

Note:

This report of the Illinois Workers' Compensation Commissions' Self-Insurers Security Fund (Fund) should be read in conjunction with the FY16 financial statements of the Fund and the auditor's report dated January 4, 2018.

In FY16, the auditors issued an adverse opinion on the Fund's financial statements due to the Commission having an inadequate process to determine the claims liabilities of the Fund, and because the proper accounting treatment for the insolvent self-insurer security collected by the State of Illinois is not determinable due to two different irreconcilable interpretations of the Worker's Compensation Act. Because of the adverse auditor opinion of the Fund's financial statements for the year ended June 30, 2016, the audit reports for the year ended prior to June 30, 2016 should not be relied upon without considering the auditor's report dated January 4, 2018.

**STATE OF ILLINOIS
WORKERS' COMPENSATION COMMISSION**

**FINANCIAL AUDIT
Self-Insurers' Security Fund
For the Year Ended June 30, 2010**

Performed as Special Assistant Auditors
for the Auditor General, State of Illinois

**STATE OF ILLINOIS
 WORKERS' COMPENSATION COMMISSION
 SELF-INSURERS' SECURITY NONSHARED - PROPRIETARY FUND
 FINANCIAL AUDIT
 For the Year Ended June 30, 2010**

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**STATE OF ILLINOIS
WORKERS' COMPENSATION COMMISSION**

AGENCY OFFICIALS

Chairman (03/22/10 to Current)	Mitch Weisz
Acting Chairman (11/21/08 to 03/22/10)	Amy Masters
Fiscal Officer	Carol Reckamp
Legal Counsel (10/01/85 to 02/28/10)	Kathryn Kelley
Assistant General Counsel (04/1/10 to Current)	Darrell Widen

Agency offices are located at:

James R. Thompson Center
100 W. Randolph Street, Suite 8-200
Chicago, Illinois 60601

4500 S. 6th Street Frontage Road
Springfield, Illinois 62703

202 N.E. Madison Avenue #201
Peoria, Illinois 61602

200 S. Wyman
Rockford, Illinois 61101

1014 Eastport Plaza Drive
Collinsville, Illinois 62234

**STATE OF ILLINOIS
WORKERS' COMPENSATION COMMISSION
SELF-INSURERS' SECURITY FUND**

FINANCIAL STATEMENT REPORT

SUMMARY

The audit of the accompanying financial statement of the Illinois Workers' Compensation Commission – Self-Insurers' Security Fund was performed by E.C. Ortiz & Co., LLP.

Based on their audit, the auditors expressed an unqualified opinion on the Self - Insurers' Security Fund's basic financial statements.

SUMMARY OF FINDINGS

The auditors identified matters involving the Agency's internal control over financial reporting that they considered to be a material weakness. The material weakness is described in the accompanying Schedule listed in the table of contents as finding 10-1, Improper Revenue Recognition.

EXIT CONFERENCE

The Commission waived having an exit conference in a letter dated December 10, 2010 from the Commission's Chairman, Mitch Weisz.

The Commission's response to the recommendation was provided by Carol Reckamp, Chief Fiscal Officer in correspondence dated December 10, 2010.



INDEPENDENT AUDITORS' REPORT

Honorable William G. Holland
Auditor General
State of Illinois

As Special Assistant Auditors for the Auditor General, we have audited the accompanying financial statements of the Self-Insurers' Security Fund of the State of Illinois Workers' Compensation Commission as of and for the year ended June 30, 2010, as listed in the table of contents. These financial statements are the responsibility of the State of Illinois Workers' Compensation Commission's 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 examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes 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 Self-Insurers' Security Fund and do not purport to, and do not, present fairly the financial position of the State of Illinois Workers' Compensation Commission as of June 30, 2010, 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 Self-Insurers' Security Fund of the State of Illinois Workers' Compensation Commission as of June 30, 2010, and the changes in financial position and cash flows, thereof for the year then ended in conformity with accounting principles generally accepted in the United States of America.

As discussed in Note 10, the financial statements have been restated as of July 1, 2009 to correct a prior year accounting error.

In accordance with *Government Auditing Standards*, we have also issued a report dated December 10, 2010 on our consideration of the State of Illinois Workers' Compensation Commission's internal control over financial reporting of the Self-Insurers' Security Fund and on our tests of the State of Illinois Workers' Compensation Commission's 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 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.

The State of Illinois Workers' Compensation Commission has not presented a management's discussion and analysis and budgetary comparison information for the Self-Insurers' Security Fund that accounting principles generally accepted in the United States of America has determined is necessary to supplement, although not required to be part of, the financial statements.

This report is intended solely for the information and use of the Auditor General, the General Assembly, the Legislative Audit Commission, the Governor, the Comptroller, and agency management, and is not intended to be and should not be used by anyone other than these specified parties.

E.C. Ortiz & Co., LLP
December 10, 2010

**STATE OF ILLINOIS
 WORKERS' COMPENSATION COMMISSION
 SELF-INSURERS' SECURITY NONSHARED - PROPRIETARY FUND
 STATEMENT OF NET ASSETS
 June 30, 2010**

ASSETS

Current Assets

Cash in State Treasury	\$ 31,680,634
Cash in Bank and on Hand	39,627
Accrued Interest Receivable	26,397
Excess Insurance Receivable	189,522
Securities Lending Collateral	12,303,179
Total Current Assets	<u>44,239,359</u>

Total Assets	<u>44,239,359</u>
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LIABILITIES

Current Liabilities

Accounts Payable	670,976
Due to Other Funds	16,450
Obligations Under Securities	12,303,179
Deferred Security Deposit	11,313,897
Liabilities for Unpaid Claims	1,357,206
Total Current Liabilities	<u>25,661,708</u>

Noncurrent Liabilities

Compensated Absences	33,206
Liabilities for Unpaid Claims	7,398,988
	<u>7,432,194</u>

Total Liabilities	<u>33,093,902</u>
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NET ASSETS

Restricted Net Assets	<u>11,145,457</u>
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Total Liabilities and Net Assets	<u>\$ 44,239,359</u>
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The accompanying notes are an integral part of the financial statements.

**STATE OF ILLINOIS
WORKERS' COMPENSATION COMMISSION
SELF-INSURERS' SECURITY NONSHARED - PROPRIETARY FUND
STATEMENT OF REVENUES, EXPENSES, AND CHANGE IN NET ASSETS
For the Year Ended June 30, 2010**

OPERATING REVENUES

Security Deposits	\$ 600,000
Excess Insurance Recoveries	542,977
Total Operating Revenues	<u>1,142,977</u>

OPERATING EXPENSES

Personal Services	140,181
Employee Retirement	39,203
Social Security Contribution	10,147
Group Insurance	19,383
Travel	1,606
Contractual Services	14,321
Telecommunications	419
Deposit Refunds	299,409
Benefit Payments	2,591,409
Total Operating Expenses	<u>3,116,078</u>

Operating Loss (1,973,101)

NONOPERATING REVENUES

Interest Income	<u>147,080</u>
Total Nonoperating Revenues	<u>147,080</u>

Change in Net Assets (1,826,021)

NET ASSETS, BEGINNING OF YEAR, as restated 12,971,478

NET ASSETS, END OF YEAR \$ 11,145,457

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

**STATE OF ILLINOIS
WORKERS' COMPENSATION COMMISSION
SELF-INSURERS' SECURITY NONSHARED - PROPRIETARY FUND
STATEMENT OF CASH FLOWS
For the Year Ended June 30, 2010**

CASH FLOWS FROM OPERATING ACTIVITIES

Cash Received from Security Deposits and Excess Insurance Recoveries	\$ 1,255,602
Payments to Suppliers - Net	569,067
Payments to Employees and Other Personal Services	(206,708)
Deposit Refunds Paid	(299,409)
Benefit Payments	(2,267,054)
Net Cash Used in Operating Activities	<u>(948,502)</u>

CASH FLOWS FROM INVESTING ACTIVITY

Interest and Dividends on Investments	<u>212,534</u>
Net Cash Provided by Investing Activity	<u>212,534</u>

Net Decrease in Cash in State Treasury, Cash in Bank and on Hand (735,968)

Cash in State Treasury, Cash in Bank and on Hand, Beginning of Year 32,456,229

Cash in State Treasury, Cash in Bank and on Hand, End of Year \$ 31,720,261

Reconciliation of Operating Loss to Net Cash

Used in Operating Activities:

Operating Loss	\$ (1,973,101)
Adjustments to Reconcile Operating Loss to Cash Flows from Operating Activities	
Changes in Assets and Liabilities:	
Excess Insurance Receivable	112,625
Accounts Payable	571,963
Due to Other Funds	13,450
Compensated Absences	2,206
Liabilities for Unpaid Claims	324,355
Net Cash Used in Operating Activities	<u>\$ (948,502)</u>

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

**STATE OF ILLINOIS
WORKERS' COMPENSATION COMMISSION
SELF-INSURERS' SECURITY NONSHARED - PROPRIETARY FUND
NOTES TO THE BASIC FINANCIAL STATEMENTS
For the Year Ended June 30, 2010**

(1) Description of Funds

The Illinois Workers' Compensation Commission Self-Insurers' Advisory Board (the "Board") established within the Illinois Workers' Compensation Commission (Commission) administers the Self-Insurers' Security nonshared proprietary fund described below. A nonshared fund is a fund in which a single State agency is responsible for administering substantially all financial transactions of the fund.

The Self-Insurers' Security Fund (940), (the "Fund"), was established by the Workers' Compensation Act (820 ILCS 305/4a-5). The Fund provides compensation to employees of insolvent self-insured employers for any type of injury or occupational disease and all claims for related administrative fees, operating costs of the Board, attorney fees and other costs reasonably incurred by the Board. The Commission may upon the direction of the Board from time to time assess each of the private self-insurers a pro rata share of the funding reasonably necessary to carry out its activities.

(2) Summary of Significant Accounting Policies

The financial statements of the individual nonshared proprietary funds administered by the Self-Insurers' Advisory Board established within the Commission have been prepared in accordance with accounting principles generally accepted in the United States of America (GAAP), as prescribed by the Governmental Accounting Standards Board (GASB). To facilitate the understanding of data included in the financial statements, summarized below are the more significant accounting policies.

A. Reporting Entity

As defined by GAAP, the financial reporting entity consists of a primary government, as well as its component units, which are legally separate organizations for which the elected officials of the primary government are financially accountable. Financial accountability is defined as:

- i) 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
- ii) Fiscal dependency on the primary government.

**STATE OF ILLINOIS
WORKERS' COMPENSATION COMMISSION
SELF-INSURERS' SECURITY NONSHARED - PROPRIETARY FUND
NOTES TO THE BASIC FINANCIAL STATEMENTS
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Based upon the required criteria, the Self-Insurers' Security nonshared proprietary fund does not have any component unit, nor is it a component unit of another entity. However, because the Self-Insurers' Security nonshared proprietary fund is not legally separate from the State of Illinois (State), it is included in the financial statements of the State as a proprietary fund. The State's Comprehensive Annual Financial Report may be obtained by writing to the State Comptroller's Office, Financial Reporting Department, 325 West Adams Street, Springfield, Illinois 62704-1871.

The financial statements present only the Self-Insurer's Security nonshared proprietary fund administered by the Self-Insurers' Advisory Board established within the Commission and do not purport to, and do not, present fairly the financial position of the Commission as of June 30, 2010, and changes in its financial position and cash flows, where applicable, for the year then ended in conformity with accounting principles generally accepted in the United States of America.

B. Basis of Presentation

In government, the basic accounting and reporting entity is a fund. A fund is defined as an independent fiscal and accounting entity with a self-balancing set of accounts recording cash and/or other resources together with all related liabilities, obligations, reserves, and equities which are segregated for the purpose of carrying on specific activities or attaining certain objectives in accordance with special regulations, restrictions, or limitations. A Statement of net assets; statement of revenues, expenses and changes in net assets; and statement of cash flows has been presented for the Self-Insurers' Security nonshared proprietary fund administered by the Self Insurers' Advisory Board established within the Commission.

Operating revenues, such as security deposits, assessments, and excess insurance reimbursements, result from exchange transactions associated with the principal activity of the Self Insurer's Security Fund. Exchange transactions are those in which each party receives and gives up essentially equal values. Nonoperating revenues, such as subsidies and investment earnings, result from nonexchange transactions or ancillary activities.

**STATE OF ILLINOIS
WORKERS' COMPENSATION COMMISSION
SELF-INSURERS' SECURITY NONSHARED - PROPRIETARY FUND
NOTES TO THE BASIC FINANCIAL STATEMENTS
For the Year Ended June 30, 2010**

C. Basis of Accounting

The Self-Insurers' Security nonshared proprietary fund is reported using the economic resources measurement focus and the accrual basis of accounting.

Revenues are recorded when earned and expenses are recorded at the time liabilities are incurred, regardless of when the related cash flow takes place. Nonexchange transactions, in which the Self Insurers' Advisory Board gives (or receives) value without directly receiving (or giving) equal value in exchange are not applicable. On an accrual basis, revenues from assessments, reimbursements from excess insurance, and security deposits are recognized in the fiscal year in which the underlying exchange transaction occurs. Resources received before the exchange has occurred are reported as deferred revenues.

Private-sector standards of accounting and financial reporting issued prior to December 1, 1989, generally are followed in the Self-Insurers' Security nonshared proprietary fund financial statements to the extent that those standards do not conflict with or contradict guidance of the Governmental Accounting Standards Board. The State also has the option of following subsequent private-sector guidance for their business type activities and enterprise funds, subject to this same limitation. The State has elected not to follow subsequent private-sector guidance for the Self-Insurers' Security nonshared proprietary fund administered by the Self-Insurers' Advisory Board established within the Commission.

D. Cash and Cash Equivalents

Cash and cash equivalents consist principally of deposits held in the State Treasury. Cash and cash equivalents also include cash on hand and cash in banks.

E. Compensated Absences

The liability for compensated absences reported in the individual nonshared proprietary funds consists of unpaid, accumulated vacation and sick leave balances for Fund 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 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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For the Year Ended June 30, 2010**

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.

F. Net Assets

Equity is displayed in one component as follow:

Restricted - This consists of net assets that are legally restricted by outside parties or by law through constitutional provisions or enabling legislation. When both restricted and unrestricted resources are available for use, generally it is the State's policy to use restricted resources first, then unrestricted resources when needed.

G. Use of Estimates

The preparation of financial statements in conformity with 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.

(3) Deposits

The State Treasurer is the custodian of the State's deposit and investment maintained in the State Treasury. As of June 30, 2010, deposits in the custody of the State Treasurer and cash in bank and on hand was \$31,680,634 and \$39,627, respectively.

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 Self Insurers' Advisory Board does not own individual securities. Details on the nature of these deposits and investments are available within the State of Illinois, Comprehensive Annual Financial Report (CAFR).

**STATE OF ILLINOIS
WORKERS' COMPENSATION COMMISSION
SELF-INSURERS' SECURITY NONSHARED - PROPRIETARY FUND
NOTES TO THE BASIC FINANCIAL STATEMENTS
For the Year Ended June 30, 2010**

(4) Interfund Balances and Activity

The following balances at June 30, 2010, represent amounts due to other Agency and State of Illinois Funds:

Office of the Auditor General	\$ 13,962
State Employees' Retirement System	1,605
Central Management System	883
	<u>\$ 16,450</u>

(5) Securities Lending Transaction

Under the authority of the Treasurer's published investment policy that was developed in accordance with the State statute, the State Treasurer lends securities to broker-dealers and other entities for collateral that will be returned for the same securities in the future. The State Treasurer has, through a Securities Lending Agreement, authorized Deutsche Bank Group to lend the State Treasurer's securities to broker-dealers and banks pursuant to a form of loan agreement.

During fiscal year 2010, Deutsche Bank Group lent 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 aggregate market 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 the fiscal year on the amount of the loans of available, 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 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 the fiscal year resulting from a default of the borrowers or Deutsche Bank Group.

During the fiscal year, the State Treasurer and the borrowers maintained the right to terminate all securities lending transactions on demand. The cash collateral received on each loan was invested in repurchase agreements with approved counterparties collateralized with securities approved by Deutsche Bank Group and marked to market daily at no less than 102%. Because the loans are terminable at will, their duration did not generally match the duration of the investments made with cash

**STATE OF ILLINOIS
WORKERS' COMPENSATION COMMISSION
SELF-INSURERS' SECURITY NONSHARED - PROPRIETARY FUND
NOTES TO THE BASIC FINANCIAL STATEMENTS
For the Year Ended June 30, 2010**

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.

In accordance with GASB Statement No. 28, paragraph 9, the Office of the State Treasurer has allocated the assets and obligations at June 30, 2010 arising from securities lending agreements to the various funds of the State. The securities lending collateral invested in repurchase agreements allocated to the Self-Insurers' Security Fund was \$12,303,179 as of June 30, 2010.

(6) Deferred Security Deposit

Deferred Security Deposit consists of proceeds including interest of a letter of credit held by the Commission as a security for the payment of the private self-insurer's obligations incurred under the Workers' Compensation Act.

(7) Liability for Unpaid Claims

The liability for unpaid claims is established based on estimates of ultimate cost of claims that have been reported but not settled, including the effects of inflation and other societal factors. The following represents changes in aggregate liabilities during the year ended June 30, 2010.

Liability for unpaid claims, beginning of year	<u>\$ 8,431,839</u>
Incurred claims:	
Incurred claims of current year	435,421
Incurred claims of prior years (net of reversal of accruals for prior year claims settled during the year)	<u>887,641</u>
Total incurred claims and claim adjustment	<u>1,323,062</u>
Payments of claims	<u>(998,707)</u>
Liability for unpaid claims, end of year	<u><u>\$ 8,756,194</u></u>

**STATE OF ILLINOIS
WORKERS' COMPENSATION COMMISSION
SELF-INSURERS' SECURITY NONSHARED - PROPRIETARY FUND
NOTES TO THE BASIC FINANCIAL STATEMENTS
For the Year Ended June 30, 2010**

(8) Pension

Substantially all of the Fund's full-time employees who are not eligible for participation in another State-sponsored retirement plan 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 in which State employees participate, except for those covered by State Universities, Teachers', General Assembly, and Judges' Retirement Systems. The financial position and results of operations of the SERS for fiscal years 2010 and 2009 are included in State of Illinois' CAFR for the years ended June 30, 2010 and 2009, respectively. The SERS also issues a separate CAFR that may be obtained by writing to the SERS, 2101 South Veterans Parkway, Springfield, Illinois, 62794-9255 or by calling (217) 785-7202. The State of Illinois CAFR may be obtained in writing to the State Comptroller's Office, Financial Reporting Department, 325 West Adams St., Springfield, Illinois 62704-1871 or by calling (217) 782-2053.

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 Commission pays employer retirement contributions in the Fund based upon an actuarially determined percentage of their payrolls. For fiscal year 2010, the employer contribution rate was 28.377%. The Commission's contribution to SERS was \$39,204 for the year ended June 30, 2010.

(9) 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 retired prior to January 1, 1998, and who are vested in the State Employee's Retirement System do not contribute towards health, dental

**STATE OF ILLINOIS
WORKERS' COMPENSATION COMMISSION
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NOTES TO THE BASIC FINANCIAL STATEMENTS
For the Year Ended June 30, 2010**

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 expenditure 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.

(10) Restatement

The Self-Insurers' Security Fund decreased the beginning Net Assets balance by \$11,242,658. This restatement of net assets was to correct the accounting treatment of the proceeds of securities drawn by the Commission when a private self-insured company that was insolvent and had subsequently emerged from bankruptcy failed to renew or replace the security. In prior years, the Fund recognized the proceeds as revenue at the time of receipt of security deposits instead of being booked as deferred revenue until the Commission assumes the responsibility to pay the obligation under the Workers' Compensation Act.



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

As Special Assistant Auditors for the Auditor General, we have audited the financial statements of the Self-Insurers' Security Fund of the State of Illinois Workers' Compensation Commission, as of and for the year ended June 30, 2010, and have issued our report thereon dated December 10, 2010. 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

In planning and performing our audit, we considered the Illinois Workers' Compensation Commission's internal control over financial reporting of the Self-Insurers' Security 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 Illinois Workers' Compensation Commission's internal control over financial reporting. Accordingly, we do not express an opinion on the effectiveness of the Illinois Workers' Compensation Commission's internal control over financial reporting.

Our consideration of internal control over financial reporting was for the limited purpose described in the preceding paragraph and was not designed to identify all deficiencies in the internal control over financial reporting that might be significant deficiencies or material weaknesses and therefore, there can be no assurance that all deficiencies, significant deficiencies, or material weaknesses have been identified. However, as described in the accompanying schedule of findings we identified certain deficiencies in internal control over financial reporting of the Self-Insurers' Security Fund that we consider to be material weaknesses.

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 misstatements on a timely basis. A *material weakness* is a deficiency, or combination of deficiencies, in internal control, such that there is a reasonable possibility that a material misstatement of the entity's financial statements will not be prevented or detected and corrected on a timely basis. We consider the deficiency described in finding 10-1 in the accompanying schedule of finding to be a material weakness.

Compliance and Other Matters

As part of obtaining reasonable assurance about whether the Self-Insurers' Security Fund's 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 State of Illinois Workers' Compensation Commission response to the finding identified in our audit is described in the accompanying schedule of finding. We did not audit the State of Illinois Workers' Compensation Commission's response and accordingly, we express no opinion on it.

This report is intended solely for the information and use of the Auditor General, the General Assembly, the Legislative Audit Commission, the Governor, and agency management and is not intended to be and should not be used by anyone other than these specified parties.

E. C. Ortiz & Co. LLP
December 10, 2010

**STATE OF ILLINOIS
WORKERS' COMPENSATION COMMISSION
SELF-INSURERS' SECURITY NONSHARED-PROPRIETARY FUND
SCHEDULE OF FINDING**

CURRENT FINDING – GOVERNMENT AUDITING STANDARDS

10-1. **Finding** (Improper revenue recognition)

The Illinois Workers' Compensation Commission - Self Insurers' Security Fund's (SISF) did not properly recognize revenue from proceeds of security deposits drawn by the SISF in accordance with the Workers' Compensation Act.

An employer may be granted permission to self-insure under the Workers' Compensation Act (Act) provided the employer deposits a security in the form of letters of credit or surety bonds in favor of the Illinois Workers' Compensation Commission (Commission) for the payment of the employer's obligations under the Act. The Self-Insurers' Security Fund was established by the Act to provide compensation to employees of insolvent self-insured employers for any type of injury or occupational disease and all claims for related administrative fees, operating costs of the Self-Insurers' Advisory Board (Board), attorney fees and other costs reasonably incurred by the Board (Board).

The Commission may draw the proceeds of securities when the Commission determines that the Bank that issued or confirmed the security no longer provides the Commission with an acceptable level of security with respect to the payments of the employer's obligations as a private self-insurer. Upon request of the employer, the Chairman of the Commission should return the proceeds of the security drawn provided the employer provides a replacement surety bond or letter of credit as a security.

During our testing, we noted SISF drew down a letter of credit totaling \$4.5 million because the bank did not renew the letters of credit of a solvent private self-insurer. The self-insured employer subsequently requested a return of the proceeds including interest by providing a replacement security. In addition, we also noted that in fiscal year 2003, SISF drew down a letter of credit of a private self-insured company totaling \$9.2 million. The private self-insured company declared bankruptcy at the time of the letters of credit drawdown but continued to assume its obligations under the Act from the time of bankruptcy and to the time it emerged from bankruptcy. The proceeds of the letters of credit drawn were in essence a security deposit posted in cash so that the company can renew its privileges to operate as a private self-insurer and ensure payments of its financial obligations in accordance with the Act. SISF recognized the proceeds of the letters of credit as revenue at the time of drawdown even though the SISF did not assume the obligations of the private self-insurer to pay and administer its workers claim in accordance with the Act. Because the substance of the transaction is cash received

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for security deposit to ensure payment of workers compensation and continue the privileges of a private self-insured company, the proceeds of the letters of credit should have been recorded as a liability instead of revenue in the accounting records.

Generally Accepted Accounting Principles require that revenue is to be recognized only when it is earned. Revenues are considered to have been earned when the entity has substantially accomplished what it must do to be entitled to the benefits represented by the revenues.

Statewide Accounting Management Systems (SAMS) procedure 03.40.10 page 4, states revenues and related receivable that result from exchange and exchange-like transactions are recognized when the exchange takes place. Resources (i.e cash) received before the exchange has occurred are reported as deferred revenues (liabilities).

Commission management stated the letters of credit were drawn upon notices received from issuing banks that the letters of credit posted as security deposit will not be renewed by the banks. At the time of receipts of the proceeds, the Commission thought that because they have provided services to self-insured companies, it was appropriate to record the proceeds as revenue in its accounting records.

As a result of the improper revenue recognition, adjustments totaling \$4.6 million which includes the principal of \$4.5 million and accrued interest of \$0.1 million were made to the statement of revenues, expenses, and changes in net assets to correct the balances. In addition, the improper revenue recognition resulted in a restatement of net assets of \$11 million consisting of \$9.2 principal and accrued interest of \$1.8 million. (Finding Code No. 10-1)

Recommendation

We recommend management review its accounting policies and procedures in recognizing revenue from proceeds of security deposits from self-insured employers. Proceeds from security are to be recognized as deferred revenues until the Commission assumes the responsibility to administer the obligations of the employer as a private self-insurer in accordance with the Act.

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Commission Response

The IWCC agrees with this recommendation.

The Commission has implemented the Accounting Standards Boards Rules recommended in regards to earned income. The Commission would like to note that it has been using a consistent methodology since 2003, and implementing the changes affects the fund balance for the current year, but does not change the actual amount of funds in the account over a multi-year period. The Commission has corrected its ledgers and GAAP Reports for this fund in FY 10 and will continue to use the recommended accounting rules.

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PRIOR FINDING NOT REPEATED

A. **Finding** (Inadequate controls over financial reporting)

During the prior year engagement, the Commission did not have adequate controls over financial reporting to allow management and employees to prevent or detect errors or misstatement in the financial reporting process and ensure proper reporting in accordance with the generally accepted accounting principles. (Finding Code No. 09-1)

Status: Not Repeated

During the current year engagement, the Commission reviewed its policies, procedures and internal controls over financial reporting and the issues noted in prior years were resolved and addressed.