STATE OF ILLINOIS
OFFICE OF THE
AUDITOR GENERAL
William G. Holland, Auditor General

SUMMARY REPORT DIGEST

# STATE OF ILLINOIS

**Statewide Financial Statement Audit**
**For the Year Ended: June 30, 2012**

**Release Date: June 20, 2013**

**Summary of Findings:**

| | |
|---|---|
| **Total this audit:** | **5** |
| **Total last audit:** | **5** |
| **Repeated from last audit:** | **5** |

## INTRODUCTION

The Illinois Office of the State Comptroller prepares the State of Illinois Comprehensive Annual Financial Report (CAFR). The CAFR is the State's official annual report which provides the readers with the financial position of the State as of June 30, 2012, and results of operations during the fiscal year.

The financial section of the CAFR includes the Independent Auditors' Report on the basic financial statements, the management discussion and analysis, the basic financial statements, required supplementary information, and individual fund statements and schedules.

## AUDITORS' OPINION

The June 30, 2012 financial statements of the State of Illinois are fairly presented in all material respects.

The financial statements reflect a continuing financial deficit. At June 30, 2012:

- The net assets of governmental activities continued to deteriorate and the deficit increased by $3.0 billion from FY11 to FY12. Overall, net assets of governmental activities are reported as a deficit of $46.6 billion. (Exhibit 1)

- The General Revenue Fund deficit increased by $1.1 billion from FY11 to FY12. The June 30, 2012 deficit was $9.1 billion. (Exhibit 2)

Over time, increases and decreases in net assets measure whether the State's financial position is improving or deteriorating. A comparison of Illinois' financial position to other states is contained in Exhibit 3.

**REPORT ON INTERNAL CONTROL OVER FINANCIAL REPORTING AND ON COMPLIANCE**

In accordance with *Government Auditing Standards*, a report on our consideration of the State of Illinois' internal control over financial reporting and our tests of its compliance is also issued as part of our financial statement audit. This report is a separate document and is summarized in this document. Our report noted that the State's decentralized internal control system is not adequate. We also reported significant financial reporting deficiencies at several State agencies.

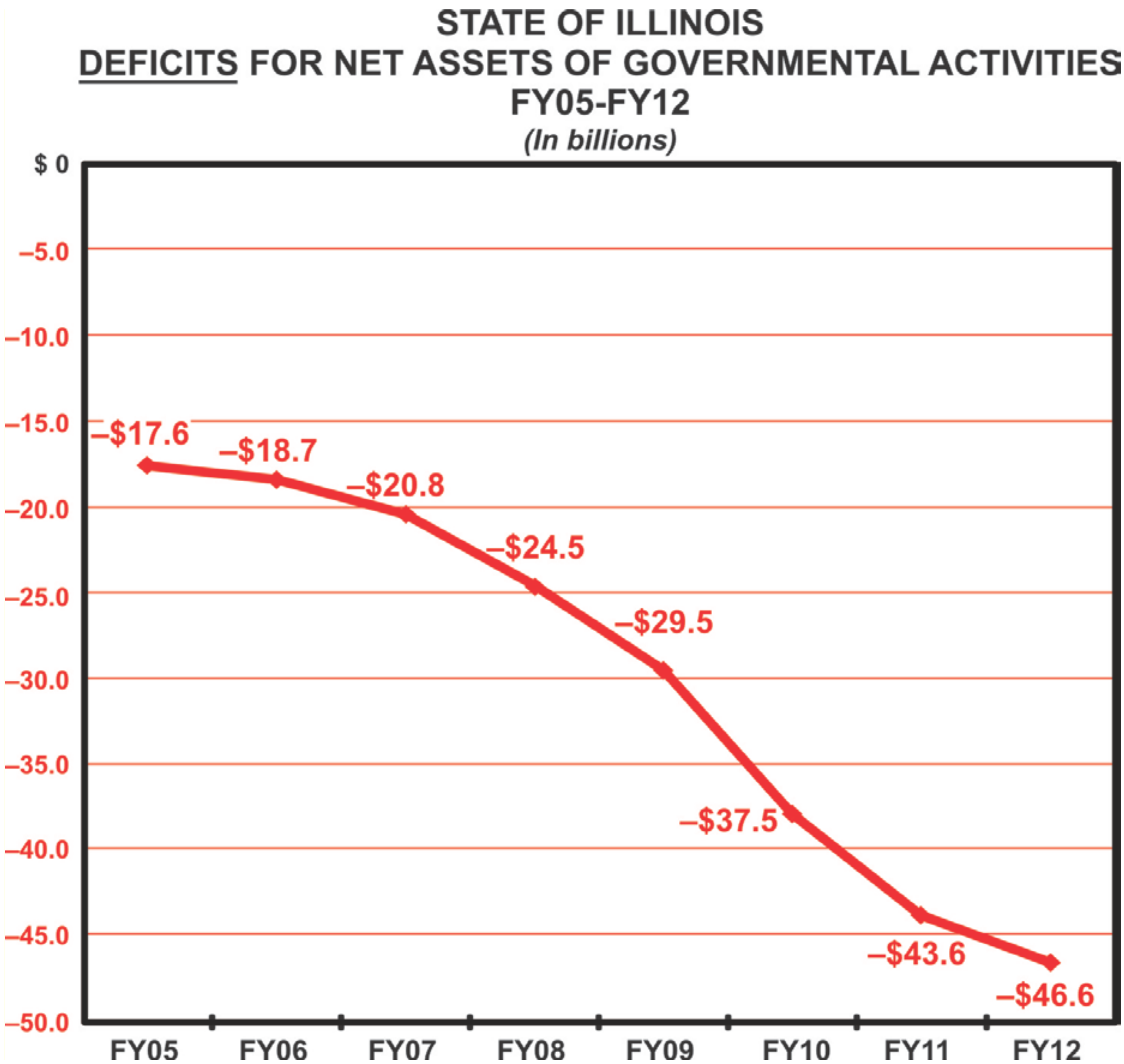
**STATE OFFICIALS**

| | |
|---|---|
| Governor | Patrick Quinn |
| Comptroller | Judy Baar Topinka |
| Speaker of the House | Michael J. Madigan |
| President of the Senate | John J. Cullerton |
| House Republican Leader | Tom Cross |
| Senate Republican Leader | Christine Radogno |

## FINANCIAL ANALYSIS OF THE STATE

The net assets of the State's governmental activities declined $2.965 billion. The following condensed financial information was derived from the government-wide Statement of Net Assets and reflects the State's governmental activities financial position as of June 30 for fiscal years 2005 through 2012.

**EXHIBIT 1**



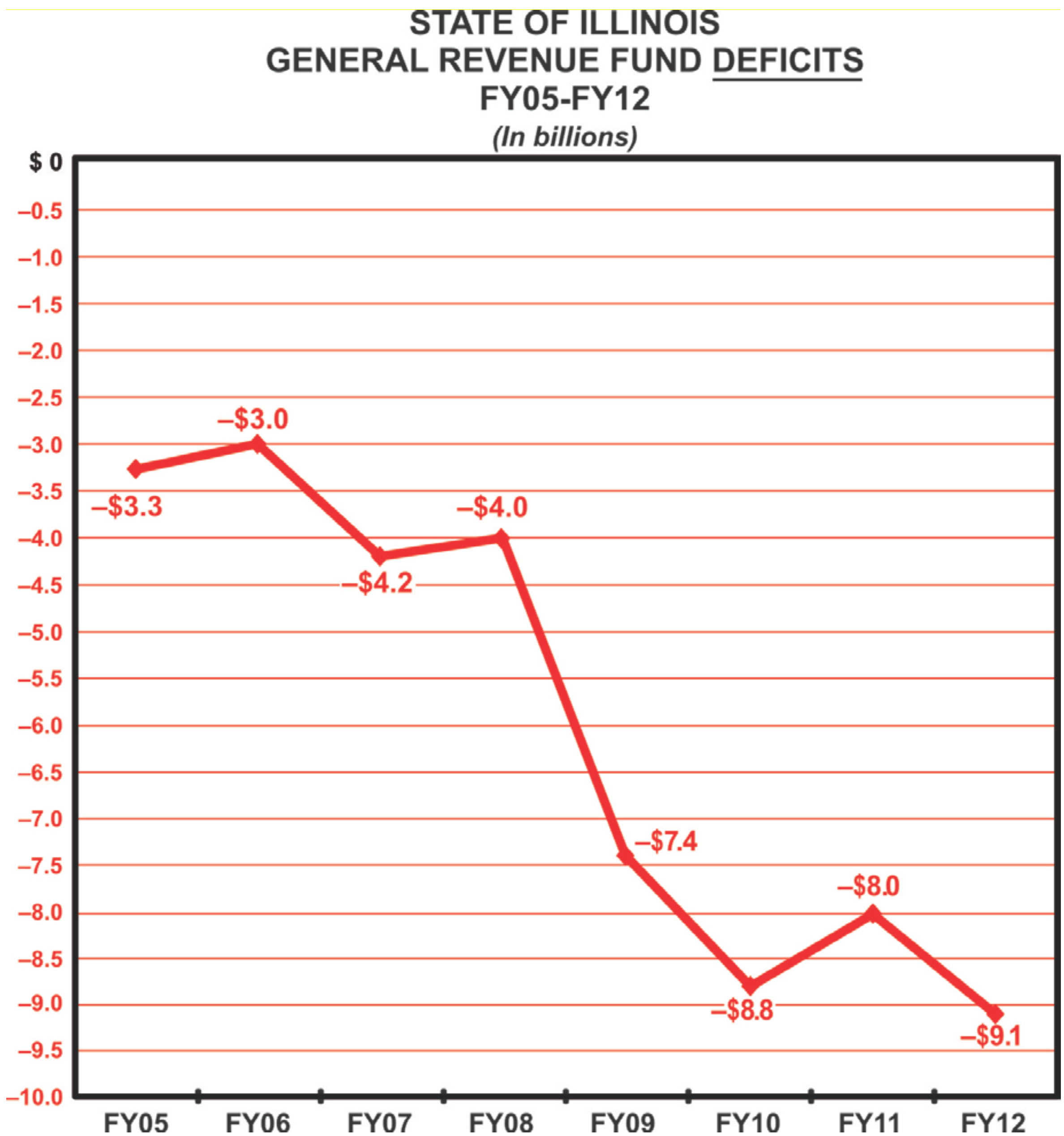

Source: Illinois' Comprehensive Annual Financial Report (2012)
Numbers reflect restatements.

The deficits reflected in Exhibit 1 are presented on an accrual basis and represent the excess of total liabilities over total assets at a given point in time. These deficits represent the deferral of current and prior year costs to future periods.

## GENERAL REVENUE FUND

Many programs are accounted for in the General Fund. The GAAP basis financial position of the General Revenue Fund deficit increased at June 30, 2012 from June 30, 2011. The fund balance deficit in the State's General Revenue Fund increased by $1.123 billion on a GAAP basis (from a deficit of $8.010 billion, as restated, to a deficit of $9.133 billion). Exhibit 2 reflects the General Revenue Fund deficit for fiscal years 2005 through 2012.

**EXHIBIT 2**

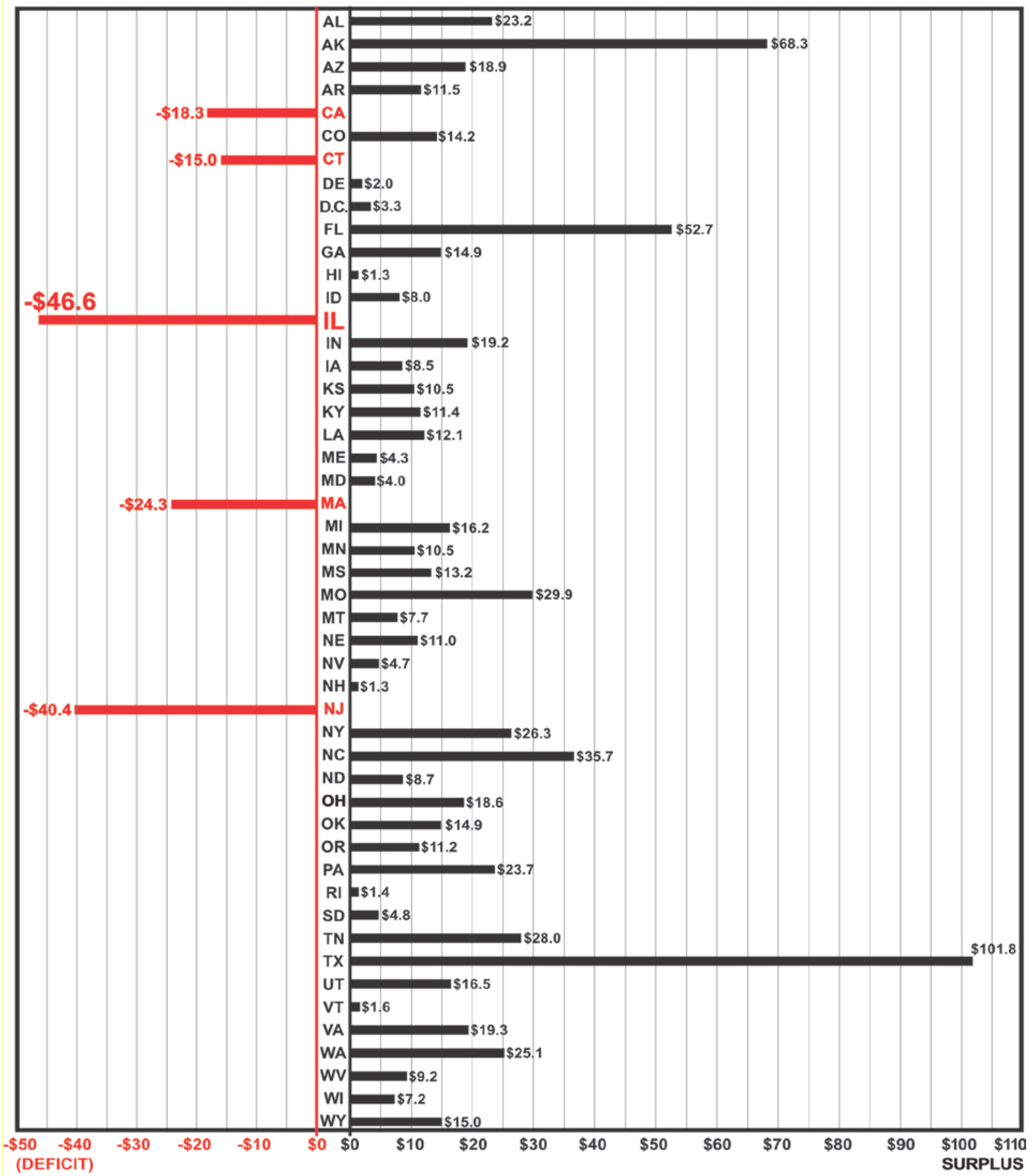



Source: Illinois' Comprehensive Annual Financial Report (2012)
Numbers reflect restatements.

## STATE COMPARISON

Exhibit 3 provides an analysis of Illinois' Net Assets at June 30, 2012 compared to other States.

EXHIBIT 3
**STATE COMPARISON OF NET ASSETS OF GOVERNMENTAL ACTIVITIES FOR FY12**
*(In billions)*




Source: Compiled by Illinois Auditor General's Office from Comprehensive Annual Financial Reports (CAFR) for each state, excluding New Mexico and South Carolina, which were not available at May 31, 2013.

## FINDINGS, CONCLUSIONS, AND RECOMMENDATIONS

### INADEQUATE FINANCIAL REPORTING PROCESS

**Process does not allow timely financial reporting**

**Financial statements not completed until the end of May for six consecutive fiscal years due to reporting issues at State agencies**

The State of Illinois' current financial reporting process does not allow the State to prepare a complete and accurate Comprehensive Annual Financial Report (CAFR) or the Schedule of Expenditures of Federal Awards (SEFA) in a timely manner. Reporting issues at various individual agencies caused delays in finalizing the financial statements, which did not occur until at least the end of May of the subsequent year for the past six fiscal years. The lack of timely financial reporting limits effective oversight of State finances, adversely affects the State's bond rating, and jeopardizes federal funding.

**Financial reporting problems continue even after numerous findings issued**

Accurate and timely financial reporting problems continue to exist even though the auditors have: 1) continuously reported numerous findings on the internal controls (material weaknesses and significant deficiencies), 2) commented on the inadequacy of the financial reporting process of the State, and 3) regularly proposed adjustments to financial statements year after year. These findings have been directed primarily toward the Office of the State Comptroller and major State agencies under the organizational structure of the Office of the Governor.

**Financial reporting problems not resolved**

**Financial reporting process dependent on post audits**

The Office of the State Comptroller has made significant changes to the system used to compile financial information and agencies have submitted their financial information in a more timely manner; however, the State has not solved all problems to effectively remediate these financial reporting weaknesses. The process is overly dependent on the post audit program being a part of the internal control for financial reporting even though the Illinois Office of the Auditor General has repeatedly informed State agency officials that the post audit function **is not and should not** be an internal control mechanism for any operational activity related to financial reporting.

**Two Public Acts have potential to positively affect process**

Although the deficiencies relative to the CAFR and SEFA financial reporting processes have been reported by the auditors for a number of years, problems continue with the State's ability to provide accurate and timely external financial reporting. Corrective action necessary to remediate these deficiencies continues to be problematic; however, two recent Public Acts have the potential to positively affect the financial reporting process. Public Act 97-408, effective August 16, 2011, established a statutory deadline of October 31 of each year for State agencies to report financial information for the previous June 30 to the State Comptroller. Public Act 97-1055, effective August 23, 2012, established the Financial Reporting Standards Board (Board). The purpose of the

Board is to "assist the State in improving the timeliness, quality, and processing of financial reporting for the State." (Finding 1, pages 7-10)

We recommended the Office of the Governor and the Office of the State Comptroller continue to work together to resolve the State's inability to produce timely and accurate GAAP basis financial information and a Statewide SEFA.

**Governor's Office agreed and SB 3794 was signed into law to create a statutory financial reporting framework**

The Governor's Office agreed with our recommendation and stated that the Governor's Office and the Governor's Office of Management and Budget (GOMB) are and will continue to work cooperatively with the Office of the Comptroller to address these challenges with effective solutions. Further, the Governor's Office stated that Governor Quinn signed into law SB 3794, an initiative of the Governor's Office, in order to create a statutory framework to begin to address the basic issues with the State's financial reporting capabilities. The response provided further details of the plans to address the issues.

**IOC agreed with auditors and will continue to assist the Governor's Office**

The Comptroller's Office agreed with our recommendation and stated that the Office will continue to assist the Governor's Office in their efforts to increase the quality of GAAP packages and provide training and technical assistance to State agencies. In addition, the Office will work with the newly created Financial Accounting Standards Board in their mission to improve the timeliness, quality and processing of financial reporting for the State.

**FINANCIAL REPORTING WEAKNESSES**

**17 of 22 agencies with 49 internal control findings over financial reporting**

The State of Illinois did not have adequate controls to assess the risk that information reported by individual agencies of the primary government would not be fairly stated and compliant with generally accepted accounting principles. The Office of the Auditor General performed audits at 27 agencies of the primary government, including five pension systems and the State Board of Investments. During these audits, we noted at 17 agencies there were a total of 22 material weaknesses and 27 significant deficiencies related to the internal controls over the financial reporting process.

**Internal control deficiencies extend financial reporting timelines**

Material weaknesses and significant deficiencies further extend financial reporting timelines since additional measurements and reporting is required. Completion or substantial completion of these audits is necessary in order for the Auditor General to issue an opinion on the State's basic financial statements.

In addition to the deficiencies noted above, restatements and material errors were noted during our audits, which are as follows:

**Beginning balances restated**

- The beginning balances in the financial statements of the primary government were restated due to the correction of three errors. The three errors resulted in a total of $211.173 million in restatements.

**Material misstatements identified**

- Material misstatements were identified by the auditors at six agencies. The misstatements ranged from $184 thousand to $401 million. (Finding 2, pages 11-14)

We recommended the State continue their efforts to improve internal control procedures in order to assess the risk of material misstatements to the financial statements and to identify such misstatements during the financial statement preparation process. The internal control procedures should include a formal evaluation of prior problems and implementation of procedures to reduce the risk of these problems reoccurring.

**Governor's Office agreed and focus is on implementing a centralized financial accounting system**

The Governor's Office agreed with our recommendation and stated that the Governor's Office has focused on solving this problem by implementing a centralized financial accounting system. Further, the Governor's Office stated that if the State had an enterprise-wide financial accounting system it would incorporate standard internal controls to lessen the risk of inaccuracy by preemptively detecting and facilitating resolution of any material

**IOC agreed with auditors and will continue to assist the Governor's Office**

The Comptroller's Office agreed with our recommendation and stated that the Office will continue to assist the Governor's Office in their efforts to increase the quality of GAAP packages and provide training and technical assistance to State agencies. In addition, the Office will work with the newly created Financial Accounting Standards Board in their mission to improve the timeliness, quality and processing of financial reporting for the State.

**FINANCES INCREASE RISKS**

**Insufficient controls over the State's finances**

**Increased risk that liabilities will not be recorded properly**

The State of Illinois did not have sufficient controls over its finances to ensure obligations are paid. This condition increases the risk that liabilities will not be properly recorded. We noted the following during our financial audit of the State's financial statements.

**$4.475 billion of approved payments on hand at June 30, 2012**

The State had transactions, totaling $4.475 billion, on hand at June 30, 2012 that had been approved for payment by the State, but remained unpaid at year end due to the State's cash flow difficulties. Of this amount, approximately $3 billion was owed to external parties, the remaining balance was related to intra-governmental transactions and statutorily mandated transfers. Due to the State not being able to pay

**$136 million paid in interest payments**

external vendors in a timely manner, the State paid approximately $136 million in interest payments during Fiscal Year 2012. (Finding 5, pages 19-20)

We recommended the Governor work with the General Assembly to improve the State's control over State finances in a manner that eliminates significant payment and unnecessary interest payments to State vendors.

**Governor's Office agreed with auditors**

The Governor's Office agreed with our recommendation and stated measures have been taken to prevent future findings in this area. The response provided further details of the steps that have been taken.

**OTHER FINDINGS**

The remaining findings included two noncompliance issues. We will review the State's progress towards the implementation of our recommendations in our next audit.

WILLIAM G. HOLLAND
Auditor General

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