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

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STATE OF ILLINOIS
DEPARTMENT OF CENTRAL MANAGEMENT SERVICES
TEACHER HEALTH INSURANCE SECURITY 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

FINANCIAL STATEMENT REPORT

SUMMARY

The audit of the accompanying financial statements of the Teacher Health Insurance Security 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 Teacher Health Insurance Security Fund's financial statements.

SUMMARY OF FINDINGS

The auditors identified matters involving the Department's internal control over financial reporting that they considered to be a material weakness. The material weakness is described in the accompanying Schedule of Findings on pages 21-23 of this report as item:

2015-001 Weaknesses in internal control over financial reporting

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.

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INDEPENDENT AUDITOR'S REPORT

Honorable Frank J. Mautino
Auditor General
State of Illinois

Report on the Financial Statements

As Special Assistant Auditors for the Auditor General, we have audited the accompanying financial statements of the Teacher Health Insurance Security 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 Teacher Health Insurance Security Fund of the State of Illinois, Department of Central Management Services, as of June 30, 2015, and the changes in financial position thereof for the year then ended in accordance with accounting principles generally accepted in the United States of America.

Emphasis of Matter

As discussed in Note 2, the financial statements present only the Teacher Health Insurance Security Fund of the State of Illinois, Department of Central Management Service, and do not purport to, and do not, present fairly the financial position of the State of Illinois or the State of Illinois, Department of Central Management Services as of June 30, 2015, and the changes in its financial position for the year then ended in conformity with accounting principles generally accepted in the United States of America. Our opinion is not modified with respect to this matter.

As discussed in Note 9 to the financial statements, the Teacher Health Insurance Security Fund has a deficit net position of $66.272 million as of June 30, 2015. Adverse experience is not covered by the current funding policy. Our opinion is not modified with respect to that matter.

Other Matters

Required Supplementary Information

Accounting principles generally accepted in the United States of America require that the Schedule of Funding Progress and Schedule of Contributions from Employers and Other Contributing Entities on pages 17-18 be presented to supplement the 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 management's discussion and analysis for the Teacher Health Insurance Security Fund 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 a report dated February 1, 2016 on our consideration of the Teacher Health Insurance Security Fund of the State of Illinois, Department of Central Management Services' internal control over financial reporting of the Teacher Health Insurance Security 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 Teacher Health Insurance Security Fund and its compliance.

Sikich LLP

Springfield, Illinois
February 1, 2016

STATE OF ILLINOIS
DEPARTMENT OF CENTRAL MANAGEMENT SERVICES
TEACHER HEALTH INSURANCE SECURITY FUND
STATEMENT OF PLAN NET POSITION
June 30, 2015

(amounts expressed in thousands)

		06/30/15
Assets		
Cash equity with State Treasurer	$	38,823
Cash and Cash Equivalents		13,115
Securities lending collateral of State Treasurer		13,586
Receivables		
Employer		4,297
Employee		5,767
Federal government		312
Interest		13
Other receivables		6,298
Due from other funds (net)		16,831
Total receivables		33,518
Total assets		99,042
Liabilities		
Accounts payable and other		151,581
Intergovernmental payables		62
Obligations under security lending of State Treasurer		13,586
Compensated absences, current		13
Total current liabilities		165,242
Long-term compensated absences		72
Total liabilities		165,314
Net position held in trust for other postemployment benefits	$	(66,272)

STATE OF ILLINOIS
DEPARTMENT OF CENTRAL MANAGEMENT SERVICES
TEACHER HEALTH INSURANCE SECURITY FUND
STATEMENT OF CHANGES IN PLAN NET POSITION
For the Year Ended June 30, 2015

(amounts expressed in thousands)

	06/30/15
Additions	
Contributions	
Employer	$ 81,415
State	100,983
Plan member:	
Actives	109,413
Retirees	124,140
Federal government Medicare Part D	2,760
Consolidated Ominbus Budget Reconciliation Act (COBRA)	108
Total contributions	418,819
Interest income	161
Total additions	418,980
Deductions	
Benefit payments and refunds	389,280
General and administrative expense	8,417
Total deductions	397,697
Net additions (deductions)	21,283
Net position held in trust for other postemployment benefits	
Beginning of year	(87,555)
End of year	$ (66,272)

1) Organization

The Teacher Health Insurance Security Fund (THISF) (also known as The Teacher Retirement Insurance Program, "TRIP") is a non-appropriated trust fund held outside the State Treasury, with the State Treasurer as custodian. Revenues deposited into the Trust are for the sole purpose of providing the health benefits to retirees, as established under the plan, and associated administrative costs. TRIP is a cost-sharing multiple-employer defined benefit post-employment healthcare plan that covers retired employees of participating school districts throughout the State of Illinois, excluding the Chicago Public School System. TRIP health coverage includes provisions for medical, prescription, and behavioral health benefits, but does not provide vision, dental, or life insurance benefits. Annuitants may participate in the State administered Preferred Provider Organization plan or choose from several managed care options. The State Employees Group Insurance Act of 1971 (5 ILCS 375/6.5) establishes the eligibility and benefit provisions for the plan. As a result of the Governor's Executive Order 12-01, the responsibilities in relation to TRIP were transferred to the Department of Central Management Services (Department) as of July 1, 2013. The Department administers the plan with the cooperation of the Teachers' Retirement System (TRS).

In order to be eligible, retirees of public schools must have been certified educators or administrators during their time of employment. Eligibility to participate in the plan is currently limited to former full-time employees, or if not a full-time employee, an individual that is in a permanent and continuous basis in a position in which services are expected to be rendered for at least one school term, and their dependents.

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 THISF has no component units and is not a component unit of any other entity. However, because the THISF is not legally separate from the State of Illinois, the financial statements of the THISF are included in the financial statements of the State of Illinois as a pension (and other employee benefit) trust 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 THISF administered by the State of Illinois, Department of Central Management Services. They are intended to present the financial position and the changes in financial position of only the THISF. 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 for the year ended in conformity with accounting principles generally accepted in the United States of America.

c) Measurement Focus and Basis of Accounting

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

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 on hand and cash in banks for locally held funds.

e) Deposits and Investments

The investments are reported at fair value.

f) Compensated Absences

The liability for compensated absences reported in the statement of plan net assets consists of unpaid, accumulated vacation and sick leave balances for Department employees. The liability has been calculated using the vesting method in which leave amounts, for both employees who currently are eligible to receive termination payments and other employees who are expected to become eligible in the future to receive such payments upon termination, are included. The liability has been calculated based on the employees' current salary level and includes salary related costs (e.g., Social Security and Medicare tax).

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 to disclose contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.

3) Contribution Information

Membership of the plan consisted of the following at June 30, 2014:

Retirees and beneficiaries receiving benefits	75,428
Waived retirees who may elect healthcare coverage in the future	19,416
Terminated plan members entitled to but not yet receiving benefits thru TRIP	9,812
Terminated plan members entitled to but not yet receiving benefits thru other TRS plans	6,123
Active plan members	154,387
Total	265,166
Number of participating employers	989

The State Employees Group Insurance Act of 1971 (5 ILCS 375/6.6) requires that all active contributors of the TRS, who are not employees of a department, make contributions to the plan at a rate of 1.02% of salary and for every employer of a teacher to contribute an amount equal to .76% of each teacher's salary. The Department determines, by rule, the percentage required, which each year shall not exceed 105% of the percentage of salary actually required to be paid in the previous fiscal year.

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

For the year ended June 30, 2015, member annuitants (including their dependent beneficiaries) contributed $124.140 million, or approximately 29.85% of total premiums, through their required contributions. Member required contributions ranged from $84.24 to $219.31, per month per retiree, and from $376.06 to $657.96, per month per retiree and spouse (assuming Medicare eligibility). For non-Medicare eligible members, required contributions ranged from $68.62 to $755.95, per month per retiree, and from $343.20 to $2,267.84, per month per retiree plus dependents. The State Employees Group Insurance Act of 1971 (5 ILCS 375/6.6) requires active teachers contribute 1.02% of salaries; they contributed $109.413 million, or approximately 26.30% of total premiums. The State Employees Group Insurance Act of 1971 (5 ILCS 375/6.6) also requires participating school districts contribute .76% of salaries; they contributed $81.415 million, or approximately 19.57% of total premiums. In addition, the State Employees Group Insurance Act of 1971 (5 ILCS 375/6.6) requires the State contribute 1.02% of salaries; they contributed $100.983 million, or approximately 24.28% of total premiums. The fund received $2,760 million in Medicare Part D subsidy payments from the federal government.

4) Deposits and Investments

a) Deposits

The State Treasurer is the custodian of the State's cash and cash equivalents for funds maintained in the State Treasury. Deposits in the custody of the State Treasurer are pooled and invested with other State funds in accordance with the Deposit of State Moneys Act of the Illinois

Compiled Statutes (15 ILCS 520/11). Funds held by the State Treasurer have not been categorized as to credit risk because the Department does not own individual securities. Detail on the nature of these deposits and investments are available within the State of Illinois' Comprehensive Annual Financial Report.

Cash on deposit with the State Treasurer totaled $38.823 million 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 in the State Treasury Investment Pool (Illinois Funds):

	Fair Value (Thousands)	Weighted Average Maturity (Years)
Illinois Public Treasurers' Investment Pool	$13,115	.120%
Total fixed income investments	$13,115	

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.

c) Reconciliation to Statement of Net Position

	Deposits (Thousands)	Investments (Thousands)
Amounts per Note 4(a)(b)	$38,823	$13,115
Cash Equivalents	13,115	(13,115)
Total per Statement of Net Position	$51,938	$ 0

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.

5) Status and Funding Progress – OPEB Plans

The funded status of the plan as of the most recent actuarial valuation date available as of June 30, 2014 is as follows (amounts expressed in thousands):

Actuarial Date	Actuarial Value of Assets (a)	Actuarial Accrued Liability (AAL)-- Projected Unit (b)	Unfunded AAL (UAAL) (b-a)	Funded Ratio (a/b)	Covered Payroll (c)	UAAL as a Percentage of Covered Payroll ([b-a]/c)
6/30/14	$(87,555)	$18,759,776	$18,847,331	-0.47%	$9,340,200	201.79%

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

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

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

Valuation date	6/30/14
Actuarial Cost Method	Projected Unit Credit
Amortization Method	Level Percentage of Pay
Remaining Amortization Period	30 Years
Asset Valuation Method	Market Value
Actuarial Assumptions:	
Inflation Rate	3.0%
Amortization Period	Open
Investment Rate of Return*	4.5 %
Healthcare Cost Trend Rate	8.5% grading down .5% per year for one year and .09% for one year .05% over 6 years - Pre-Medicare Medical/Rx Initial 8.5% grading down .5% per year over 8 years to 4.5% - Post-Medicare Medical/Rx Initial 5.0% for 8 years grading down to 4.5% in the 9th year - Ultimate

*The participating employers are not expected to make additional contributions to advance-fund the benefit obligation. The interest rate used to calculate the present value and cost should be consistent with assets supporting liabilities, which for this case is the long-range expected return on short-term fixed income instruments. The plan sponsor has selected an interest discount rate of 4.5 percent for this purpose.

6) 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	$81	$52	$48	$85	$13
Total	$81	$52	$48	$85	$13

7) Pension Plan

The vested full-time employees paid from the THISF 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.

8) 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 Employees Retirement System do not contribute towards health, dental, and vision benefits. For annuitants who retired on or after January 1, 1998, the annuitant's contribution amount is reduced five percent for each year of credited service with the State allowing those annuitants with twenty or more years of credited service to not have to contribute towards health, dental, and vision benefits. 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 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 of Central Management Services. A copy of the financial statements of the Department may be obtained by writing to the Department of Central Management Services, 401 South Spring, Springfield, Illinois, 62706.

9) Fund Deficit

For the fiscal year ending June 30, 2015, total benefits and expenses were $397.697 million which were partially financed by $100.983 million in State contributions, $81.415 million in employer contributions, $2.760 million in the federal government Medicare Part D subsidy, $109.413 million in active member contributions, and $124.140 million in retired member contributions, resulting in a net total of approximately $21.283 million or approximately 5.35% of total benefits and expenses.

Because contributions made by the State, employers, employees, and retired members are defined as a fixed percentage of payroll, the funding policy does not provide a provision for adverse experience. The following factor contributed to the fund deficit: the current financing policy does not provide a specific provision for claims incurred during the fiscal year that are expected to be paid in the following fiscal year. At June 30, the fund deficit was $66.272 million.

10) Commitments and 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
DEPARTMENT OF CENTRAL MANAGEMENT SERVICES
TEACHER HEALTH INSURANCE SECURITY FUND
REQUIRED SUPPLEMENTARY INFORMATION
SCHEDULE OF FUNDING PROGRESS
(amounts expressed in thousands)
(Unaudited)

Actuarial Valuation Date	Actuarial Value of Assets (a)	Actuarial Accrued Liability (AAL)-- Projected Unit (b)	Unfunded AAL (UAAL) (b-a)	Funded Ratio (a/b)	Covered Payroll (c)	UAAL as a Percentage of Covered Payroll ([b-a]/c)
6/30/2007	$ 65,790	$ 14,284,678	$ 14,218,888	0.46%	$ 7,785,458	182.63%
6/30/2009	$ 54,603	$ 14,931,396	$ 14,876,793	0.37%	$ 8,428,359	176.51%
6/30/2011	$ 7,125	$ 18,860,375	$ 18,853,250	0.04%	$ 8,791,038	214.46%
6/30/2013	$ (80,139)	$ 19,459,607	$ 19,539,746	-0.41%	$ 9,110,415	214.48%
6/30/2014	$ (87,555)	$ 18,759,776	$ 18,847,331	-0.47%	$ 9,340,200	201.79%

STATE OF ILLINOIS
DEPARTMENT OF CENTRAL MANAGEMENT SERVICES
TEACHER HEALTH INSURANCE SECURITY FUND
REQUIRED SUPPLEMENTARY INFORMATION
SCHEDULE OF CONTRIBUTIONS FROM EMPLOYERS
AND OTHER CONTRIBUTING ENTITIES
(amounts expressed in thousands)
(Unaudited)

Year Ended June 30	Annual Required Contribution	State Contributions	State Percentage Contributed	Employer's Contributions	Employer's Percentage Contributed	Medicare Part D Contributions	Medicare Part D Percentage Contributed
2010	$ 1,197,052	$ 79,007	6.60%	$ 67,706	5.66%	$ 23,897	2.00%
2011	$ 1,540,322	$ 85,953	5.58%	$ 70,570	4.58%	$ 23,422	1.52%
2012	$ 1,609,637	$ 87,622	5.44%	$ 71,376	4.43%	$ 24,911	1.55%
2013	$ 1,513,939	$ 86,683	5.73%	$ 74,023	4.89%	$ 23,958	1.58%
2014	$ 1,445,469	$ 90,430	6.26%	$ 77,290	5.35%	$ 16,360	1.13%
2015	$ 1,370,166	$ 100,983	7.37%	$ 81,415	5.94%	$ 2,760	0.20%

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INDEPENDENT AUDITOR'S REPORT ON INTERNAL CONTROL OVER FINANCIAL REPORTING AND ON COMPLIANCE AND OTHER MATTERS BASED ON AN AUDIT OF FINANCIAL STATEMENTS PERFORMED IN ACCORDANCE WITH *GOVERNMENT AUDITING STANDARDS*

Honorable Frank J. Mautino
Auditor General
State of Illinois

As Special Assistant Auditors for the Auditor General, we have audited, in accordance with the auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards* issued by the Comptroller General of the United States, the financial statements of the Teacher Health Insurance Security 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 Teacher Health Insurance Security 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 Teacher Health Insurance Security 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

2015-001 **FINDING** (Weaknesses in internal control over financial reporting)

The Department of Central Management Services' (the Department's) year-end financial reporting in accordance with generally accepted accounting principles (GAAP) to the Illinois Office of the State Comptroller contained a material error in the determination of certain year-end account balances.

The Illinois Office of the State Comptroller (IOC) requires State agencies to prepare year-end financial reports (GAAP Reporting Packages) for each of their funds to assist in the annual preparation of the Statewide financial statements and the Department's financial statements. GAAP Reporting Package instructions are specified in the Statewide Accounting Management System (SAMS) Manual, Chapter 27.

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.

During the audit of the June 30, 2015 financial statements, we noted material weaknesses resulting from the Department's failure to establish adequate internal control over the accumulation of information necessary for the proper reporting of financial information as follows:

- The Department failed to record a liability for health insurance claims which were incurred but not adjudicated at June 30, 2015 in the Teachers' Health Insurance Security Fund (Fund 0203). Incurred but not adjudicated claims include both unreported claims and claims which have been reported but for which a determination of the amount to be paid by the Department has not been made. This error resulted in the understatement of liabilities and expenses by $15.641 million. The Department revised the applicable financial statements for this error.

- The Department failed to establish a reasonable estimation methodology for certain rebate receivables resulting in a $4.788 million overstatement 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 $8.382 million 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 $3.594 million. The Department revised the applicable financial statements for this error.

The Department stated these weaknesses were primarily due to lack of key personnel. In addition, financial reporting for the Department is currently handled by a different agency (Shared Services) which contributed to the disconnect of the sharing and correct interpretation of financial information. The Department further 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.

As a result of this error, the Department's GAAP reporting package for the Teachers' Health Insurance Security Fund was inaccurate and required corrections which delayed completion and testing of the financial statements. In addition, staffing vacancies and turnover at the Department and the Administrative and Regulatory Shared Services Center during the GAAP reporting process perpetuated these delays. (Finding Code No. 2015-001)

RECOMMENDATION

We recommend the Department implement procedures and cross-training measures to ensure required financial information is prepared in a timely, accurate and complete manner. This should include allocating sufficient staff resources and the implementation of formal procedures to ensure accurate and reliable financial information is prepared and submitted to the Office of the State Comptroller. These procedures should address all elements of the Department's financial reporting process including, but not limited to, accruals for liabilities, supervisory review of supporting spreadsheets for data accumulation, and the preparation of management estimates. Finally, we recommend the Department establish and document its process for preparing accounting estimates significant to its financial statements.

DEPARTMENT RESPONSE

The Department agrees with the finding and recommendation. The Department has now filled two vacant positions responsible for financial reporting. Additionally, the Department will work toward more comprehensive cross-training and communication among financial reporting staff at CMS and Shared Services. In regards to the overstatement of the rebate receivable, the Department has remedied the situation through a new contract requirement for the vendor to provide the necessary information within 60 days. Finally, the Department has begun an overhaul of its financial reporting procedures to ensure accurate and reliable financial information is prepared and submitted to the Office of the Comptroller.

PRIOR FINDINGS NOT REPEATED

None.