

**State of Illinois
DEPARTMENT OF
CENTRAL MANAGEMENT SERVICES
LOCAL GOVERNMENT HEALTH INSURANCE
RESERVE FUND
FINANCIAL AUDIT
For the Year Ended June 30, 2016**

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, 2016

TABLE OF CONTENTS

	<u>Page(s)</u>
Agency Officials	1
Financial Statement Report	
Summary	2
Independent Auditor’s Report.....	3-5
Basic Financial Statements	
Statement of Net Position.....	6
Statement of Revenues, Expenses and Changes in Fund Net Position	7
Statement of Cash Flows	8
Notes to the Financial Statements	9-16
Required Supplementary Information	
Schedule of Claims for Active Employees.....	17
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 <i>Government Auditing Standards</i>	18-19
Schedule of Findings.....	20
Prior Findings Not Repeated.....	21

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)
Assistant Directors	Markus Veile (1/20/15 – present) Kimberly McCullough-Starks (3/23/15 – 7/25/16)
Chief Administrative Officer	Vacant
Chief Operating Officer	Jennifer Waldinger (6/30/15 – present)
Chief Fiscal Officer	Karen Pape (3/3/15 – present)
General Counsel	Ryan Green, Acting (11/1/16 – present) LaShonda Hunt, Acting (7/1/16 – 10/31/16) Mike Basil (2/9/15 – 7/1/16)
Chief Internal Auditor	Jack Rakers, Acting (1/2/17 – present) Deborah Abbott (3/1/13 – 12/31/16)

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, 2016

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

None.

EXIT CONFERENCE

The Department waived an exit conference.

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, 2016, 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' 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 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, 2016, 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, 2016, 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, 2016 on page 17 be presented to supplement the basic financial statements. Such 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. 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 basic financial statements, and other knowledge we obtained during our audit of the basic 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 for the Local Government Health Insurance Reserve Fund 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 the missing information.

Other Reporting Required by *Government Auditing Standards*

In accordance with *Government Auditing Standards*, we have also issued our report dated February 7, 2017 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.

SIGNED ORIGINAL ON FILE

Springfield, Illinois
February 7, 2017

BASIC FINANCIAL STATEMENTS

STATE OF ILLINOIS
DEPARTMENT OF CENTRAL MANAGEMENT SERVICES
LOCAL GOVERNMENT HEALTH INSURANCE RESERVE FUND
STATEMENT OF NET POSITION
June 30, 2016

(Expressed in Thousands)

ASSETS

Cash equity with State Treasurer	\$	5,648
Cash and cash equivalents		1,459
Securities lending collateral equity with State Treasurer		1,277
Due from other government - federal		8
Due from other government - local		397
Other receivables, net		280
Total current assets		9,069
 Total assets		 9,069

LIABILITIES

Accounts payable and accrued liabilities		6,291
Due to other government - federal		2
Due to other Department funds		32
Due to other State funds		17
Unearned Revenue		25
Obligations under securities lending of State Treasurer		1,277
Current portion of long-term obligations		5
Total current liabilities		7,649
 Noncurrent portion of long-term obligations		 104
Total liabilities		7,753

NET POSITION

Unrestricted		1,316
Total net position		\$ 1,316

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, 2016

(Expressed in Thousands)

OPERATING REVENUES	
Charges for sales and services	\$ 40,999
Total operating revenues	<u>40,999</u>
 OPERATING EXPENSES	
Benefit payments and refunds	40,732
General and administrative	<u>1,018</u>
Total operating expenses	<u>41,750</u>
 Operating income (loss)	 (751)
 NONOPERATING REVENUES (EXPENSES)	
Interest and investment income	20
Interest expense	(22)
Other revenues	<u>52</u>
 Change in net position	 (701)
 Net position, July 1, 2015	 <u>2,017</u>
NET POSITION, JUNE 30, 2016	<u>\$ 1,316</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 CASH FLOWS
For the Year Ended June 30, 2016

(Expressed in Thousands)

CASH FLOWS FROM OPERATING ACTIVITIES:

Cash received from sales and services	\$ 41,008
Cash payments to suppliers for goods and services	(40,309)
Cash payments to employees for services	(906)
Cash receipts from other operating activities	1,088
Net cash provided (used) by operating activities	<u>881</u>

CASH FLOWS FROM NONCAPITAL FINANCING ACTIVITIES:

Interest paid on other borrowings	(22)
Operating grants received	52
Net cash provided (used) by noncapital financing activities	<u>30</u>

CASH FLOWS FROM INVESTING ACTIVITIES:

Interest and dividends on investments	20
Net cash provided (used) by investing activities	<u>20</u>

Net increase (decrease) in cash and cash equivalents 931

Cash and cash equivalents, July 1, 2015 6,176

CASH AND CASH EQUIVALENTS, JUNE 30, 2016 \$ 7,107

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

Total cash and cash equivalents per the Statement of Net Position	\$ 1,459
Add: cash equity with State Treasurer	5,648
CASH AND CASH EQUIVALENTS, JUNE 30, 2016	<u><u>\$ 7,107</u></u>

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

OPERATING INCOME (LOSS)	<u>\$ (751)</u>
Adjustments to reconcile operating income (loss) to net cash provided (used) by operating activities:	
Changes in assets and liabilities:	
(Increase) decrease in accounts receivable	232
(Increase) decrease in intergovernmental receivables	(318)
Increase (decrease) in accounts payable and accrued liabilities	1,721
Increase (decrease) in due to other funds	23
Increase (decrease) in unearned revenues	(16)
Increase (decrease) in other liabilities	(10)
Total adjustments	<u>1,632</u>
NET CASH PROVIDED (USED) BY OPERATING ACTIVITIES	<u><u>\$ 881</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
NOTES TO THE FINANCIAL STATEMENTS
June 30, 2016

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, 2016, there were 294 local governmental entities participating with approximately 2,937 employees, 2,126 dependents and 201 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.

STATE OF ILLINOIS
DEPARTMENT OF CENTRAL MANAGEMENT SERVICES
LOCAL GOVERNMENT HEALTH INSURANCE RESERVE FUND
NOTES TO THE FINANCIAL STATEMENTS
June 30, 2016

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 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, 2016 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.

The Illinois Public Treasurers' Investment Pool, known as The Illinois Funds, operates as a 2a7-like pool and thus reports all investments at amortized cost rather than market value. The fair value of the pool is the same as the value of the pool shares. The Treasurer's investment policies are governed by state statute. In addition, the Treasurer's Office has adopted its own investment practices which supplement the statutory requirement.

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 acquisition value at the time received. Capital assets are depreciated using the straight-line method.

STATE OF ILLINOIS
DEPARTMENT OF CENTRAL MANAGEMENT SERVICES
LOCAL GOVERNMENT HEALTH INSURANCE RESERVE FUND
NOTES TO THE FINANCIAL STATEMENTS
June 30, 2016

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.

STATE OF ILLINOIS
DEPARTMENT OF CENTRAL MANAGEMENT SERVICES
LOCAL GOVERNMENT HEALTH INSURANCE RESERVE FUND
NOTES TO THE FINANCIAL STATEMENTS
June 30, 2016

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, is available within the State of Illinois' Comprehensive Annual Financial Report.

Cash on deposit with the State Treasurer totaled \$5.648 million and cash on deposit for funds held outside the State Treasurer totaled \$0 at June 30, 2016.

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, 2016, the Department had the following investments outside of the State Treasury:

	Fair Value (Thousands)	Weighted Average Maturity (Years)
Illinois Public Treasurers' Investment Pool	\$1,459	0.122
Total fixed income investments	\$1,459	

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.

STATE OF ILLINOIS
DEPARTMENT OF CENTRAL MANAGEMENT SERVICES
LOCAL GOVERNMENT HEALTH INSURANCE RESERVE FUND
NOTES TO THE FINANCIAL STATEMENTS
June 30, 2016

c) Reconciliation to Statement of Net Position

	<u>Deposits (Thousands)</u>	<u>Investments (Thousands)</u>
Amounts per Note 3(a)(b)	\$5,648	\$1,459
Cash Equivalents	<u>1,459</u>	<u>(1,459)</u>
Total per Statement of Net Position	<u>\$7,107</u>	<u>\$ 0</u>

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

During fiscal year 2016 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 on loan amounts of available and eligible securities during fiscal year 2016. 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. Moreover, there were no losses during fiscal year 2016 resulting from a default of the borrowers or Deutsche Bank AG.

During fiscal year 2016, 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 invested in repurchase agreements and the fair value of securities on loan for the State Treasurer as of June 30, 2016 were \$2,603,015,000 and \$2,587,869,617, respectively.

4) Long-Term Obligations

Changes in long-term obligations (amounts expressed in thousands) for the year ended June 30, 2016 were as follows:

	<u>Balance July 1, 2015</u>	<u>Additions</u>	<u>Deletions</u>	<u>Balance June 30, 2016</u>	<u>Amounts Due Within One Year</u>
Compensated Absences	\$ 119	\$ 65	\$ (75)	\$ 109	\$ 5
Total	<u>\$ 119</u>	<u>\$ 65</u>	<u>\$ (75)</u>	<u>\$ 109</u>	<u>\$ 5</u>

STATE OF ILLINOIS
DEPARTMENT OF CENTRAL MANAGEMENT SERVICES
LOCAL GOVERNMENT HEALTH INSURANCE RESERVE FUND
NOTES TO THE FINANCIAL STATEMENTS
June 30, 2016

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, 2016.

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, 2016, 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, 2016 is as follows:

Claims incurred and reported but not paid as of June 30	\$4,393
Estimated liability for claims incurred but not reported	<u>1,725</u>
Total estimated liability for future claims	<u><u>\$6,118</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	\$39,106
Less: liability for unpaid claims, beginning of year	<u>4,492</u>
Subtotal	34,614
Add: liability for unpaid claims, end of year	<u>6,118</u>
Total benefit claim payments and refunds	<u><u>\$40,732</u></u>

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

	Healthcare Claims	
	2016	2015
Unpaid claims and claim adjustment expense at beginning of year	\$4,492	\$ 3,916
Incurred claim and adjustment expenses:		
Provision for insured claims of the current year	44,219	39,520
Decrease in provisions for claims of prior year	(3,487)	(2,630)
Total incurred claims and claim adjustments	40,732	36,890
Payments:		
Claims and claim adjustment expense attributable to claims of the current year	38,101	35,028
Claims and claim adjustment expense attributable to claims of prior year	1,005	1,286
Total Payment	39,106	36,314
Total unpaid claims and claim adjustments expense at end of year	\$6,118	\$ 4,492

STATE OF ILLINOIS
DEPARTMENT OF CENTRAL MANAGEMENT SERVICES
LOCAL GOVERNMENT HEALTH INSURANCE RESERVE FUND
NOTES TO THE FINANCIAL STATEMENTS
June 30, 2016

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 2016 are included in the State of Illinois' Comprehensive Annual Financial Report (CAFR) for the year ended June 30, 2016. 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 2016, the employer contribution rate was 45.598%. 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.

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.

STATE OF ILLINOIS
DEPARTMENT OF CENTRAL MANAGEMENT SERVICES
LOCAL GOVERNMENT HEALTH INSURANCE RESERVE FUND
NOTES TO THE FINANCIAL STATEMENTS
June 30, 2016

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.

REQUIRED SUPPLEMENTARY INFORMATION

STATE OF ILLINOIS
DEPARTMENT OF CENTRAL MANAGEMENT SERVICES
LOCAL GOVERNMENT HEALTH INSURANCE RESERVE FUND
SCHEDULE OF CLAIMS FOR ACTIVE EMPLOYEES
For the Ten Years Ended June 30, 2016

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, 2016

	2016	2015	2014	2013	2012	2011	2010	2009	2008	2007
Net earned required contribution and investment revenue:										
Earned	\$ 41,019	\$ 37,362	\$ 35,340	\$ 38,870	\$ 45,795	\$ 52,612	\$ 53,060	\$ 54,999	\$ 60,924	\$ 64,261
Ceded	-	-	-	-	-	-	-	-	-	-
Net earned revenue	41,019	37,362	35,340	38,870	45,795	52,612	53,060	54,999	60,924	64,261
Unallocated expenses	1,018	1,005	1,286	2,083	2,553	2,004	1,934	3,073	901	1,869
Estimated incurred claims and expenses, end of the policy year:										
Incurred	44,219	39,520	35,935	40,742	46,768	54,050	57,236	56,615	61,044	61,423
Ceded	-	-	-	-	-	-	-	-	-	-
Net incurred claims	44,219	39,520	35,935	40,742	46,768	54,050	57,236	56,615	61,044	61,423
Paid (cumulative) as of:										
End of policy year	38,101	35,028	32,019	35,135	40,009	46,900	53,801	53,450	56,830	57,021
One year later		36,033	33,305	37,218	42,562	48,471	55,975	55,042	58,980	60,692
Two years later			33,305	37,218	42,562	48,471	55,975	55,042	58,980	60,692
Three years later				37,218	42,562	48,471	55,975	55,042	58,980	60,692
Four years later					42,562	48,471	55,975	55,042	58,980	60,692
Five years later						48,471	55,975	55,042	58,980	60,692
Six years later							55,975	55,042	58,980	60,692
Seven years later								55,042	58,980	60,692
Eight years later									58,980	60,692
Nine years later										60,692
Reestimated ceded losses and expenses	-	-	-	-	-	-	-	-	-	-
Reestimated incurred claims and expenses:										
End of policy year	44,219	39,520	35,935	40,742	46,768	54,050	57,236	56,615	61,044	61,423
One year later		36,033	33,305	37,218	42,562	48,471	55,975	55,042	58,980	60,692
Two years later			33,305	37,218	42,562	48,471	55,975	55,042	58,980	60,692
Three years later				37,218	42,562	48,471	55,975	55,042	58,980	60,692
Four years later					42,562	48,471	55,975	55,042	58,980	60,692
Five years later						48,471	55,975	55,042	58,980	60,692
Six years later							55,975	55,042	58,980	60,692
Seven years later								55,042	58,980	60,692
Eight years later									58,980	60,692
Nine years later										60,692
Increase (decrease) in estimated incurred claims and expenses from end of policy year	\$ -	\$ (3,487)	\$ (2,630)	\$ (3,524)	\$ (4,206)	\$ (5,579)	\$ (1,261)	\$ (1,573)	\$ (2,064)	\$ (731)

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 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, 2016, 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 7, 2017.

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.

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. *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.

Our consideration of internal control was for the limited purpose described in the first paragraph of this section and was not designed to identify all deficiencies in internal control that might be material weaknesses or significant deficiencies. Given these limitations, during our audit we did not identify any deficiencies in internal control that we consider to be material weaknesses. However, material weaknesses may exist that have not been identified.

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*.

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.

SIGNED ORIGINAL ON FILE

Springfield, Illinois
February 7, 2017

SCHEDULE OF FINDINGS

CURRENT FINDINGS – *Government Auditing Standards*

None

PRIOR FINDINGS NOT REPEATED

A. **FINDING** (Failure to establish reasonable estimation methodology)

During the prior audit, auditors found 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 understatement was the result of the Department's practice of recording current year receivables at the amount of the formulary rebate payment received for the prior year without consideration of changes in relevant factors affecting the amounts to be received at each fiscal year end.

For the current audit period, the Department contracted with a new prescription benefits manager which makes rebate payments more timely allowing the Department to record a receivable for the amount received subsequent to year-end but before the financial statements are issued.

(Finding Code No. 2015-001)