STATE OF ILLINOIS
COMPREHENSIVE ANNUAL FINANCIAL REPORT

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*

For the Year Ended June 30, 2017

STATE OF ILLINOIS
COMPREHENSIVE ANNUAL FINANCIAL REPORT
FINANCIAL AUDIT
For the Year Ended June 30, 2017

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The annual financial statements of the State of Illinois for the year ended June 30, 2017, were issued under a separate cover.

STATE OF ILLINOIS
COMPREHENSIVE ANNUAL FINANCIAL REPORT
FINANCIAL AUDIT
For the Year Ended June 30, 2017

STATE OFFICIALS

Governor	Bruce Rauner
Comptroller	Leslie Geissler Munger (7/1/16 through 12/4/16)
Comptroller	Susana A. Mendoza (12/5/16 through present)
Speaker of the House	Michael J. Madigan
President of the Senate	John J. Cullerton
House Republican Leader	Jim Durkin
Senate Republican Leader	Christine Radogno (7/1/16 through 7/1/17)
Senate Republican Leader Designee	William E. Brady (7/1/17 through 8/29/17)
Senate Republican Leader	William E. Brady (8/29/17 through present)

STATE OF ILLINOIS
COMPREHENSIVE ANNUAL FINANCIAL REPORT
FINANCIAL AUDIT
For the Year Ended June 30, 2017

SUMMARY

The audit of the State of Illinois' financial statements was performed in accordance with *Government Auditing Standards*. This report is an integral part of that audit.

SUMMARY OF FINDINGS

Number of	Current Report	Prior Report
Findings	5	5
Repeated findings	5	5
Prior recommendations implemented or not repeated	0	0

SCHEDULE OF FINDINGS

Item No.	Page	Description	Finding Type
		FINDINGS (*GOVERNMENT AUDITING STANDARDS*)	
2017-001	7	Inadequate Financial Reporting Process	Material Weakness
2017-002	10	Financial Reporting Weaknesses	Material Weakness
2017-003	15	Late Payment of Statutorily Mandated Transfers	Noncompliance
2017-004	17	Debt Covenant Violation	Noncompliance
2017-005	19	Insufficient Controls over Finances	Material Weakness

EXIT CONFERENCE

The Office of the State Comptroller and the Office of the Governor have waived an exit conference.

AGENCY RESPONSES

Responses to the findings and recommendations were provided as follows:

Ms. Roma Larson, Deputy General Counsel, Governor's Office of Management and Budget on March 13, 2018.

Ms. Katie Madonia, Director of Financial Reporting, Office of the State Comptroller on March 8, 2018.

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OFFICE OF THE AUDITOR GENERAL
FRANK J. MAUTINO

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 Michael J. Madigan, Speaker of the House
Honorable John J. Cullerton, President of the Senate
Members of the General Assembly
Honorable Bruce Rauner, Governor
Honorable Susana Mendoza, Comptroller

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 governmental activities, the business-type activities, the aggregate discretely presented component units, each major fund, and the aggregate remaining fund information of the State of Illinois, as of and for the year ended June 30, 2017, and the related notes to the financial statements, which collectively comprise the State of Illinois' basic financial statements as listed in the Table of Contents for Section II of the Illinois Comprehensive Annual Financial Report, and have issued our report thereon dated March 15, 2018.

Our report is modified to include a reference to other auditors who audited the financial statements of certain university related organizations and included an emphasis-of-matter paragraph which stated the deficit for the net position of governmental activities in Fiscal Year 2017 continued to increase by $10,091,734,000, from $131,569,222,000 at June 30, 2016, to $141,660,956,000 at June 30, 2017. This deficit, which is presented on an accrual basis, is the excess of total liabilities and deferred inflows of resources over total assets and deferred outflows of resources and represents a deferral of current and prior year costs to future periods.

For purposes of this report, our consideration of internal control over financial reporting and our tests of compliance with certain provisions of laws, regulations, contracts, and grant agreements, and other matters did not include the State's discretely presented component units. Separate reports have been issued for those entities. The findings, if any, included in those reports are not included herein.

Internal Control Over Financial Reporting

In planning and performing our audit of the financial statements, we considered the State of Illinois' internal control over financial reporting (internal control) to determine the audit procedures that are appropriate in the circumstances for the purpose of expressing our opinions on the financial statements, but not for the purpose of expressing an opinion on the effectiveness of the State of Illinois' internal control. Accordingly, we do not express an opinion on the effectiveness of the State of Illinois' 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 and, therefore, material weaknesses or significant deficiencies may exist that were not identified. We did identify certain deficiencies in internal control, described in the accompanying schedule of findings as items 2017-001, 2017-002, and 2017-005, that we consider to be material weaknesses.

Compliance and Other Matters

As part of obtaining reasonable assurance about whether the State of Illinois' 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 instances of noncompliance or other matters that are required to be reported under *Government Auditing Standards* and which are described in the accompanying schedule of findings as items 2017-003 and 2017-004.

The Office of the Governor's and Office of the State Comptroller's Responses to Findings

The Office of the Governor's and the Office of the State Comptroller's responses to the findings identified in our audit are described in the accompanying schedule of findings. The Office of the Governor's and the Office of the State Comptroller's 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' 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' internal control and compliance. Accordingly, this communication is not suitable for any other purpose.

SIGNED ORIGINAL ON FILE

FRANK J. MAUTINO
Auditor General
State of Illinois

SIGNED ORIGINAL ON FILE

JANE CLARK, CPA
Director of Financial and Compliance Audits
Office of the Auditor General

Springfield, Illinois
March 15, 2018

2017-001. **FINDING** (Inadequate Financial Reporting Process)

The State of Illinois' current financial reporting process does not allow the State to prepare a complete and accurate Comprehensive Annual Financial Report (CAFR) in a timely manner. Reporting issues at various individual agencies caused delays in finalizing the financial statements. See also Finding 2017-002 for additional detail. The lack of timely financial reporting limits effective oversight of State finances and may adversely affect the State's bond rating.

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 towards major State agencies under the organizational structure of the Office of the Governor and towards the Office of the State Comptroller.

The Office of the State Comptroller has made significant changes to the system used to compile financial information; however, the State has not solved all the problems to effectively remediate these financial reporting weaknesses. The process is overly dependent on the post audit program even though the Office of the Auditor General has repeatedly informed State agency officials that the post audit function **is not** a substitute for appropriate internal controls at State agencies.

The State has a highly decentralized financial reporting process. During an Office of the Auditor General's management audit (released February 2011) of the State's financial reporting system, it was reported that 88 of 90 primary units of government had 263 different financial reporting systems that are used by primary government agencies. Furthermore, it was reported that only 16 percent of these financial reporting systems are compliant with Generally Accepted Accounting Principles (GAAP), which drastically increases the amount of time spent by the agencies during the year-end GAAP conversion process. In addition, 53 percent of the financial reporting systems are not interrelated, which, consequently, requires manual intervention to convert data. This process is time consuming and increases the likelihood of errors.

Annual financial reporting to the Office of the State Comptroller requires the State's agencies to prepare a series of financial reporting forms (SCO forms) designed by the Office of the State Comptroller, which are utilized to prepare the CAFR. For the most part, these SCO forms are completed for each of the State's 818 primary government/fiduciary funds and 16 component units. The forms are completed by accounting personnel within each State agency who have varying levels of knowledge, experience, and understanding of GAAP and of the State's accounting policies and procedures. Agency personnel involved with this process are not under the organizational control or jurisdiction of the Office of the State Comptroller.

Although these SCO forms are subject to review by the Office of the State Comptroller's financial reporting staff during the CAFR preparation process and there are minimum qualifications for all new GAAP coordinators who oversee the preparation of the SCO forms, the current process still lacks sufficient internal controls at individual agencies. As a result, audit adjustments and significant internal control deficiencies relative to individual agencies' financial reporting continue to occur.

Concepts Statement No. 1 of the Governmental Accounting Standards Board *Objectives of Financial Reporting* (GASBCS 1, paragraph 66) states, "if financial reports are to be useful, they must be issued soon enough after the reported events to affect decisions."

The Office of the Governor's management stated the weaknesses are due to (1) lack of a Statewide accounting and grants management system and (2) lack of personnel adequately trained in governmental accounting and federal grants management. Without adequate financial and grants management systems, agency staff are required to perform highly manual calculations of balance sheet and Schedule of Expenditure and Federal Awards amounts in a short time frame which results in increased errors. The lack of adequate financial and grants management personnel is due in part to a failure to update the qualifications in the respective job titles to ensure that applicants have the minimum required education and skill sets to be properly trained.

The Office of the State Comptroller's management indicated that delays at the departmental level were caused by a lack of sufficient internal control processes in State agencies for the accumulation and reporting of financial information used to prepare the financial statements.

Failure to establish effective internal controls at all State agencies regarding financial reporting for the timely and accurate preparation of the CAFR prevents the State from completing an audit in a timely manner, delays financial reporting, and decreases the usefulness of such information. (Finding Code No. 2017-001, 2016-001, 2015-001, 2014-001, 2013-001, 12-1, 11-1, 10-1, 09-2, 08-2, 07-2)

RECOMMENDATION

We recommend 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.

AGENCY RESPONSES

Office of the Governor:

The Office of the Governor concurs with the auditor's finding and recommendation. The Office of the Governor and the Office of the State Comptroller will continue to work together to address the core issues of the State's inability to produce timely and accurate GAAP basis financial information. Both Offices are in the midst of a multi-year implementation of an Enterprise Resource Planning (ERP) system to develop an integrated enterprise-wide application system for financials, which is an aspect of the Governor's Executive Order that created the Illinois Department of Innovation and Technology to transform Illinois' IT system to be more responsive to State employees and taxpayers. An operational ERP system will improve the State's control environment and processes to produce accurate financial statements in a timely manner.

Office of the State Comptroller:

The Office of the State Comptroller accepts the recommendation. The State still faces several road blocks in the timely completion of the CAFR. The General Assembly enacted P.A. 97-0691, which extended lapse period from August 31 to December 31 for fiscal year 2013 and future fiscal years for medical assistance payments of the Department of Healthcare and Family Services. As a result of the extension, the preparation and completion of critical financial schedules will continue to be delayed. In addition, during fiscal year 2016 and 2017, the State operated without a complete budget. P.A. 100-0021, which provided for a significant portion of the fiscal year 2017 appropriations, was not signed into law until July 6, 2017, further delaying the financial reporting process. More importantly, the CAFR completion continues to be delayed because of financial reporting issues identified during individual State agency financial and compliance audits. The CAFR cannot be finalized until these issues are resolved at the individual State agency reporting level.

The Office of the State Comptroller will continue to work with the Governor's Office, the Auditor General's Office, and agency GAAP coordinators to improve the timeliness, quality, and processing of financial reporting for the State.

2017-002. **FINDING** (Financial Reporting Weaknesses)

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. As reported in Finding 2017-001, the State has a decentralized financial reporting process. Primarily in response to this decentralized process, we performed audits at 25 agencies of the primary government, including the five pension systems and the Illinois State Board of Investment. During these audits, we noted deficiencies that were either material weaknesses or significant deficiencies related to the internal controls over the financial reporting process.

A *material weakness* is a deficiency, or a combination of deficiencies, in internal control over financial reporting, 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 over financial reporting that is less severe than a material weakness yet important enough to merit attention by those charged with governance.

The chart below summarizes the number of material weaknesses and significant deficiencies we reported for each agency.

Agency	**Material Weaknesses**	**Significant Deficiencies**	**Combined Total**
Secretary of State	1	0	1
Office of the Treasurer – Fiscal Officer	0	1	1
Office of the Treasurer – Illinois Funds	0	2	2
Office of the Treasurer – College Savings Program	1	1	2
Office of the Treasurer – Illinois ABLE Program	1	0	1
Department of Central Management Services	1	0	1
Department of Employment Security	0	1	1
Department of the Lottery	1	1	2
Department of Human Services	5	1	6
Department of Healthcare and Family Services	8	0	8
Department of Human Services and Department of Healthcare and Family Services *	4	1	5
Department of Revenue	1	1	2
Environmental Protection Agency	0	1	1
Illinois State Board of Investment	1	0	1
Illinois Gaming Board	0	1	1
State Board of Education	1	0	1
Total	25	11	36

**Five findings were reported in both the Department of Human Services' and the Department of Healthcare and Family Services' departmental financial audit reports.*

Specifically, some of the more significant issues noted by the auditors included the following:

- The Department of Human Services (DHS) and the Department of Healthcare and Family Services (DHFS) (Departments) lacked controls over the Integrated Eligibility System (IES). IES is utilized for the intake of applications and the determination of eligibility for the State's human services programs. As of June 30, 2017, the Departments had incurred a backlog of 74,649 applications that were more than 45 days old, with the oldest application dating back to November 19, 2014 (DHS Finding 2017-007 and DHFS Finding 2017-006). In addition, IES programmers' access rights had not been properly restricted from making changes to IES (DHS Finding 2017-010 and DHFS Finding 2017-009). Further, the Departments were unable to provide complete population records of servers in which IES resides for the auditors to determine security controls over the servers (DHS Finding 2017-011 and DHFS Finding 2017-010).

- The DHFS failed to implement adequate fiscal-related monitoring controls over Managed Care Organization (MCO) contracts. In addition, the DHFS failed to exercise or enforce fiscal-related monitoring controls as provided for in the various MCO contracts (DHFS Finding 2017-001). The DHFS did not calculate the annual Medical Loss Ratios (MLRs) of the State's MCOs for mandatory enrollment for Coverage Years 2013, 2014, and 2015. As a result, the DHFS did not seek and collect an estimated $65 million in potential refunds due back from the MCOs to the State (DHFS Finding 2017-002). Further, the DHFS made payments to MCOs using incorrect rates (DHFS Finding 2017-004) and made incorrect claim payments to medical providers and MCOs (DHFS Finding 2017-005).

- The Office of the Treasurer, College Savings Program (Office) did not have an adequate process to identify and eliminate intra-fund activity within its financial statements. As a result, the Statement of Changes in Fiduciary Net Position overstated Participant Program Contributions and Participant Program Distributions by $3.59 billion and $1.69 billion for the fiscal years ended June 30, 2017 and 2016, respectively (Office Finding 2017-001). This adjustment was for the elimination of intra-fund activity and had no effect on net position.

Details of all material weaknesses and significant deficiencies are reported in each agency's financial audit for the year ended June 30, 2017 (reports are available on the Auditor General's website). Material weaknesses and significant deficiencies further extend financial reporting timelines since additional measurements and reporting are required. Completion or substantial completion of these audits is necessary for the Auditor General to issue an opinion on the State's basic financial statements.

In addition to the deficiencies noted above, we identified misstatements during the audit process. The following chart indicates audit adjustments/reclassifications identified during our testing.

Opinion Unit	Amount (in thousands)	Responsible Agency
Aggregate Remaining Fund Information	$89,046*	Department of the Lottery
Aggregate Remaining Fund Information	$2,231	Department of Central Management Services
Aggregate Remaining Fund Information	$181,694*	Office of the State Comptroller – Statewide Reporting
Aggregate Remaining Fund Information	$3,592,139*	Office of the Treasurer – College Savings Program

**Represents a reclassification entry with no effect on net position.*

Furthermore, the Office of the State Comptroller did not follow its Statewide financial reporting policies and procedures in the preparation of Footnote 15 of the Comprehensive Annual Financial Report (CAFR). As a result, the amounts reported as prior year defeased debt in Table 15-3 of the CAFR's Footnote 15 were overstated for both the primary government and major component units by $273.1 million and $381.1 million, respectively. The correction of the amounts reported in this table had no effect on the financial statements.

The State's decentralized reporting system and related decentralized internal control system are not adequate to reduce the likelihood that a material misstatement of the State's financial statements could occur and not be detected during the normal course of business. Audit adjustments were routinely identified for the primary government's State agencies required to prepare financial statements that were not deemed material by agency management and were not posted to the financial statements. In working with the Office of the State Comptroller to finalize the State's financial statements, it is necessary to accumulate all of the uncorrected adjustments and evaluate these adjustments in total to ensure that they do not materially misstate the State's financial statements. Because of the volume of these passed adjustments, there is a continual risk that the State's financial statements could potentially be materially misstated until this accumulation and evaluation process is completed. In addition, these uncorrected adjustments require continued accumulation and evaluation in the subsequent year.

The Office of the Governor's management stated the weaknesses are due to the lack of Statewide accounting and grants management systems. The State currently has more than 170 disparate accounting systems; this condition hinders the State's ability to implement standardized internal controls and business processes to ensure accurate and timely preparation of financial statements. This is compounded by the lack of personnel adequately trained in governmental accounting and federal grant reporting. The lack of adequate financial and grants management personnel is due in part to a failure to update the qualifications in the respective job titles to ensure that applicants have the minimum required education and skill sets to be properly trained.

The Office of the State Comptroller's management stated the misstatements at the departmental level were caused by a lack of sufficient internal control processes in State agencies for the accumulation and reporting of financial information used to prepare the financial statements. The Office of the State Comptroller has the statutory authority to develop and prescribe accounting policies for the State but does not have the statutory authority to monitor adherence to these policies as performed by State agencies.

In accordance with the Fiscal Control and Internal Auditing Act (30 ILCS 10/1002), each State agency's chief executive officer maintains statutory responsibility for the establishment and continuous monitoring of the internal control function for accounting and other operating policies of the officer's agency. (Finding Code No. 2017-002, 2016-002, 2015-002, 2014-002, 2013-002, 12-2, 11-2, 10-2, 09-1, 08-1, 07-1, 06-1, 05-1, 04-1, 03-1, 02-1)

RECOMMENDATION

We recommend the State continue its 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.

AGENCY RESPONSES

Office of the Governor:

The Office of the Governor concurs with the auditor's finding and recommendation. The Office of the Governor will work with the Office of the State Comptroller to continue efforts to improve internal control procedures to reduce the likelihood of material misstatements to the financial statements. Both Offices are in the midst of a multi-year implementation of an Enterprise Resource Planning (ERP) system to develop an integrated enterprise-wide application system for financials, which is an aspect of the Governor's Executive Order that created the Illinois Department of Innovation and Technology to transform Illinois' IT systems to be more responsive to State employees and taxpayers. An operational ERP system will improve the State's control environment and processes to assess the risk of material misstatements to the financial statements and to identify such misstatements during the financial statement preparation process.

Office of the State Comptroller:

The Office of the State Comptroller accepts the recommendation. The Office of the State Comptroller will continue to assist the Governor's Office in their efforts to increase the quality of GAAP packages by providing enhanced training and technical assistance to State agencies.

2017-003. **FINDING** (Late Payment of Statutorily Mandated Transfers)

The Office of the State Comptroller (Comptroller) did not make all statutorily mandated transfers between State funds within established timeframes, as required.

The Comptroller had a system in place to identify and record inter-fund transfers it was required to make. During the fiscal year ended June 30, 2017, the Comptroller timely recorded within the Statewide Accounting Management System (SAMS) the receivables and related payables for transfers of money in the State Treasury to be made between the State of Illinois' funds. However, not all transfers were made timely. During Fiscal Year 2017, we noted 472 transfers between State funds that were made greater than 30 days after the statutorily mandated transfer date. Transfers that were made between one and 30 days after the statutorily mandated transfer date were excluded from the information provided in the following table. The following summary concerning late payment of statutorily mandated transfers highlights the delays in making such transfers in Fiscal Year 2017 compared to Fiscal Year 2016 and Fiscal Year 2015:

	Fiscal Year 2017	Fiscal Year 2016	Fiscal Year 2015
• Number of late transfers	472 transfers (360 from GRF)	468 transfers (360 from GRF)	475 transfers (373 from GRF)
• Range of days transfers were late	31 to 479 days*	31 to 449 days*	31 to 459 days*
• Total volume of late transfers, in dollars	$3.31 billion ($2.58 billion from GRF)	$3.37 billion ($2.64 billion from GRF)	$3.36 billion ($2.60 billion from GRF)
• Late transfers outstanding as of and paid after June 30	$2.14 billion ($1.42 billion from GRF)	$1.51 billion ($808 million from GRF)	$1.64 billion ($894 million from GRF)

**This analysis was prepared as of October 23, 2017, October 31, 2016, and November 2, 2015, for Fiscal Year 2017, Fiscal Year 2016, and Fiscal Year 2015, respectively. Some transfers were completed after these dates.*

Further, the following table contains the number and amount of late transfers still outstanding as of October 23, 2017, relating to Fiscal Year 2016 and Fiscal Year 2015.

	Fiscal Year 2016	Fiscal Year 2015
Number of late transfers outstanding as of 10/23/2017	184	1
Amount of late transfers outstanding as of 10/23/2017	$906 million	$30 million

The transfers noted above are mandated by various State statutes that contain the required funds, amounts, and timeline.

Comptroller management stated, as it did during the prior examinations, that the late payment of transfers occurred because of cash management decisions and prioritization that was required due to the lack of available cash in the State Treasury. Further, some statutory provisions relating to transfers contain language such as "as soon as practicable" or "as soon as possible" which management feels should give them more time to complete the transfers. Comptroller management stated that approximately 105 (all from GRF) of the Fiscal Year 2017 transfers totaling $913 million contained this type of language.

Failure to make inter-fund transfers within applicable timeframes represents noncompliance with State law and untimely transfers of monies may have delayed the receiving fund's use of appropriated funds. (Finding Code No. 2017-003, 2016-003, 2015-003, 2014-003, 2013-003, 12-3, 11-3, 10-3, 09-3)

RECOMMENDATION

We recommend the Office of the State Comptroller make transfers within timeframes established by applicable statute. While we realize that lack of available funds in the State Treasury requires prioritization and cash management decisions, we recommend the Office of the State Comptroller continue in its efforts to make transfers in as timely a manner as possible.

AGENCY RESPONSE

Office of the State Comptroller:

> The Office of the State Comptroller accepts the recommendation. Taking into account the financial condition of State funds facing at times a $16 billion bill backlog, the Office of the State Comptroller will continue in its efforts to make the required transfers to the extent possible given all the competing payments from limited resources in the State treasury.

2017-004. **FINDING** (Debt Covenant Violation)

The Illinois Student Assistance Commission (Commission) (Illinois Designated Account Purchase Program) was not in compliance with one of the covenants relating to the Commission's revolving line of credit agreement.

During the audit of Fiscal Year 2017 financial statements, the Illinois Designated Account Purchase Program (IDAPP) was in violation of one of the debt covenants related to the Commission's revolving credit (loan) agreement. In addition, the Three-Year Asset Backed Revolving Credit Facility (Facility) matured on July 27, 2010, and has not been repaid. Per the agreement, the default ratio is set at a maximum three-month rolling average of 5.0% or a maximum of 6.25% for any settlement period. We reviewed the monthly reports noting that eight of these months rose above at least one of these ratios, ranging from 5.54% to 7.88% for the three-month average and 6.48% to 9.73% for the settlement period.

As a result of the debt covenant violation and the maturity of the facility, the bank has certain remedies available to it under the terms of the loan agreement, principal of which would be rights to call the loan and take possession of the collateral (the underlying student loan portfolio). The bank has been made aware of the default ratio issues and the maturity of the loan and has not communicated to IDAPP any intent to exercise the remedies available to it under the terms of the loan agreement. The balance of the line of credit with the bank was $135,456,827 at June 30, 2017.

According to Commission management, the default ratio issues are due to the poor performance of the portfolio. The portfolio continues to experience a high level of delinquent accounts. The line of credit has not been refinanced because of the conditions in the private loan credit market.

As a result of the violation, the bank may have certain remedies under the terms of the loan agreement, principal of which would be the right to call the loan and take possession of the collateral (the underlying student loan portfolio of IDAPP). (Finding Code No. 2017-004, 2016-004, 2015-004, 2014-004, 2013-004, 12-4, 11-4, 10-6, 09-3)

RECOMMENDATION

We recommend IDAPP continue to monitor the loan covenant violations and continue seeking remedies from the lender involved.

AGENCY RESPONSE

Office of the Governor:

The Office of the Governor concurs with the auditor's recommendation. We will work with the Commission to continue to monitor the loan covenant violations and continue seeking remedies from the lender involved.

2017-005. **FINDING** (Insufficient Controls over Finances)

The State of Illinois did not have sufficient controls over its finances. This condition increases the risk that liabilities will not be properly recorded. Further, this condition increases risk and diminishes the oversight and authority of the budgeting and appropriation process. We noted the following during our audit of the State's financial statements.

As disclosed in Footnote 19 B, the State had transactions, totaling $10.876 billion, on hand at June 30, 2017, 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 $7.435 billion was owed to external parties; the remaining balance was related to intra-governmental transactions and statutorily mandated transfers. The external parties include State vendors, State Universities, local schools, and local governments. The majority of these "held-payments" were payable from the General Revenue Fund.

The State's inadequate financial reporting process as described in Finding 2017-001 was designed in 1981 under the assumption that cash payments would be made at the time the expenditures were processed by the Comptroller. Since this was not the case at year end, extra effort was required by the accountants and the auditors to ensure the "held-payments" were appropriately accounted for. In addition, due to the State not being able to pay external vendors in a timely manner, the State paid (on a cash basis) approximately $226.381 million in interest payments during Fiscal Year 2017, and the State has paid an additional $579.761 million during Fiscal Year 2018 as of March 15, 2018.

Economic conditions and the lack of a timely approved budget, as well as years of unbalanced budgets, appear to be the cause of the above condition.

Sound business practices require the State to have adequate controls over its finances and budget process. (Finding Code No. 2017-005, 2016-005, 2015-005, 2014-005, 2013-005, 12-5, 11-5, 10-7)

RECOMMENDATION

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

AGENCY RESPONSE

Office of the Governor:

The Office of the Governor concurs with the auditor's finding and recommendation. The Office of the Governor will work with the General Assembly, the Office of the

State Comptroller and the Office of the State Treasurer to improve the State's control over finances to eliminate significant payment delays and unnecessary interest payments to State vendors.