)</u>	<u>\$ (2,064)</u>	<u>\$ (731)</u>	<u>\$ (1,776)</u>

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 Local Government Health Insurance Reserve Fund of the State of Illinois, Department of Central Management Services, as of and for the year ended June 30, 2015, and the related notes to the financial statements, which collectively comprise the Local Government Health Insurance Reserve Fund of the State of Illinois, Department of Central Management Services' financial statements, and have issued our report thereon dated February 1, 2016.

Internal Control Over Financial Reporting

In planning and performing our audit of the financial statements, we considered the State of Illinois, Department of Central Management 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 opinion on the financial statements, but not for the purpose of expressing an opinion on the effectiveness of the State of Illinois, Department of Central Management Services' internal control. Accordingly, we do not express an opinion on the effectiveness of the State of Illinois, Department of Central Management 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 a material weakness.

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 item 2015-001 to be a material weakness.

Compliance and Other Matters

As part of obtaining reasonable assurance about whether the Local Government Health Insurance Reserve Fund of the State of Illinois, Department of Central Management 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 no instances of noncompliance or other matters that are required to be reported under *Government Auditing Standards*.

Department of Central Management Services' Response to Findings

The Department of Central Management Services' responses to the finding identified in our audit are described in the accompanying schedule of findings. The Department of Central Management 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 Central Management 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 Central Management Services' internal control and compliance. Accordingly, this communication is not suitable for any other purpose.

Sikich LLP

Springfield, Illinois
February 1, 2016

SCHEDULE OF FINDINGS

CURRENT FINDINGS – Government Auditing Standards

2015-001 FINDING (Failure to establish reasonable estimation methodology)

The Department failed to establish a reasonable estimation methodology for certain rebate receivables resulting in a \$59 thousand understatement of receivables at June 30, 2015.

The Department receives formulary rebates from its pharmacy benefit vendor. Under the terms of the contract, the Department is guaranteed a minimum rebate amount per claim processed and paid. Following the end of each contract year, the vendor calculates the actual rebates earned by the State for utilization by its members and determines the amount due to the State. The vendor has 180 days after contract year-end to pay the amount due to the State. Due to proprietary and confidential contractual agreements entered into by the vendor, the Department does not have the ability to independently calculate the formulary rebate due at each year-end. It has been the Department's practice to record current year receivables at the amount of the formulary rebate payment received for the prior year. Specifically, the rebate receivables of \$312 thousand at June 30, 2015 were the amount of the formulary rebate payment related to fiscal year 2014 activity received in fiscal year 2015. The Department failed to consider any changes in relevant factors between fiscal years 2014 and 2015 in estimating the rebates to be received for fiscal year 2015. Such factors might include the number of claims processed and paid, the average cost per claim, the average number of plan members, or other historical trends such as rebates received as a percentage of total claims expense. Rebate reports received from the vendor on December 30, 2015 showed the actual rebate payment to be \$371 thousand. The Department deemed this error to be immaterial and did not revise the financial statements.

In accordance with the Fiscal Control and Internal Auditing Act (30 ILCS 10/3001), management is responsible for establishing and maintaining a system, or systems, of internal fiscal and administrative controls, that will provide assurance that, among other things, 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. Management is also responsible for establishing a process for preparing reasonable accounting estimates.

The Department stated that a reasonable estimation methodology for rebate receivables could not be established as the information required would not be provided by the vendor until late December.

Failure to establish a process for preparing reasonable estimates increases potential for significant misstatements and reduces the reliability of reported financial information. Failure to disclose the significance and uncertainty of these estimates prevents users from making assessments of the uncertainties and possible outcomes. (Finding Code No. 2015-001)

RECOMMENDATION

We recommend the Department establish a process for preparing reasonable accounting estimates. Such processes normally consist of identifying relevant factors that may affect the accounting estimate; accumulating relevant, sufficient, and reliable data on which to base the accounting estimate; developing assumptions that represent management's judgment of the most likely circumstances and events with respect to the relevant factors; and determining the estimated amount based on the assumptions and relevant factors. In the event amounts are not reasonably estimable, the Department should consider the need to disclose the significance and uncertainty of those estimates.

DEPARTMENT RESPONSE

The Department agrees with the finding and recommendation. The Department has remedied the situation through a new contract requirement for the vendor to provide the necessary information within 60 days.

PRIOR FINDINGS NOT REPEATED

None.