

**STATE OF ILLINOIS
DEPARTMENT OF HEALTHCARE AND FAMILY SERVICES
LOCAL GOVERNMENT HEALTH INSURANCE RESERVE FUND**

**FINANCIAL AUDIT
For the Year Ended June 30, 2012**

STATE OF ILLINOIS
DEPARTMENT OF HEALTHCARE AND FAMILY SERVICES
LOCAL GOVERNMENT HEALTH INSURANCE RESERVE FUND
FINANCIAL AUDIT
For the Year Ended June 30, 2012

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AGENCY OFFICIALS

Director	Julie Hamos
Assistant Director	Sharron Matthews
General Counsel	Jeanette Badrov
Inspector General	John C. Allen (07/01/11 – 10/31/11) Bradley Hart (11/01/11 – Current)
Division of Finance, Administrator	Vacant (07/01/11 – 08/31/11) Frank Kopel (09/01/11 – 12/31/12) Vacant (1/1/13 - 2/28/13) Michael Casey (3/1/13 - Current)
Office of Fiscal Management, Chief	Jack Dodds

Department of Healthcare and Family Services offices are located at:

201 South Grand Avenue East
Springfield, IL 62763

2200 Churchill Road
Springfield, IL 62702

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FINANCIAL STATEMENT REPORT

SUMMARY

The audit of the accompanying financial statements of the Illinois Department of Healthcare and Family Services' Local Government Health Insurance Reserve Fund was performed by the Office of the Auditor General.

Based on their audit, the auditors expressed an unqualified opinion on the Local Government Health Insurance Reserve Fund's financial statements.

EXIT CONFERENCE

The Department waived an exit conference in correspondence dated March 18, 2013.

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CHICAGO OFFICE:

MICHAEL A. BILANDIC BLDG. • SUITE S-900
160 NORTH LASALLE • 60601-3103
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FAX: 312/814-4006

OFFICE OF THE AUDITOR GENERAL
WILLIAM G. HOLLAND

INDEPENDENT AUDITORS' REPORT

Honorable William G. Holland
Auditor General
State of Illinois

We have audited the accompanying financial statements of the Local Government Health Insurance Reserve Fund of the State of Illinois, Department of Healthcare and Family Services, as of and for the year ended June 30, 2012, as listed in the table of contents. These financial statements are the responsibility of the State of Illinois, Department of Healthcare and Family Services' management. 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 of material misstatement. An audit includes consideration of internal control over financial reporting as a basis for designing audit procedures that are appropriate for the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the State of Illinois, Department of Healthcare and Family Services' internal control over financial reporting. Accordingly, we express no such opinion. An audit also includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and the significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audit provides a reasonable basis for our opinion.

As discussed in Note 2, the financial statements present only the Local Government Health Insurance Reserve Fund and do not purport to, and do not, present fairly the financial position of the State of Illinois, Department of Healthcare and Family Services as of June 30, 2012, and its changes in financial position and cash flows for the year then ended in conformity with accounting principles generally accepted in the United States of America.

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of the Local Government Health Insurance Reserve Fund of the State of Illinois, Department of Healthcare and Family Services, as of June 30, 2012, and the changes in its financial

position and its cash flows thereof for the year then ended in conformity with accounting principles generally accepted in the United States of America.

In accordance with *Government Auditing Standards*, we have also issued a report dated March 29, 2013 on our consideration of the State of Illinois, Department of Healthcare and Family Services' internal control over financial reporting of the Local Government Health Insurance Reserve Fund and on our tests of the State of Illinois, Department of Healthcare and Family Services' 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* and should be considered in assessing the results of our audit.

Accounting principles generally accepted in the United States of America require that the Schedule of Claims for the Ten Years Ended June 30, 2012 on page 18 be presented to supplement the fund financial statements. Such information, although not a part of the financial statements of the Local Government Health Insurance Reserve Fund is required by the Governmental Accounting Standards Board who considers it to be an essential part of financial reporting for placing the fund 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 fund financial statements, and other knowledge we obtained during our audit of the fund 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 Local Government Health Insurance Reserve Fund that accounting principles generally accepted in the United States of America require to be presented to supplement the fund financial statements. Such missing information, although not a part of the fund financial statements, is required by the Governmental Accounting Standards Board who considers it to be an essential part of the financial reporting for placing the fund financial statements in an appropriate operational, economic, or historical context. Our opinion on the fund financial statements is not affected by this missing information.



Bruce L. Bullard, CPA

Director of Financial and Compliance Audits

March 29, 2013

STATE OF ILLINOIS
DEPARTMENT OF HEALTHCARE AND FAMILY SERVICES
LOCAL GOVERNMENT HEALTH INSURANCE RESERVE FUND
STATEMENT OF NET ASSETS
June 30, 2012

(Expressed in Thousands)

ASSETS

Cash equity with State Treasurer	\$ 5,036
Cash and cash equivalents	2,159
Securities lending collateral equity with State Treasurer	2,339
Due from other government - federal	27
Due from other government - local	147
Other receivables, net	259
Total current assets	9,967
 Capital assets being depreciated, net	-
Total assets	9,967

LIABILITIES

Accounts payable and accrued liabilities	6,934
Due to other government - federal	3
Due to other Department funds	8
Due to other State funds	37
Unearned Revenue	47
Obligations under securities lending of State Treasurer	2,339
Total current liabilities	9,368
 Noncurrent portion of long-term obligations	109
Total liabilities	9,477

NET ASSETS

Invested in capital assets	-
Unrestricted	490
Total net assets	\$ 490

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

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**STATEMENT OF REVENUES, EXPENSES
AND CHANGES IN FUND NET ASSETS**
For the Year Ended June 30, 2012

(Expressed in Thousands)

OPERATING REVENUES	
Charges for sales and services	\$ 45,773
Total operating revenues	45,773
 OPERATING EXPENSES	
Benefit payments and refunds	41,189
Interest expense	175
General and administrative	2,378
Total operating expenses	43,742
Operating income (loss)	2,031
 NONOPERATING REVENUES (EXPENSES)	
Interest and investment income	22
Other revenues	107
Change in net assets	2,160
Net assets, July 1, 2011	(1,670)
NET ASSETS, JUNE 30, 2012	\$ 490

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

STATE OF ILLINOIS
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STATEMENT OF CASH FLOWS
For the Year Ended June 30, 2012

(Expressed in Thousands)

CASH FLOWS FROM OPERATING ACTIVITIES:	
Cash received from sales and services	\$ 45,760
Cash payments to suppliers for goods and services	(43,684)
Cash payments to employees for services	(1,223)
Cash receipts from other operating activities	827
Net cash provided (used) by operating activities	<u>1,680</u>
CASH FLOWS FROM NONCAPITAL FINANCING ACTIVITIES:	
Operating grants received	<u>106</u>
Net cash provided (used) by noncapital financing activities	<u>106</u>
CASH FLOWS FROM CAPITAL AND RELATED FINANCING ACTIVITIES:	
Acquisition and construction of capital assets	<u>-</u>
Net cash (used) by capital and related financing activities	<u>-</u>
CASH FLOWS FROM INVESTING ACTIVITIES:	
Interest and dividends on investments	<u>21</u>
Net cash provided (used) by investing activities	<u>21</u>
Net increase (decrease) in cash and cash equivalents	1,807
Cash and cash equivalents, July 1, 2011	5,388
CASH AND CASH EQUIVALENTS, JUNE 30, 2012	<u>\$ 7,195</u>
Reconciliation of cash and cash equivalents to the Statement of Net Assets:	
Total cash and cash equivalents per the Statement of Net Assets	\$ 2,159
Add: cash equity with State Treasurer	5,036
CASH AND CASH EQUIVALENTS, JUNE 30, 2012	<u>\$ 7,195</u>
Reconciliation of operating income (loss) to net cash provided (used) by operating activities:	
OPERATING INCOME (LOSS)	<u>\$ 2,031</u>
Adjustments to reconcile operating income (loss) to net cash provided (used) by operating activities:	
Changes in assets and liabilities:	
(Increase) decrease in accounts receivable	(36)
(Increase) decrease in intergovernmental receivables	(18)
Increase (decrease) in accounts payable and accrued liabilities	(313)
Increase (decrease) in intergovernmental payables	1
Increase (decrease) in due to other funds	(3)
Increase (decrease) in deferred revenues	4
Increase (decrease) in other liabilities	14
Total adjustments	<u>(351)</u>
NET CASH PROVIDED (USED) BY OPERATING ACTIVITIES	<u>\$ 1,680</u>

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

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NOTES TO THE FINANCIAL STATEMENTS
June 30, 2012

1) Organization

The Local Government Health Insurance Reserve Fund (LGHIRF) was established to provide health and dental insurance to participating local governmental entities. The fund is part of the primary government of the State of Illinois. The Department of Healthcare and Family Services (Department) is responsible for the financial reporting of the fund.

As of June 30, 2012, there were 370 local governmental entities participating with approximately 3,195 employees, 2,087 dependents and 202 retirees covered. Each participating local governmental unit is required to enter into a written agreement with the Department of Central Management Services (DCMS). The agreement sets forth the responsibilities of both parties. The Department works in conjunction with DCMS to administer the Local Government Health Plan.

The responsibilities required of the DCMS are:

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

The responsibilities required of the Department of Healthcare and Family Services are:

- Establishment of the Local Government Health Insurance Reserve Fund
- Processing and paying authorized claims

The responsibilities required of the local governmental units are:

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

2) Summary of Significant Accounting Policies

a) Financial Reporting Entity

As defined by Generally Accepted Accounting Principles (GAAP), the financial reporting entity consists of a primary government, as well as its component units, which

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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.

Based upon the required criteria, the Local Government Health Insurance Reserve Fund has no component units and is not a component unit of any other entity. However, because the Local Government Health Insurance Reserve Fund is not legally separate from the State of Illinois, the financial statements of the Local Government Health Insurance Reserve Fund are included in the financial statements of the State of Illinois as a nonmajor enterprise fund. The State of Illinois' Comprehensive Annual Financial Report may be obtained by writing to the State Comptroller's Office, Division of Financial Reporting, 325 West Adams Street, Springfield, Illinois, 62704-1871.

b) Basis of Presentation

The financial statements present only the Local Government Health Insurance Reserve Fund administered by the State of Illinois, Department of Healthcare and Family Services. They are intended to present the financial position, the changes in financial position, and the cash flows of only the Local Government Health Insurance Reserve Fund. They do not purport to, and do not present fairly, the financial position of the State of Illinois or the Department of Healthcare and Family Services as of June 30, 2012, and the changes in financial position and cash flows for the year ended in conformity with accounting principles generally accepted in the United States of America.

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

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

Private-sector standards of accounting and financial reporting issued prior to December 1, 1989, generally are followed in the proprietary fund financial statements to the extent that those standards do not conflict with or contradict guidance of the Governmental Accounting Standards Board. The Department has elected not to follow subsequent private-sector guidance as it relates to the LGHIRF's operations.

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

c) 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.

d) Investments

Investments are reported at fair value.

e) Capital Assets

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

Capitalization thresholds and the estimated useful lives are as follows:

Capital Asset Category	Capitalization Threshold	Estimated Useful Life (in years)
Equipment	\$5,000	3-10 years

f) Compensated Absences

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

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Legislation that became effective January 1, 1998, capped the paid sick leave for all State Employees' Retirement System members at December 31, 1997. Employees continue to accrue twelve sick days per year, but will not receive monetary compensation for any additional time earned after December 31, 1997. Sick days earned between 1984 and December 31, 1997, (with a 50% cash value) would only be used after all days with no cash value are depleted. Any sick days earned and unused after December 31, 1997, will be converted to service time for purposes of calculating employee pension benefits.

g) Use of Estimates

The preparation of financial statements in conformity with Generally Accepted Accounting Principles (GAAP) requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.

h) Health Benefits Claims Processing

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

3) Deposits and Investments

a) Deposits

The State Treasurer is the custodian of the State's cash and cash equivalents for funds maintained in the State Treasury. Deposits in the custody of the State Treasurer are pooled and invested with other State funds in accordance with the Deposit of State Moneys Act of the Illinois Compiled Statutes (15 ILCS 520/11). Funds held by the State Treasurer have not been categorized as to credit risk because the Department does not own individual securities. Detail on the nature of these deposits and investments is available within the State of Illinois' Comprehensive Annual Financial Report.

Cash on deposit with the State Treasurer totaled \$5,036 thousand and cash on deposit for funds held outside the State Treasurer totaled \$17 thousand at June 30, 2012.

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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, 2012, the Department had the following investments outside of the State Treasury:

	Fair Value (Thousands)	Weighted Average Maturity (Years)
Illinois Public Treasurers’ Investment Pool	<u>\$2,142</u>	0.069
Total fixed income investments	<u>\$2,142</u>	

Interest Rate Risk: 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: The Department does not have a formal investment policy that limits investment choices. The Illinois Public Treasurers’ Investment Pool was rated AAAM by Standard & Poor’s.

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4) Capital Assets

Capital Asset Activity (amounts expressed in thousands) for the year ended June 30, 2012 is as follows:

	Balance July 1, 2011	Additions	Deletions	Net Transfers	Balance June 30, 2012
Capital assets being depreciated:					
Equipment	\$ 9	\$ -	\$ -	\$ -	\$ 9
Less accumulated depreciation:					
Equipment	9	-	-	-	9
Total capital assets being depreciated, net	<u>\$ -</u>	<u>\$ -</u>	<u>\$ -</u>	<u>\$ -</u>	<u>\$ -</u>

5) Long-Term Obligations

Changes in long-term obligations (amounts expressed in thousands) for the year ended June 30, 2012 were as follows:

	Balance July 1, 2011	Additions	Deletions	Balance June 30, 2012	Amounts Due Within One Year
Compensated Absences	\$ 95	\$ 73	\$ (59)	\$ 109	\$ -
Total	<u>\$ 95</u>	<u>\$ 73</u>	<u>\$ (59)</u>	<u>\$ 109</u>	<u>\$ -</u>

6) Risk Pool Disclosure

The LGHIRF had previously contracted with third party reinsurers for reinsurance coverage. However, no such coverage was in place for the year ended June 30, 2012.

The basis used in calculating the estimated liability for future claims is based on claims reported but not paid during the fiscal year plus an estimate of claims incurred but not reported (IBNR). The estimate for claims incurred but not reported was calculated using a factor based on historical experience stated as a percentage of claims reported vs. total claims incurred during the policy cycle. The estimated ultimate cost of settling the claims includes the effect of inflation and other societal and economic factors. For the year ended June 30, 2012, all claims are paid on a two-year claim cycle.

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Based on the above method, the liability for future claims (amounts expressed in thousands) at June 30, 2012 is as follows:

Claims incurred and reported but not paid as of June 30	\$4,672
Estimated liability for claims incurred but not reported	<u>2,087</u>
Total estimated liability for future claims	<u><u>\$6,759</u></u>

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

Payments made for benefit claims	\$41,580
Less: liability for unpaid claims, beginning of year	<u>7,150</u>
Subtotal	34,430
Add: liability for unpaid claims, end of year	<u>6,759</u>
Total benefit claim payments and refunds	<u><u>\$41,189</u></u>

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

	Healthcare Claims	
	2012	2011
Unpaid claims and claim adjustment expense at beginning of year	\$ 7,150	\$ 3,435
Incurred claim and adjustment expenses:		
Provision for insured claims of the current year	46,768	54,050
Decrease in provisions for claims of prior year	(5,579)	(1,261)
Total incurred claims and claim adjustments	\$41,189	\$52,789
Payments:		
Claims and claim adjustment expense attributable to claims of the current year	\$40,009	\$46,900
Claims and claim adjustment expense attributable to claims of prior year	1,571	2,174
Total Payment	\$41,580	\$49,074
Total unpaid claims and claim adjustments expense at end of year	\$ 6,759	\$ 7,150

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7) Pension Plan

The vested full-time employees paid from the Local Government Health Insurance Reserve Fund 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 2012 are included in the State of Illinois' Comprehensive Annual Financial Report (CAFR) for the year ended June 30, 2012. 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 2012, the employer contribution rate was 34.190%. 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 of Healthcare and Family Services along with the Department of Central Management Services. 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

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retired prior to January 1, 1998, and who are vested in the State Employee's Retirement System do not contribute towards health, dental, and vision benefits. For annuitants who retired on or after January 1, 1998, the annuitant's contribution amount is reduced five percent for each year of credited service with the State allowing those annuitants with twenty or more years of credited service to not have to contribute towards health, dental, and vision benefits. Annuitants also receive life insurance coverage equal to the annual salary of the last day of employment until age 60, at which time the benefit becomes \$5,000.

The total cost of the State's portion of health, dental, vision, and life insurance benefits of all members, including post-employment health, dental, vision, and life insurance benefits, is recognized as an expense by the State in the Illinois Comprehensive Annual Financial Report. The State finances the costs on a pay-as-you-go basis. The total costs incurred for health, dental, vision, and life insurance benefits are not separated by department or component unit for annuitants and their dependents nor active employees and their dependents.

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 Healthcare and Family Services. A copy of the financial statements of the Department of Healthcare and Family Services may be obtained by writing to the Department of Healthcare and Family Services, 201 South Grand Ave., Springfield, Illinois, 62763-3838.

9) 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.

10) 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 years 2012 and 2011, Deutsche Bank Group lent U.S. Treasury and U.S. agency 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 aggregated market

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value of the loaned securities. Loans are marked to market daily. If the market value of collateral falls below 100%, the borrower must provide additional collateral to raise the market value to 100%.

The State Treasurer did not impose any restrictions during fiscal years 2012 and 2011 on the amount of the loans available or the eligible securities. 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 the 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 2012 and 2011 resulting from a default of the borrowers or Deutsche Bank Group.

During fiscal years 2012 and 2011, 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 the 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 the 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, 2012 were \$4,556,511,251 and \$4,551,829,732, 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, 2011 were \$3,456,373,500 and \$3,446,138,880, respectively.

In accordance with GASB Statement No. 28, paragraph 9, the Office of the State Treasurer has allocated the assets and obligations at June 30, 2012 arising from securities lending agreements to the various funds of the State. The total allocated to the Local Government Health Insurance Reserve Fund at June 30, 2012 was \$2,339 thousand.

11) Transfer of Administration of Funds to Other State Agency

Per the Governor's Executive Order 12-01, the Department's respective powers, duties, rights and responsibilities related to the Local Government Health Insurance program are transferred to the Department of Central Management Services as of July 1, 2012.

STATE OF ILLINOIS
DEPARTMENT OF HEALTHCARE AND FAMILY SERVICES
LOCAL GOVERNMENT HEALTH INSURANCE RESERVE FUND
SCHEDULE OF CLAIMS FOR ACTIVE EMPLOYEES
For the Ten Years Ended June 30, 2012

DEVELOPMENT INFORMATION

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

The following information for the ten fiscal years ended June 30, 2012.

	2012	2011	2010	2009	2008	2007	2006	2005	2004	2003
Net earned required contribution and investment revenue:										
Earned	\$ 45,795	\$ 52,612	\$ 53,060	\$ 54,999	\$ 60,924	\$ 64,261	\$ 67,074	\$ 67,876	\$ 72,400	\$ 81,854
Ceded	-	-	-	-	-	-	-	-	-	-
Net earned revenue	<u>45,795</u>	<u>52,612</u>	<u>53,060</u>	<u>54,999</u>	<u>60,924</u>	<u>64,261</u>	<u>67,074</u>	<u>67,876</u>	<u>72,400</u>	<u>81,854</u>
Unallocated expenses	<u>2,553</u>	<u>2,004</u>	<u>1,934</u>	<u>3,073</u>	<u>901</u>	<u>1,869</u>	<u>835</u>	<u>2,799</u>	<u>2,796</u>	<u>785</u>
Estimated incurred claims and expenses, end of the policy year:										
Incurred	46,768	54,050	57,236	56,615	61,044	61,423	68,778	75,003	74,749	69,914
Ceded	-	-	-	-	-	-	-	-	-	-
Net incurred claims	<u>46,768</u>	<u>54,050</u>	<u>57,236</u>	<u>56,615</u>	<u>61,044</u>	<u>61,423</u>	<u>68,778</u>	<u>75,003</u>	<u>74,749</u>	<u>69,914</u>
Paid (cumulative) as of:										
End of policy year	<u>40,009</u>	<u>46,900</u>	<u>53,801</u>	<u>53,450</u>	<u>56,830</u>	<u>57,021</u>	<u>63,274</u>	<u>67,053</u>	<u>64,416</u>	<u>58,355</u>
One year later		<u>48,471</u>	<u>55,975</u>	<u>55,042</u>	<u>58,980</u>	<u>60,692</u>	<u>67,002</u>	<u>70,891</u>	<u>67,833</u>	<u>63,399</u>
Two years later			<u>55,975</u>	<u>55,042</u>	<u>58,980</u>	<u>60,692</u>	<u>67,002</u>	<u>70,891</u>	<u>67,833</u>	<u>63,399</u>
Three years later				<u>55,042</u>	<u>58,980</u>	<u>60,692</u>	<u>67,002</u>	<u>70,891</u>	<u>67,833</u>	<u>63,399</u>
Four years later					<u>58,980</u>	<u>60,692</u>	<u>67,002</u>	<u>70,891</u>	<u>67,833</u>	<u>63,399</u>
Five years later						<u>60,692</u>	<u>67,002</u>	<u>70,891</u>	<u>67,833</u>	<u>63,399</u>
Six years later							<u>67,002</u>	<u>70,891</u>	<u>67,833</u>	<u>63,399</u>
Seven years later								<u>70,891</u>	<u>67,833</u>	<u>63,399</u>
Eight years later									<u>67,833</u>	<u>63,399</u>
Nine years later										<u>63,399</u>
Reestimated ceded losses and expenses	-	-	-	-	-	-	-	-	-	-
Reestimated incurred claims and expenses:										
End of policy year	<u>46,768</u>	<u>54,050</u>	<u>57,236</u>	<u>56,615</u>	<u>61,044</u>	<u>61,423</u>	<u>68,778</u>	<u>75,003</u>	<u>74,749</u>	<u>69,914</u>
One year later		<u>48,471</u>	<u>55,975</u>	<u>55,042</u>	<u>58,980</u>	<u>60,692</u>	<u>67,002</u>	<u>70,891</u>	<u>67,833</u>	<u>63,399</u>
Two years later			<u>55,975</u>	<u>55,042</u>	<u>58,980</u>	<u>60,692</u>	<u>67,002</u>	<u>70,891</u>	<u>67,833</u>	<u>63,399</u>
Three years later				<u>55,042</u>	<u>58,980</u>	<u>60,692</u>	<u>67,002</u>	<u>70,891</u>	<u>67,833</u>	<u>63,399</u>
Four years later					<u>58,980</u>	<u>60,692</u>	<u>67,002</u>	<u>70,891</u>	<u>67,833</u>	<u>63,399</u>
Five years later						<u>60,692</u>	<u>67,002</u>	<u>70,891</u>	<u>67,833</u>	<u>63,399</u>
Six years later							<u>67,002</u>	<u>70,891</u>	<u>67,833</u>	<u>63,399</u>
Seven years later								<u>70,891</u>	<u>67,833</u>	<u>63,399</u>
Eight years later									<u>67,833</u>	<u>63,399</u>
Nine years later										<u>63,399</u>
Increase (decrease) in estimated incurred claims and expenses from end of policy year	<u>-</u>	<u>\$ (5,579)</u>	<u>\$ (1,261)</u>	<u>\$ (1,573)</u>	<u>\$ (2,064)</u>	<u>\$ (731)</u>	<u>\$ (1,776)</u>	<u>\$ (4,112)</u>	<u>\$ (6,916)</u>	<u>\$ (6,515)</u>

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OFFICE OF THE AUDITOR GENERAL
WILLIAM G. HOLLAND

INDEPENDENT AUDITORS' 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 William G. Holland
Auditor General
State of Illinois

We have audited the Local Government Health Insurance Reserve Fund of the State of Illinois, Department of Healthcare and Family Services, as of and for the year ended June 30, 2012, and have issued our report thereon dated March 29, 2013. 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.

Internal Control Over Financial Reporting

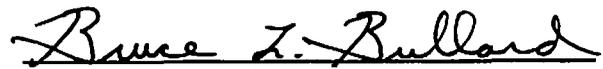
Management of the State of Illinois, Department of Healthcare and Family Services is responsible for establishing and maintaining effective internal control over financial reporting. In planning and performing our audit, we considered the State of Illinois, Department of Healthcare and Family Services' internal control over financial reporting of the Local Government Health Insurance Reserve Fund as a basis for designing our auditing procedures 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 Healthcare and Family Services' internal control over financial reporting. Accordingly, we do not express an opinion on the effectiveness of the State of Illinois, Department of Healthcare and Family Services' internal control over financial reporting.

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.

Our consideration of internal control over financial reporting was for the limited purpose described in the first paragraph of this section and was not designed to identify all deficiencies in internal control over financial reporting that might be deficiencies, significant deficiencies or material weaknesses. We did not identify any deficiencies in internal control over financial reporting of the Local Government Health Insurance Reserve Fund that we consider to be material weaknesses, as defined above.

Compliance and Other Matters

As part of obtaining reasonable assurance about whether the State of Illinois, Department of Healthcare and Family Services' Local Government Health Insurance Reserve Fund financial statements are free of 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*.



Bruce L. Bullard, CPA
Director of Financial and Compliance Audits

March 29, 2013

STATE OF ILLINOIS
DEPARTMENT OF HEALTHCARE AND FAMILY SERVICES
LOCAL GOVERNMENT HEALTH INSURANCE RESERVE FUND
PRIOR FINDINGS NOT REPEATED
For the Year Ended June 30, 2012

A. **FINDING** (Financial statement preparation)

In the prior year, the Illinois Department of Healthcare and Family Services' (Department) year-end financial reporting in accordance with generally accepted accounting principles to the Illinois Office of the Comptroller contained weaknesses and inaccuracies that could have materially misstated the Local Government Health Insurance Reserve Fund's (Fund) financial statements. Specifically, the Department did not correctly calculate accounts payable resulting in an adjustment totaling \$1.613 million to reduce accounts payable.

In the current year, the Department improved the process of financial reporting and during our testing of the year-end financial reporting we noted no weaknesses or inaccuracies that materially misstated the Fund's financial statements. (Finding Code No. 11-1)