



**STATE OF ILLINOIS  
DEPARTMENT OF CENTRAL  
MANAGEMENT SERVICES  
LOCAL GOVERNMENT HEALTH  
INSURANCE RESERVE FUND**

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FINANCIAL AUDIT

For the Year Ended June 30, 2017

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

A background graphic consisting of a complex, overlapping grid of lines and geometric shapes in shades of gray, creating a sense of depth and structure.

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STATE OF ILLINOIS  
DEPARTMENT OF CENTRAL MANAGEMENT SERVICES  
LOCAL GOVERNMENT HEALTH INSURANCE RESERVE FUND  
FINANCIAL AUDIT  
For the Year Ended June 30, 2017

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STATE OF ILLINOIS  
DEPARTMENT OF CENTRAL MANAGEMENT SERVICES

**AGENCY OFFICIALS**

Director	Michael Hoffman, Acting
Assistant Directors	Markus Veile Amiel Harper (8/1/17 – present) Jimmy Odom, Acting (1/13/17 – 5/8/17) Kimberly McCullough-Starks (through 7/25/16)
Chief Administrative Officer	Vacant
Chief Operating Officer	Jennifer Waldinger (through 6/15/17) Vacant (6/16/17 – present)
Chief Fiscal Officer	Mark Lewis (7/1/17 – present) Karen Pape (through 6/30/17)
General Counsel	Ryan Green, Acting (11/1/16 – present) LaShonda Hunt, Acting (7/1/16 – 10/31/16)
Chief Internal Auditor	Jack Rakers, Acting (1/2/17 – present) Deborah Abbott (through 12/31/16)

Agency main offices are located at:

715 Stratton Office Building  
401 South Spring Street  
Springfield, IL 62706

STATE OF ILLINOIS  
DEPARTMENT OF CENTRAL MANAGEMENT SERVICES  
LOCAL GOVERNMENT HEALTH INSURANCE RESERVE FUND  
FINANCIAL AUDIT  
For the Year Ended June 30, 2017

**FINANCIAL STATEMENT REPORT**

**SUMMARY**

The audit of the accompanying financial statements of the Local Government Health Insurance Reserve Fund of the State of Illinois, Department of Central Management Services (Department), was performed by Sikich LLP.

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

**SUMMARY OF FINDINGS**

The auditors identified matters involving the Department's internal control over financial reporting that they considered to be significant deficiencies. The significant deficiencies are described in the accompanying Schedule of Findings on pages 20-21 of this report as item:

2017-001 Weaknesses in internal control over financial reporting

**EXIT CONFERENCE**

The Department waived an exit conference. The responses to the recommendations were provided by Mr. Michael Hoffman, Acting Director, on January 17, 2018.

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Springfield, IL 62704  
217.793.3363

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## INDEPENDENT AUDITOR'S REPORT

Honorable Frank J. Mautino  
Auditor General  
State of Illinois

### **Report on the Financial Statements**

As Special Assistant Auditors for the Auditor General, we have audited the accompanying financial statements of the Local Government Health Insurance Reserve Fund of the State of Illinois, Department of Central Management Services, as of and for the year ended June 30, 2017, and the related notes to the financial statements, which collectively comprise the Local Government Health Insurance Reserve Fund of the State of Illinois, Department of Central Management Services' basic financial statements as listed in the table of contents.

### ***Management's Responsibility for the Financial Statements***

Management is responsible for the preparation and fair presentation of these financial statements in accordance with accounting principles generally accepted in the United States of America; this includes the design, implementation, and maintenance of internal control relevant to the preparation and fair presentation of financial statements that are free from material misstatement, whether due to fraud or error.

### ***Auditor's Responsibility***

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 from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and fair presentation of the financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. Accordingly, we express no such opinion. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of significant accounting estimates made by management, as well as evaluating the overall presentation of the financial statements.

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinion.

### ***Opinion***

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 Central Management Services, as of June 30, 2017, and the changes in financial position and cash flows thereof for the year then ended in accordance with accounting principles generally accepted in the United States of America.

### ***Emphasis of Matter***

As discussed in Note 2, the financial statements present only the Local Government Health Insurance Reserve Fund of the State of Illinois, Department of Central Management Services and do not purport to, and do not, present fairly the financial position of the State of Illinois of the State of Illinois, Department of Central Management Services, as of June 30, 2017, and the changes in its financial position or its cash flows for the year then ended in conformity with accounting principles generally accepted in the United States of America. Our opinion is not modified with respect to this matter.

### ***Other Matters***

#### ***Required Supplementary Information***

Accounting principles generally accepted in the United States of America require that the Schedule of Claims for Active Employees for the Ten Years Ended June 30, 2017 on page 17 be presented to supplement the basic financial statements. Such information, although not a part of the basic financial statements, is required by the Governmental Accounting Standards Board who considers it to be an essential part of financial reporting for placing the basic 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 basic financial statements, and other knowledge we obtained during our audit of the basic 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 a 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 basic financial statements. Such missing information, although not a part of the basic financial statements, is required by the Governmental Accounting Standards Board who considers it to be an essential part of financial reporting for placing the basic financial statements in an appropriate operational, economic, or historical context. Our opinion on the basic financial statements is not affected by the missing information.

## **Other Reporting Required by *Government Auditing Standards***

In accordance with *Government Auditing Standards*, we have also issued our report dated January 25, 2018 on our consideration of the Local Government Health Insurance Reserve Fund of the State of Illinois, Department of Central Management Services' internal control over financial reporting of the Local Government Health Insurance Reserve Fund and on our tests of its 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* in considering the State of Illinois, Department of Central Management Services' internal control over financial reporting of the Local Government Health Insurance Reserve Fund and its compliance.

**SIGNED ORIGINAL ON FILE**

Springfield, Illinois  
January 25, 2018

## BASIC FINANCIAL STATEMENTS

STATE OF ILLINOIS  
DEPARTMENT OF CENTRAL MANAGEMENT SERVICES  
LOCAL GOVERNMENT HEALTH INSURANCE RESERVE FUND  
**STATEMENT OF NET POSITION**  
June 30, 2017

(Expressed in Thousands)

**ASSETS**

Cash equity with State Treasurer	\$ 7,290
Cash and cash equivalents	2,021
Securities lending collateral equity with State Treasurer	2,023
Due from other government - federal	50
Due from other government - local	884
Other receivables, net	320
<b>Total current assets</b>	12,588
 <b>Total assets</b>	 12,588

**LIABILITIES**

Accounts payable and accrued liabilities	8,947
Due to other State funds	22
Unearned Revenue	25
Obligations under securities lending of State Treasurer	2,023
Current portion of long-term obligations	5
<b>Total current liabilities</b>	11,022
 Noncurrent portion of long-term obligations	 14
<b>Total liabilities</b>	11,036

**NET POSITION**

Unrestricted	1,552
<b>Total net position</b>	\$ 1,552

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

STATE OF ILLINOIS  
DEPARTMENT OF CENTRAL MANAGEMENT SERVICES  
LOCAL GOVERNMENT HEALTH INSURANCE RESERVE FUND  
**STATEMENT OF REVENUES, EXPENSES  
AND CHANGES IN FUND NET POSITION**  
For the Year Ended June 30, 2017

(Expressed in Thousands)

<b>OPERATING REVENUES</b>	
Charges for sales and services	\$ 44,053
<b>Total operating revenues</b>	<u>44,053</u>
 <b>OPERATING EXPENSES</b>	
Benefit payments and refunds	42,605
General and administrative	<u>1,299</u>
<b>Total operating expenses</b>	<u>43,904</u>
 <b>Operating income (loss)</b>	 149
 <b>NONOPERATING REVENUES (EXPENSES)</b>	
Interest and investment income	51
Interest expense	(35)
Other revenues	<u>71</u>
 <b>Change in net position</b>	 236
 Net position, July 1, 2016	 <u>1,316</u>
<b>NET POSITION, JUNE 30, 2017</b>	<b><u>\$ 1,552</u></b>

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

STATE OF ILLINOIS  
DEPARTMENT OF CENTRAL MANAGEMENT SERVICES  
LOCAL GOVERNMENT HEALTH INSURANCE RESERVE FUND  
**STATEMENT OF CASH FLOWS**  
For the Year Ended June 30, 2017

(Expressed in Thousands)

**CASH FLOWS FROM OPERATING ACTIVITIES:**

Cash received from sales and services	\$ 43,232
Cash payments to suppliers for goods and services	(41,433)
Cash payments to employees for services	(791)
Cash receipts from other operating activities	1,155
Net cash provided (used) by operating activities	<u>2,163</u>

**CASH FLOWS FROM NONCAPITAL FINANCING ACTIVITIES:**

Interest paid on other borrowings	(35)
Operating grants received	29
Net cash provided (used) by noncapital financing activities	<u>(6)</u>

**CASH FLOWS FROM INVESTING ACTIVITIES:**

Interest and dividends on investments	47
Net cash provided (used) by investing activities	<u>47</u>

**Net increase (decrease) in cash and cash equivalents** 2,204

Cash and cash equivalents, July 1, 2016 7,107

**CASH AND CASH EQUIVALENTS, JUNE 30, 2017** \$ 9,311

**Reconciliation of cash and cash equivalents to the Statement of Net Assets:**

Total cash and cash equivalents per the Statement of Net Position	\$ 2,021
Add: cash equity with State Treasurer	7,290

**CASH AND CASH EQUIVALENTS, JUNE 30, 2016** \$ 9,311

**Reconciliation of operating income (loss) to net cash provided (used) by operating activities:**

**OPERATING INCOME (LOSS)** \$ 149

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	(487)
Increase (decrease) in accounts payable and accrued liabilities	2,656
Increase (decrease) in intergovernmental payables	(2)
Increase (decrease) in due to other funds	(27)
Increase (decrease) in other liabilities	(90)
Total adjustments	<u>2,014</u>

**NET CASH PROVIDED (USED) BY OPERATING ACTIVITIES** \$ 2,163

STATE OF ILLINOIS  
DEPARTMENT OF CENTRAL MANAGEMENT SERVICES  
LOCAL GOVERNMENT HEALTH INSURANCE RESERVE FUND  
**NOTES TO THE FINANCIAL STATEMENTS**  
June 30, 2017

**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. As a result of the Governor's Executive Order 12-01, the responsibilities in relation to LGHIRF were transferred to the Department of Central Management Services (Department) as of July 1, 2013. The Department is responsible for the financial reporting of the fund.

As of June 30, 2017, there were 276 local governmental entities participating with approximately 2,731 employees, 2,059 dependents and 216 retirees covered. Each participating local governmental unit is required to enter into a written agreement with the Department. The agreement sets forth the responsibilities of both parties. The Department administers the Local Government Health Insurance Plan.

The responsibilities required of the Department 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
- 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 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 and the possibility that the component unit will provide a financial benefit to or impose a financial burden on the primary government.

STATE OF ILLINOIS  
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**NOTES TO THE FINANCIAL STATEMENTS**  
June 30, 2017

**2) Summary of Significant Accounting Policies (continued)**

**a) Financial Reporting Entity (continued)**

Based upon the required criteria, the LGHIRF has no component units and is not a component unit of any other entity. However, because the LGHIRF is not legally separate from the State of Illinois, the financial statements of the LGHIRF are included in the financial statements of the State of Illinois as a non major 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 LGHIRF administered by the State of Illinois, Department of Central Management Services. They are intended to present the financial position, the changes in financial position, and the cash flows of only the LGHIRF. They do not purport to, and do not, present fairly, the financial position of the State of Illinois or the Department as of June 30, 2017 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.

**c) Measurement Focus and Basis of Accounting**

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.

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.

**d) 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 equity with State Treasurer and cash in banks for locally held funds.

**e) Investments**

Investments are reported at fair value.

The Illinois Public Treasurers' Investment Pool, known as The Illinois Funds, operates as a 2a7-like pool and thus reports all investments at amortized cost rather than market value. The fair value of the pool is the same as the value of the pool shares. The Treasurer's investment policies are governed by state statute. In addition, the Treasurer's Office has adopted its own investment practices which supplement the statutory requirement.

STATE OF ILLINOIS  
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**NOTES TO THE FINANCIAL STATEMENTS**  
June 30, 2017

**2) Summary of Significant Accounting Policies (continued)**

**f) 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 acquisition 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

**g) Compensated Absences**

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

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.

**h) 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.

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**2) Summary of Significant Accounting Policies (continued)**

**i) 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 \$7.290 million and cash on deposit for funds held outside the State Treasurer totaled \$0 at June 30, 2017.

**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, 2017, the Department had the following investments outside of the State Treasury:

	<b>Fair Value (Thousands)</b>	<b>Weighted Average Maturity (Years)</b>
Illinois Public Treasurers' Investment Pool	<u>\$2,021</u>	0.136
Total fixed income investments	<u>\$2,021</u>	

**Interest Rate Risk:** Interest rate risk is the risk that changes in interest rates will adversely affect the fair value of an investment. 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.

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**NOTES TO THE FINANCIAL STATEMENTS**  
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**3) Deposits and Investments (continued)**

**b) Investments (continued)**

Credit Risk: Credit risk is the risk that an issuer or other counterparty to an investment will not fulfill its obligations. The Department does not have a formal investment policy that limits investment choices. Investments in the Illinois Public Treasurers' Investment Pool were rated AAAM by Standard & Poor's.

Custodial Credit Risk: The Department does not have a formal investment policy which restricts investments to address custodial credit risk. Custodial credit risk is the risk that, in the event of failure of the counterparty to a transaction, the Department would not be able to recover the value of investments or collateral securities in the possession of an outside party.

The Illinois Public Treasurers' Investment Pool, known as The Illinois Funds, operates as a qualified external investment pool in accordance with the criteria established in GASB Statement No. 79, Certain External Investment Pools and Pool Participants, and thus, reports all investments at amortized cost rather than market value. The investment in The Illinois Funds by participants is also reported at amortized cost. The Illinois Funds does not have any limitations or restrictions on participant withdrawals. The Illinois Treasurer's Office issues a separate financial report for The Illinois Funds which may be obtained by contacting the Administrative Office at Illinois Business Center, 400 West Monroe Street, Suite 401, Springfield, Illinois 62704.

**c) Reconciliation to Statement of Net Position**

	<b>Deposits (Thousands)</b>	<b>Investments (Thousands)</b>
Amounts per Note 3(a)(b)	\$7,290	\$2,021
Cash Equivalents	<u>2,021</u>	<u>(2,021)</u>
Total per Statement of Net Position	<u>\$9,311</u>	<u>\$ 0</u>

**d) 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 AG to lend the State Treasurer's securities to broker-dealers and banks pursuant to a form of loan agreement.

During fiscal year 2017, Deutsche Bank AG lent U.S. Agency securities and U.S. Treasury 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 fair value of the loaned securities. Loans are marked to market daily. If the fair value of collateral falls below 100%, the borrower must provide additional collateral to raise the fair value to 100%.

The State Treasurer did not impose any restrictions during fiscal year 2017 on the amount of the loans of available, eligible securities. In the event of borrower default, Deutsche Bank AG provides the State Treasurer with counterparty default indemnification. In addition, Deutsche Bank AG is obligated to indemnify the State Treasurer if Deutsche Bank AG loses any securities, collateral or investments of the State Treasurer in Deutsche Bank AG's custody. There were no losses during fiscal year 2017 resulting from a default of the borrowers or Deutsche Bank AG.

STATE OF ILLINOIS  
DEPARTMENT OF CENTRAL MANAGEMENT SERVICES  
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**NOTES TO THE FINANCIAL STATEMENTS**  
June 30, 2017

**3) Deposits and Investments (continued)**

**d) Securities Lending Transactions (continued)**

During fiscal year 2017, 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 AG 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 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 received that was invested in repurchase agreements and the fair value of securities on loan for the State Treasurer as of June 30, 2017 were \$3,522,922,500 and \$3,475,790,990, respectively.

**4) Long-Term Obligations**

Changes in long-term obligations (amounts expressed in thousands) for the year ended June 30, 2017 were as follows:

	<b>Balance July 1, 2016</b>	<b>Additions</b>	<b>Deletions</b>	<b>Balance June 30, 2017</b>	<b>Amounts Due Within One Year</b>
Compensated Absences	\$ 109	\$ 42	\$ (132)	\$ 19	\$ 5
<b>Total</b>	<b>\$ 109</b>	<b>\$ 42</b>	<b>\$ (132)</b>	<b>\$ 19</b>	<b>\$ 5</b>

**5) 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, 2017.

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, 2017, all claims are paid on a two-year claim cycle.

Based on the above method, the liability for future claims (amounts expressed in thousands) at June 30, 2017 is as follows:

Claims incurred and reported but not paid as of June 30	\$ 5,599
Estimated liability for claims incurred but not reported	2,725
<b>Total estimated liability for future claims</b>	<b>\$ 8,324</b>

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	\$ 40,399
Less: liability for unpaid claims, beginning of year	6,118
Subtotal	34,281
Add: liability for unpaid claims, end of year	8,324
<b>Total benefit claim payments and refunds</b>	<b>\$ 42,605</b>

STATE OF ILLINOIS  
DEPARTMENT OF CENTRAL MANAGEMENT SERVICES  
LOCAL GOVERNMENT HEALTH INSURANCE RESERVE FUND  
**NOTES TO THE FINANCIAL STATEMENTS**  
June 30, 2017

**5) Risk Pool Disclosure (continued)**

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

	Healthcare Claims	
	2017	2016
Unpaid claims and claim adjustment expense at beginning of year	\$ 6,118	\$ 4,492
Incurred claim and adjustment expenses:		
Provision for insured claims of the current year	47,705	44,219
Decrease in provisions for claims of prior year	(5,100)	(3,487)
Total incurred claims and claim adjustments	42,605	40,732
Payments:		
Claims and claim adjustment expense attributable to claims of the current year	39,381	38,101
Claims and claim adjustment expense attributable to claims of prior year	1,018	1,005
Total Payment	40,399	39,106
Total unpaid claims and claim adjustments expense at end of year	\$ 8,324	\$ 6,118

**6) Pension Plan**

The vested full-time employees paid from the LGHIRF 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 2017 are included in the State of Illinois' Comprehensive Annual Financial Report (CAFR) for the year ended June 30, 2017. 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 2017, the employer contribution rate was 44.568%. 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.

STATE OF ILLINOIS  
DEPARTMENT OF CENTRAL MANAGEMENT SERVICES  
LOCAL GOVERNMENT HEALTH INSURANCE RESERVE FUND  
**NOTES TO THE FINANCIAL STATEMENTS**  
June 30, 2017

**7) 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. 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, 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. A copy of the financial statements of the Department may be obtained by writing to the Department of Central Management Services, 401 South Spring Street, Springfield, Illinois, 62706-4100.

**8) 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.

REQUIRED SUPPLEMENTARY INFORMATION

STATE OF ILLINOIS  
DEPARTMENT OF CENTRAL MANAGEMENT SERVICES  
LOCAL GOVERNMENT HEALTH INSURANCE RESERVE FUND  
**SCHEDULE OF CLAIMS FOR ACTIVE EMPLOYEES**  
For the Ten Years Ended June 30, 2017

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, 2017

	2017	2016	2015	2014	2013	2012	2011	2010	2009	2008
Net earned required contribution and investment revenue:										
Earned	\$ 44,104	\$ 41,019	\$ 37,362	\$ 35,340	\$ 38,870	\$ 45,795	\$ 52,612	\$ 53,060	\$ 54,999	\$ 60,924
Ceded	-	-	-	-	-	-	-	-	-	-
Net earned revenue	<u>44,104</u>	<u>41,019</u>	<u>37,362</u>	<u>35,340</u>	<u>38,870</u>	<u>45,795</u>	<u>52,612</u>	<u>53,060</u>	<u>54,999</u>	<u>60,924</u>
Unallocated expenses	1,299	1,018	1,005	1,286	2,083	2,553	2,004	1,934	3,073	901
Estimated incurred claims and expenses, end of the policy year:										
Incurred	47,705	44,219	39,520	35,935	40,742	46,768	54,050	57,236	56,615	61,044
Ceded	-	-	-	-	-	-	-	-	-	-
Net incurred claims	<u>47,705</u>	<u>44,219</u>	<u>39,520</u>	<u>35,935</u>	<u>40,742</u>	<u>46,768</u>	<u>54,050</u>	<u>57,236</u>	<u>56,615</u>	<u>61,044</u>
Paid (cumulative) as of:										
End of policy year	39,381	38,101	35,028	32,019	35,135	40,009	46,900	53,801	53,450	56,830
One year later	-	39,119	36,033	33,305	37,218	42,562	48,471	55,975	55,042	58,980
Two years later	-	-	36,033	33,305	37,218	42,562	48,471	55,975	55,042	58,980
Three years later	-	-	-	33,305	37,218	42,562	48,471	55,975	55,042	58,980
Four years later	-	-	-	-	37,218	42,562	48,471	55,975	55,042	58,980
Five years later	-	-	-	-	-	42,562	48,471	55,975	55,042	58,980
Six years later	-	-	-	-	-	-	48,471	55,975	55,042	58,980
Seven years later	-	-	-	-	-	-	-	55,975	55,042	58,980
Eight years later	-	-	-	-	-	-	-	-	55,042	58,980
Nine years later	-	-	-	-	-	-	-	-	-	58,980
Reestimated ceded losses and expenses	-	-	-	-	-	-	-	-	-	-
Reestimated incurred claims and expenses:										
End of policy year	47,705	44,219	39,520	35,935	40,742	46,768	54,050	57,236	56,615	61,044
One year later	-	39,119	36,033	33,305	37,218	42,562	48,471	55,975	55,042	58,980
Two years later	-	-	36,033	33,305	37,218	42,562	48,471	55,975	55,042	58,980
Three years later	-	-	-	33,305	37,218	42,562	48,471	55,975	55,042	58,980
Four years later	-	-	-	-	37,218	42,562	48,471	55,975	55,042	58,980
Five years later	-	-	-	-	-	42,562	48,471	55,975	55,042	58,980
Six years later	-	-	-	-	-	-	48,471	55,975	55,042	58,980
Seven years later	-	-	-	-	-	-	-	55,975	55,042	58,980
Eight years later	-	-	-	-	-	-	-	-	55,042	58,980
Nine years later	-	-	-	-	-	-	-	-	-	58,980
Increase (decrease) in estimated incurred claims and expenses from end of policy year	\$ -	\$ (5,100)	\$ (3,487)	\$ (2,630)	\$ (3,524)	\$ (4,206)	\$ (5,579)	\$ (1,261)	\$ (1,573)	\$ (2,064)

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INDEPENDENT AUDITOR'S REPORT ON INTERNAL CONTROL OVER  
FINANCIAL REPORTING AND ON COMPLIANCE AND OTHER MATTERS  
BASED ON AN AUDIT OF FINANCIAL STATEMENTS PERFORMED  
IN ACCORDANCE WITH GOVERNMENT AUDITING STANDARDS

Honorable Frank J. Mautino  
Auditor General  
State of Illinois

As Special Assistant Auditors for the Auditor General, we have audited, 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, the financial statements of the Local Government Health Insurance Reserve Fund of the State of Illinois, Department of Central Management Services, as of and for the year ended June 30, 2017, and the related notes to the financial statements, which collectively comprise the Local Government Health Insurance Reserve Fund of the State of Illinois, Department of Central Management Services' financial statements, and have issued our report thereon dated January 25, 2018.

**Internal Control Over Financial Reporting**

In planning and performing our audit of the financial statements, we considered the State of Illinois, Department of Central Management Services' internal control over financial reporting (internal control) to determine the audit procedures that are appropriate in the circumstances 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 Central Management Services' internal control. Accordingly, we do not express an opinion on the effectiveness of the State of Illinois, Department of Central Management Services' internal control.

A *deficiency in internal control* exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent, or detect and correct, misstatements on a timely basis. A *material weakness* is a deficiency, or a combination of deficiencies, in internal control, such that there is a reasonable possibility that a material misstatement of the entity's financial statements will not be prevented, or detected and corrected on a timely basis. A *significant deficiency* is a deficiency, or a combination of deficiencies, in internal control that is less severe than a material weakness, yet important enough to merit attention by those charged with governance.

Our consideration of internal control was for the limited purpose described in the first paragraph of this section and was not designed to identify all deficiencies in internal control that might be material weaknesses or significant deficiencies and therefore, material weaknesses or significant deficiencies may exist that were not identified. Given these limitations, during our audit we did not identify any deficiencies in internal control that we consider to be material weaknesses. We did identify certain deficiencies in internal control, described in the accompanying schedule of findings, as item 2017-001, that we consider to be significant deficiencies.

### **Compliance and Other Matters**

As part of obtaining reasonable assurance about whether the Local Government Health Insurance Reserve Fund of the State of Illinois, Department of Central Management Services' financial statements are free from material misstatement, we performed tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements, noncompliance with which could have a direct and material effect on the determination of financial statement amounts. However, providing an opinion on compliance with those provisions was not an objective of our audit, and accordingly, we do not express such an opinion. The results of our tests disclosed no instances of noncompliance or other matters that are required to be reported under *Government Auditing Standards*.

### **Department of Central Management Services' Response to Findings**

The Department of Central Management Services' response to the finding identified in our audit is described in the accompanying schedule of findings. The Department of Central Management Services' response was not subjected to the auditing procedures applied in the audit of the financial statements and, accordingly, we express no opinion on the response.

### **Purpose of this Report**

The purpose of this report is solely to describe the scope of our testing of internal control and compliance and the results of that testing, and not to provide an opinion on the effectiveness of the State of Illinois, Department of Central Management Services' internal control or on compliance. This report is an integral part of an audit performed in accordance with *Government Auditing Standards* in considering the State of Illinois, Department of Central Management Services' internal control and compliance. Accordingly, this communication is not suitable for any other purpose.

**SIGNED ORIGINAL ON FILE**

Springfield, Illinois  
January 25, 2018

## **SCHEDULE OF FINDINGS**

### **CURRENT FINDINGS – Government Auditing Standards**

**2017-001 FINDING** (Weaknesses in internal control over financial reporting)

The Department of Central Management Services' (the Department's) year-end financial reporting in accordance with Generally Accepted Accounting Principles (GAAP) to the Illinois Office of the State Comptroller contained errors in the determination of certain year-end account balances for the Local Government Health Insurance Reserve Fund.

During the audit of the June 30, 2017 financial statements, we noted the following errors:

- The Department understated accrued liabilities in Local Government Health Insurance Reserve Fund (0193) by \$247 thousand due to the exclusion of certain prescription drug benefit liabilities. The Department revised the applicable financial statements for this error.
- The Department overstated accounts receivable in Fund 0193 by \$296 thousand due to including a deposit in transit in accounts receivable and cash. It should not have been included in accounts receivable. The Department revised the applicable financial statements for this error.

The Illinois Office of the State Comptroller (IOC) requires State agencies to prepare year-end financial reports (GAAP Reporting Packages) for each of their funds to assist in the annual preparation of the Statewide financial statements and the Department's financial statements. GAAP Reporting Package instructions are specified in the Statewide Accounting Management System (SAMS) Manual, Chapter 27.

In accordance with the Fiscal Control and Internal Auditing Act (30 ILCS 10/3001), management is responsible for establishing and maintaining a system, or systems, of internal fiscal and administrative controls, to provide assurance that, among other things, revenues, expenditures, and transfers of assets, resources, or funds applicable to operations are properly recorded and accounted for to permit the preparation of accounts and reliable financial and statistical reports and to maintain accountability over the State's resources. Management is also responsible for establishing a process for preparing reasonable accounting estimates.

The Department stated human error combined with staffing resources limiting independent review of financial transactions resulted in the deficiencies noted.

As a result of this error, the Department's GAAP reporting package for Fund 0193 was inaccurate and required corrections. (Finding Code No. 2017-001)

### **RECOMMENDATION**

We recommend the Department implement procedures and cross-training measures throughout the Department to ensure required financial information is submitted to those responsible for financial reporting in a timely, accurate and complete manner. This should include allocating sufficient staff resources and the implementation of formal procedures to ensure accurate and reliable financial information is prepared and submitted to the Office of the State Comptroller.

These procedures should address all elements of the Department's financial reporting process including, but not limited to, accruals for liabilities and receivables and supervisory review of supporting spreadsheets for data accumulation.

**DEPARTMENT RESPONSE**

The Department agrees with the finding and recommendation. The Department will strive to implement cross-training measures and financial reporting procedures to ensure the timeliness, accuracy, reliability and reasonableness of data utilized to perform financial reporting. Additionally, the Department will continue to work diligently to fill key positions to ensure an independent, internal analytical review of calculations is documented and completed timely.

**PRIOR YEAR FINDINGS NOT REPEATED**

None.