SUMMARY REPORT DIGEST

OFFICE OF THE TREASURER
FISCAL OFFICER RESPONSIBILITIES

Financial Audit and Compliance Examination
For the Year Ended: June 30, 2010

Release Date: April 21, 2011

Summary of Findings:

Total this report	**6**
Total last report	**1**
Repeated from last report:	**1**

INTRODUCTION

This digest covers our financial audit and compliance examination of the State of Illinois Office of the Treasurer – Fiscal Officer Responsibilities for the year ended June 30, 2010.

SYNOPSIS

- The State of Illinois Office of the Treasurer's (Office) internal control over the preparation of the Fiscal Officer Responsibilities' financial statements and related notes did not identify errors in the preparation of the financial statements.
- During testing of the Office's securities lending program auditors identified a number of weaknesses.
- The Office is including unrealized gains and losses incurred in its investment portfolio to calculate the yield used to allocate and distribute investment income to the State of Illinois' pooled funds that are statutorily required to receive interest from investments.

{Financial data is summarized on the reverse page.}

OFFICE OF THE STATE TREASURER - STATE OF ILLINOIS

FISCAL OFFICER RESPONSIBILITIES

FINANCIAL AUDIT AND COMPLIANCE EXAMINATION

For The Year Ended June 30, 2010

ASSETS, LIABILITIES AND ACCOUNTABILITIES	**JUNE 30, 2010**	**JUNE 30, 2009**
Assets and Other Debits		
Cash and Cash Equivalents..	$ 3,945,708,936	$ 5,989,981,984
Deposits and Investments, short-term...	5,223,955,569	1,470,634,318
Deposits and Investments, long -term..	956,564,001	1,035,496,164
Securties Lending Collateral..	3,107,545,325	961,557,402
Other Assets..	10,362,803	20,060,892
Amount of Future General Revenues Obligated for Debt Service........	38,861,217,880	33,485,887,771
TOTAL ASSETS AND OTHER DEBITS.................................	$ 52,105,354,514	$ 42,963,618,531
Liabilites and Accountabilities		
Liabilities for Balances on Deposit..	$ 9,240,201,301	$ 7,862,502,298
Obligations Under Securities Lending..	3,107,545,325	961,557,402
General Obligation Indebtedness..	39,746,483,993	34,125,091,138
Accountabilities..	11,123,895	14,467,693
TOTAL LIABILITIES AND ACCOUNTABILITIES..............	$ 52,105,354,514	$ 42,963,618,531

FINANCIAL HIGHLIGHTS	**FY 2010**	**FY 2009**
Investment income earned..	$ 50,655,198	$ 165,518,156
Average yield on investments (unaudited)..	0.59%	2.05%
Increase / (Decrease) in investment base from		
prior year (unaudited)..	$ 555,000,000	$ (729,000,000)
Total amount of estate tax collections (unaudited)..............................	$ 243,378,978	$ 287,757,169
Total amount of estate tax distributions (unaudited)...........................	$ 14,292,768	$ 16,718,322
Total amount of estate tax refunds (unaudited)..................................	$ 7,624,537	$ 8,999,403
# of warrants issued, countersigned and recorded (unaudited)............	7,775,459	7,867,518
# of warrants cancelled, paid and recorded (unaudited)......................	7,493,807	7,740,834
$ of warrants issued, countersigned and recorded (unaudited)............	$ 71,170,889,945	$ 66,155,335,947

STATE TREASURER
During Engagement Period: Honorable Alexi Giannoulias
Currently: Honorable Dan Rutherford

FINDINGS, CONCLUSIONS, AND RECOMMENDATIONS

WEAKNESSES IDENTIFIED IN THE FINANCIAL STATEMENT PROCESS

During testing of the Office's financial statements and related notes for the Fiscal Officer Responsibilities, the auditors identified the following issues:

$184,544,307 reclassification entry not properly recorded

- A reclassification entry was not properly recorded causing two accounts to be understated by $184,544,307 on the fiscal year 2010 Statement of Assets, Liabilities and Accountabilities. Office management upon being made aware of the reclassification not being properly recorded adjusted the fiscal year 2010 financial statements.

Other Asset account for the Illinois Insured Mortgage Pilot Program needed adjusted for $1,543,393

- During fiscal year 2010, the Illinois Insured Mortgage Pilot Program (IIMPP) Trust sold the only remaining hotel property of the IIMPP; however, the Office failed to reduce the value of the Other Asset related to the cash received from the property sale overstating Other Assets and Total Assets by $1,543,393. Office management upon being made aware of the issue adjusted the fiscal year 2010 financial statements.

Failure to maintain adequate controls over the financial reporting process led to a material misstatement of the financial statements. (Finding Code No. 10-1, pages 11-12)

We recommended the Office continue to evaluate and improve its internal control over the financial reporting process to ensure accurate preparation of financial statements.

Treasurer agreed with the recommendation

The Treasurer agreed with the finding and recommendation noting the Office will continue to strengthen controls over the financial reporting process.

WEAKNESSES IDENTIFIED IN THE SECURITIES LENDING PROGRAM

Securities lending program had over $3 billion of securities on loan

The Deposit of State Moneys Act (Act) allows the Treasurer with approval of the Governor, to lend securities. The Act also sets forth that securities lent must be done in accordance with Federal Financial Institution Examination Council (FFIEC) guidelines. At June 30, 2010 the Office had $3,095,533,634 of securities on loan. The auditors identified the following issues while testing the Office's securities lending program:

Office did not have required written policies and procedures

- The Office has not developed written policies and procedures covering each of the requirements listed in the FFIEC guidelines for securities lending as required by FFIEC guidelines.

Internal audits of securities lending program not performed

- Periodic internal audits have not been performed covering all internal audit requirements outlined in the FFIEC guidelines for securities lending.

No documentation of Governor's approval for securities lending program

- The Office could not provide documentation of approval from the Governor to lend securities as required by the Act.

No specific investment policy for the securities lending program as required by Office's Investment Policy

- The Office has not created a specific investment policy for the governance of securities lending as set forth in the Office's Investment Policy.

Exceptions were noted in reviewing securities lending reports and reconciliations

- 8 of 33 (24%) daily securities lending reports tested were not reviewed by Office personnel.
- 1 of 33 (3%) daily securities lending reports tested did not contain adequate notations to support review by Office personnel.
- 2 of 33 (6%) daily securities lending reconciliations were approved by a Banking Division Supervisor 7 and 9 business days after they were completed. The Office strives to complete their reviews on a daily basis.

Without a documented securities lending policy, the Office's securities lending program may not be functioning in accordance with the FFIEC guidelines as required by the Act.

Not following Office internal control procedures to perform and, or document performance and approval, of required reviews identifies a weakness of the Offices control environment in the securities lending program. In addition, failure to comply with mandated responsibilities is noncompliance with statutory requirements and does not fulfill the legislative intent of the Act. (Finding Code No.10-3, pages 15-17)

We recommended the Office strengthen its internal controls over the securities lending program to ensure daily securities lending reports and investment reconciliations are reviewed timely and adequately. In addition, the Office should develop written policies and procedures to ensure compliance with the FFIEC guidelines and the Fiscal Officer Investment Policy. Lastly, the Office should ensure adequate internal audits are performed over the securities lending program.

Treasurer agreed with the recommendation

The Treasurer agreed with the finding and recommendation and noted the Office has either implemented or will be implementing changes to address the issues identified.

UNREALIZED GAINS AND LOSSES INCLUDED IN THE INVESTMENT INCOME ALLOCATION PROCESS

The Office is including unrealized gains and losses incurred in its investment portfolio to calculate the yield used to allocate and distribute investment income to the State of Illinois' pooled funds that are statutorily required to receive interest from investments.

Unrealized gains and losses are included in the yield computation used to distribute investment income

The Office implemented a new accounting standard in 1998 and in implementing the standard incorporated the computing of the changes in fair value (unrealized gains and losses) of its investments to its monthly computation of portfolio yield used to allocate and distribute investment income to the required pooled funds. The allocation of the investment income is distributed to the required pooled funds in cash on a monthly basis.

In a month when there are unrealized gains included in the calculated allocation, the Office "borrows" realized income that would have been distributed to the General Revenue Fund to distribute to the required pooled funds. In a month when there are unrealized losses included in the calculated allocation, the Office documents a negative adjustment, but does not repay the General Revenue Fund during that month. The negative adjustment (allocation) is netted against future positive investment income, until such time as investment income becomes positive and available for distribution.

Unrealized gains and losses are not tangible/realized and should not be used in determining amounts to distribute and/or deposit

The inclusion of unrealized gains and losses as a result of changes in investment fair values does not result in an actual event that would be a tangible/realized gain or loss that should be included in investment income to be distributed and/or deposited. (Finding Code No. 10-4, pages 18-19).

We recommended the Office revise its investment income allocation process to ensure unrealized gains and losses are recognized as investment income for financial reporting purposes, but are not used to determine the amount of investment income to be distributed in cash to the pooled State funds.

Treasurer agreed with the recommendation

The Treasurer agreed with the finding and recommendation noting the Office has begun the process of implementing a new interest allocation system that will exclude unrealized gains / losses for Investment Income Allocation purposes.

OTHER FINDINGS

The remaining findings are reportedly being given attention by the Office. We will review the Office's progress towards the implementation of our recommendations in our next engagement.

OTHER DISCLOSURE

ILLINOIS INSURED MORTGAGE PILOT PROGRAM TRUST

Illinois Insured Mortgage Pilot Program Trust mortgage agreements

The Illinois Insured Mortgage Pilot Program Trust (Trust) was created in October 1982 in order to stimulate construction activity in the State. The State purchased $120,000,000 of investment certificates for which the underlying collateral was a pool of mortgage loans for the purpose of providing financing to approved construction projects. Two mortgage agreements in the pool were secured by hotel properties, the Collinsville Holiday Inn (Collinsville Hotel) and the Abraham Lincoln Hotel and Conference Center (formerly the Renaissance).

Collinsville Hotel property sale and collection on letters of credit

Through the result of defaulting on the loan and subsequent foreclosure, the Trust purchased the Collinsville Hotel and all associated property for $25,375,654. The sale price was paid in full through the Trust's credit of the sale price against the unpaid principal and interest secured by the mortgage on the property. On November 1, 2007 the court issued a judicial deed, and the Trust took title to the property. At a sealed bid auction, the Trust sold the Collinsville Hotel property to a hotel developer for $5.25 million. The sale closed on August 26, 2008. The Trust subsequently received approximately $600,000 from an outstanding operating account of the Collinsville Hotel. In May 2010, the Trust settled litigation against a financial institution related to the collection on four letters of credit totaling $1,637,375, that were additional loan collateral. After the financial institution transferred $853,874 and the deeds and/or titles to several properties, the litigation was dismissed. It is anticipated the properties will be sold for an amount less than $1 million.

President Lincoln Hotel property sale

Again, through the result of defaulting on the loan and subsequent foreclosure, the Trust, on March 4, 2008, purchased the President Lincoln Hotel and all associated property for $100,000. The sale price was paid in full through the Trust's credit of the sale price against the unpaid principal and interest of the mortgage note. The court confirmed the sale on March 14, 2008. The President Lincoln Hotel was sold via public auction on December 14, 2009 to the high bidder for $6.5 million. The transaction closed on February 2010, with the purchaser transferring the sale price to the Trust accounts.

$16 million transferred from Trust to State Treasury

The Trust transferred $16 million to the State Treasury on September 30, 2010.

AUDITORS' OPINION

The auditors stated the Office of the Treasurer, Fiscal Officer Responsibilities financial statements as of June 30, 2010 and for the year then ended were presented fairly in all material respects. The auditors noted the financial statements have been prepared on a comprehensive basis of accounting other than accounting principles general accepted in the United States of America.

WILLIAM G. HOLLAND
Auditor General

WGH:RPU:pp

SPECIAL ASSISTANT AUDITORS

Crowe Horwath LLP were our Special Assistant Auditors for this engagement.