



**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, 2020

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



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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, 2020

**TABLE OF CONTENTS**

	<u>Page(s)</u>
Agency Officials .....	1
Financial Statement Report	
Summary .....	2
Independent Auditor’s Report.....	3-5
Basic Financial Statements	
Statement of Net Position.....	6
Statement of Revenues, Expenses and Changes in Fund Net Position .....	7
Statement of Cash Flows.....	8
Notes to the Financial Statements .....	9-17
Required Supplementary Information	
Schedule of Claims for Active Employees .....	18
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 <i>Government Auditing Standards</i> .....	19-20
Schedule of Findings	
Current Finding .....	21-24

STATE OF ILLINOIS  
DEPARTMENT OF CENTRAL MANAGEMENT SERVICES

FINANCIAL AUDIT  
For the Year Ended June 30, 2020

**AGENCY OFFICIALS**

Director (2/18/2020 - Present)	Ms. Janel Forde
Director (Acting) (7/1/2019 - 2/17/2020)	Ms. Janel Forde
Assistant Director (12/4/2020-Present)	Vacant
Assistant Director (Acting) (7/15/2019 – 12/3/2020)	Mr. Michael Merchant
Assistant Director (7/1/2019 - 7/14/2019)	Vacant
Chief of Staff	Mr. Anthony Pascente
Chief Administrative Officer	Mr. Mark Mahoney
Chief Operating Officer	Ms. Aysegul Kalaycioglu
Chief Fiscal Officer (1/21/2021-Present)	Ms. Karen Pape
Chief Fiscal Officer (Acting) (7/1/2019-1/20/2021)	Ms. Karen Pape
General Counsel (7/22/2019 – Present)	Mr. Terrence Glavin
General Counsel (7/1/2019 - 7/21/2019)	Vacant
Chief Internal Auditor	Mr. Jack Rakers

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, 2020

**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 one matter involving the Department's internal control over financial reporting that they considered to be a significant deficiency.

<u>Item No.</u>	<u>Pages</u>	<u>Last/First Report</u>	<u>Description</u>	<u>Finding Type</u>
CURRENT FINDINGS				
2020-001	21-24	2020/New	Inadequate Review of External Service Providers	Significant Deficiency

**EXIT CONFERENCE**

The Department waived an exit conference in a correspondence from Amy Lange, Audit Liaison, on April 20, 2021. The responses to the recommendations were provided by Amy Lange, Audit Liaison, in a correspondence dated April 30, 2021.

3201 W. White Oaks Dr., Suite 102  
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 (Fund) of the State of Illinois, Department of Central Management Services (Department), as of and for the year ended June 30, 2020, and the related notes to the financial statements, which collectively comprise the Fund's 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 opinions 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 opinions.

### ***Opinion***

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of the Fund, as of June 30, 2020, and the respective 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 Fund and do not purport to, and do not, present fairly the financial position of the State of Illinois or the Department, as of June 30, 2020, and the respective changes in its financial position or its cash flows for the year then ended in accordance 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, 2020 on page 18 be presented to supplement the financial statements. Such information, although not a part of the financial statements, is required by the Governmental Accounting Standards Board who considers it to be an essential part of financial reporting for placing the 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 financial statements, and other knowledge we obtained during our audit of the 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 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 May 6, 2021, on our consideration of the Department's internal control over financial reporting of the 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 solely 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 effectiveness of the Department's 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 Department's internal control over financial reporting and compliance.

**SIGNED ORIGINAL ON FILE**

Springfield, Illinois  
May 6, 2021

## BASIC FINANCIAL STATEMENTS

STATE OF ILLINOIS  
DEPARTMENT OF CENTRAL MANAGEMENT SERVICES  
LOCAL GOVERNMENT HEALTH INSURANCE RESERVE FUND  
**STATEMENT OF NET POSITION**  
June 30, 2020

(Expressed in Thousands)

**ASSETS**

Cash Equity with State Treasurer	\$ 5,176
Cash and Cash Equivalents	1,972
Securities Lending Collateral Equity with State Treasurer	1,673
Due from Other Government - Federal	31
Due from Other Government - Local	453
Other Receivables, net	298
Prepaid Expenses	1,104
<b>Total Current Assets</b>	<u>10,707</u>
 <b>Total Assets</b>	 <u>10,707</u>

**LIABILITIES**

Accounts Payable and Accrued Liabilities	3,738
Due to other government - federal	1
Due to Other State Funds	16
Unearned Revenue	19
Obligations under Securities Lending of State Treasurer	1,673
Current Portion of Long-term Obligations	8
<b>Total Current Liabilities</b>	<u>5,455</u>
 Noncurrent Portion of Long-term Obligations	 <u>12</u>
<b>Total Liabilities</b>	 <u>5,467</u>

**NET POSITION**

Unrestricted	5,240
<b>Total Net Position</b>	<u><u>\$ 5,240</u></u>

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, 2020

(Expressed in Thousands)

**OPERATING REVENUES**

Charges for Sales and Services	\$ 40,174
<b>Total Operating Revenues</b>	40,174

**OPERATING EXPENSES**

Benefit Payments and Refunds	34,088
General and Administrative	1,472
<b>Total Operating Expenses</b>	35,560

<b>Operating Income</b>	4,614
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**NONOPERATING REVENUES (EXPENSES)**

Interest and Investment Income	59
Interest Expense	(4)
Other Revenues	31
	31

<b>Change in Net position</b>	4,700
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Net Position, July 1, 2019	540
<b>NET POSITION, JUNE 30, 2020</b>	<b>\$ 5,240</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, 2020

(Expressed in Thousands)

**CASH FLOWS FROM OPERATING ACTIVITIES:**

Cash received from sales and services	\$ 39,967
Cash payments to suppliers for goods and services	(38,410)
Cash payments to internal service funds	(205)
Cash payments to employees for services	(504)
Cash receipts from other operating activities	1,356
Net Cash Provided (used) by Operating Activities	<u>2,204</u>

**CASH FLOWS FROM NONCAPITAL FINANCING ACTIVITIES:**

Interest paid on other borrowings	(5)
Operating grants received	45
Net Cash Provided (used) by Noncapital Financing Activities	<u>40</u>

**CASH FLOWS FROM INVESTING ACTIVITIES:**

Interest and dividends on investments	59
Net Cash Provided (used) by Investing Activities	<u>59</u>

**Net Increase (Decrease) in Cash and Cash Equivalents** 2,303

Cash and Cash Equivalents, July 1, 2019 4,845

**CASH AND CASH EQUIVALENTS, JUNE 30, 2020** \$ 7,148

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

Total cash and cash equivalents per the Statement of Net Position	\$ 1,972
Add: cash equity with State Treasurer	5,176
<b>CASH AND CASH EQUIVALENTS, JUNE 30, 2019</b>	<u>\$ 7,148</u>

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

<b>OPERATING INCOME (LOSS)</b>	<u>\$ 4,614</u>
Adjustments to reconcile operating income (loss) to net cash provided (used) by operating activities:	
Changes in assets and liabilities:	
(Increase) decrease in accounts receivable	95
(Increase) decrease in intergovernmental receivables	(225)
(Increase) decrease in prepaid expenses	(1,104)
Increase (decrease) in accounts payable and accrued liabilities	(1,094)
Increase (decrease) in due to other funds	(69)
Increase (decrease) in unearned revenues	1
Increase (decrease) in other liabilities	(14)
Total adjustments	<u>(2,410)</u>
<b>NET CASH PROVIDED (USED) BY OPERATING ACTIVITIES</b>	<u>\$ 2,204</u>

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  
**NOTES TO THE FINANCIAL STATEMENTS**  
June 30, 2020

**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, 2020, there were 241 local governmental entities participating with approximately 1,979 employees, 1,546 dependents and 135 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  
DEPARTMENT OF CENTRAL MANAGEMENT SERVICES  
LOCAL GOVERNMENT HEALTH INSURANCE RESERVE FUND  
**NOTES TO THE FINANCIAL STATEMENTS**  
June 30, 2020

**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, 2020 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  
DEPARTMENT OF CENTRAL MANAGEMENT SERVICES  
LOCAL GOVERNMENT HEALTH INSURANCE RESERVE FUND  
**NOTES TO THE FINANCIAL STATEMENTS**  
June 30, 2020

**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.

STATE OF ILLINOIS  
DEPARTMENT OF CENTRAL MANAGEMENT SERVICES  
LOCAL GOVERNMENT HEALTH INSURANCE RESERVE FUND  
**NOTES TO THE FINANCIAL STATEMENTS**  
June 30, 2020

**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 \$5,176 million and cash on deposit for funds held outside the State Treasurer totaled \$0 at June 30, 2020.

**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, 2020, 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	\$ 1,972	0.194
Total fixed income investments	\$ 1,972	

**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.

STATE OF ILLINOIS  
DEPARTMENT OF CENTRAL MANAGEMENT SERVICES  
LOCAL GOVERNMENT HEALTH INSURANCE RESERVE FUND  
**NOTES TO THE FINANCIAL STATEMENTS**  
June 30, 2020

**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)	\$ 5,176	\$ 1,972
Cash Equivalents	1,972	(1,972)
Total per Statement of Net Position	<u>\$ 7,148</u>	<u>\$ -</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 2020, 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 2020 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 2020 resulting from a default of the borrowers or Deutsche Bank AG.

STATE OF ILLINOIS  
DEPARTMENT OF CENTRAL MANAGEMENT SERVICES  
LOCAL GOVERNMENT HEALTH INSURANCE RESERVE FUND  
**NOTES TO THE FINANCIAL STATEMENTS**  
June 30, 2020

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

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

During fiscal year 2020, 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, 2020 were \$4,344,267,500 and \$4,290,619,359, respectively.

In accordance with GASB Statement No. 28, *Accounting and Financial Reporting for Securities Lending Transactions*, paragraph 9, the Office of the State Treasurer has allocated the assets and obligations at June 30, 2020 arising from securities lending agreements to the various funds of the State. The total allocated to the LGHIRF at June 30, 2020 was \$1.673 million.

**4) Long-Term Obligations**

Changes in long-term obligations (amounts expressed in thousands) for the year ended June 30, 2020 were as follows:

	<b>Balance July 1, 2019</b>	<b>Additions</b>	<b>Deletions</b>	<b>Balance June 30, 2020</b>	<b>Amounts Due Within One Year</b>
Compensated Absences	\$ 34	\$ 37	\$ (51)	\$ 20	\$ 8
<b>Total</b>	<b>\$ 34</b>	<b>\$ 37</b>	<b>\$ (51)</b>	<b>\$ 20</b>	<b>\$ 8</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, 2020.

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, 2020, 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, 2020 is as follows:

Claims incurred and reported but not paid as of June 30	\$ 2,279
Estimated liability for claims incurred but not reported	<u>1,340</u>
Total estimated liability for future claims	<u>\$ 3,619</u>

STATE OF ILLINOIS  
DEPARTMENT OF CENTRAL MANAGEMENT SERVICES  
LOCAL GOVERNMENT HEALTH INSURANCE RESERVE FUND  
**NOTES TO THE FINANCIAL STATEMENTS**  
June 30, 2020

**5) Risk Pool Disclosure (Continued)**

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	\$ 35,077
Less: liability for unpaid claims, beginning of year	<u>(4,608)</u>
Subtotal	30,469
Add: liability for unpaid claims, end of year	<u>3,619</u>
Total benefit claim payments and refunds	<u>\$ 34,088</u>

Changes in aggregate liabilities for healthcare claims (amounts expressed in thousands) for the Fund for the year ended June 30, 2020 and 2019 were as follows:

	Healthcare Claims	
	2020	2019
Unpaid claims and claim adjustment expense at beginning of year	\$ 4,608	\$ 7,750
Incurred claim and adjustment expenses:		
Provision for insured claims of the current year	36,938	49,274
Decrease in provisions for claims of prior year	(2,850)	(6,829)
Total incurred claims and claim adjustments	34,088	42,445
Payments:		
Claims and claim adjustment expense attributable to claims of the current year	33,319	44,666
Claims and claim adjustment expense attributable to claims of prior year	1,758	921
Total Payment	35,077	45,587
Total unpaid claims and claim adjustments expense at end of year	\$ 3,619	\$ 4,608

**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 2020 are included in the State of Illinois' Comprehensive Annual Financial Report for the year ended June 30, 2020. The SERS issues a separate Comprehensive Annual Financial Report 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' Comprehensive Annual Financial Report. Also included is a discussion of employer and employee obligations to contribute and the authority under which those obligations are established.

STATE OF ILLINOIS  
DEPARTMENT OF CENTRAL MANAGEMENT SERVICES  
LOCAL GOVERNMENT HEALTH INSURANCE RESERVE FUND  
**NOTES TO THE FINANCIAL STATEMENTS**  
June 30, 2020

**6) Pension Plan (Continued)**

The Department pays employer retirement contributions based upon an actuarially determined percentage of their payrolls. For fiscal year 2020, the employer contribution rate was 54.290%. 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.

**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.

STATE OF ILLINOIS  
DEPARTMENT OF CENTRAL MANAGEMENT SERVICES  
LOCAL GOVERNMENT HEALTH INSURANCE RESERVE FUND  
**NOTES TO THE FINANCIAL STATEMENTS**  
June 30, 2020

**9) Coronavirus Pandemic Implications**

In December 2019, a novel strain of coronavirus surfaced and spread around the world, resulting in business and social disruption. The coronavirus was declared a Public Health Emergency of International Concern by the World Health Organization on January 30, 2020. The United States and the State of Illinois declared a state of emergency in March 2020. The June 30, 2020 financial statements reflect the known financial impact of the COVID-19 outbreak and related stay at home orders for fiscal year 2020. The Department anticipates continued impact to its financial position and continues to monitor and evaluate the situation. The extent to which the coronavirus may impact financial activity will depend on future developments, which are highly uncertain and cannot be predicted. New information continues to emerge concerning the severity of the coronavirus and the actions required to contain or treat it, potentially impacting operations and program management.

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, 2020

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, 2020

	2020	2019	2018	2017	2016	2015	2014	2013	2012	2011
Net earned required contribution and investment revenue:										
Earned	40,233	44,659	45,324	44,104	41,019	37,362	35,340	38,870	45,795	52,612
Ceded	-	-	-	-	-	-	-	-	-	-
Net earned revenue	<u>40,233</u>	<u>44,659</u>	<u>45,324</u>	<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>
Unallocated expenses	1,472	1,758	921	1,299	1,018	1,005	1,286	2,083	2,553	2,004
Estimated incurred claims and expenses, end of the policy year:										
Incurred	36,938	49,274	52,944	47,705	44,219	39,520	35,935	40,742	46,768	54,050
Ceded	-	-	-	-	-	-	-	-	-	-
Net incurred claims	<u>36,938</u>	<u>49,274</u>	<u>52,944</u>	<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>
Paid (cumulative) as of:										
End of policy year	33,319	44,666	45,194	39,381	38,101	35,028	32,019	35,135	40,009	46,900
One year later	-	46,424	46,115	40,680	39,119	36,033	33,305	37,218	42,562	48,471
Two years later	-	-	46,115	40,680	39,119	36,033	33,305	37,218	42,562	48,471
Three years later	-	-	-	40,680	39,119	36,033	33,305	37,218	42,562	48,471
Four years later	-	-	-	-	39,119	36,033	33,305	37,218	42,562	48,471
Five years later	-	-	-	-	-	36,033	33,305	37,218	42,562	48,471
Six years later	-	-	-	-	-	-	33,305	37,218	42,562	48,471
Seven years later	-	-	-	-	-	-	-	37,218	42,562	48,471
Eight years later	-	-	-	-	-	-	-	-	42,562	48,471
Nine years later	-	-	-	-	-	-	-	-	-	48,471
Reestimated ceded losses and expenses	-	-	-	-	-	-	-	-	-	-
Reestimated incurred claims and expenses:										
End of policy year	36,938	49,274	52,944	47,705	44,219	39,520	35,935	40,742	46,768	54,050
One year later	-	46,424	46,115	40,680	39,119	36,033	33,305	37,218	42,562	48,471
Two years later	-	-	46,115	40,680	39,119	36,033	33,305	37,218	42,562	48,471
Three years later	-	-	-	40,680	39,119	36,033	33,305	37,218	42,562	48,471
Four years later	-	-	-	-	39,119	36,033	33,305	37,218	42,562	48,471
Five years later	-	-	-	-	-	36,033	33,305	37,218	42,562	48,471
Six years later	-	-	-	-	-	-	33,305	37,218	42,562	48,471
Seven years later	-	-	-	-	-	-	-	37,218	42,562	48,471
Eight years later	-	-	-	-	-	-	-	-	42,562	48,471
Nine years later	-	-	-	-	-	-	-	-	-	48,471
Increase (decrease) in estimated incurred claims and expenses from end of policy year	\$ -	\$ (2,850)	\$ (6,829)	\$ (7,025)	\$ (5,100)	\$ (3,487)	\$ (2,630)	\$ (3,524)	\$ (4,206)	\$ (5,579)

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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

**Report on the Financial Statements**

As Special Assistant Auditors for the Auditor General, we have audited, in accordance with the auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards* issued by the Comptroller General of the United States, the financial statements of the Local Government Health Insurance Reserve Fund (Fund) of the State of Illinois, Department of Central Management Services (Department), as of and for the year ended June 30, 2020, and the related notes to the financial statements, and we have issued our report thereon dated May 6, 2021.

**Compliance and Other Matters**

As part of obtaining reasonable assurance about whether the Department’s financial statements of the Fund 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 financial statements. 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 an instance of noncompliance or other matters that are required to be reported under *Government Auditing Standards* and which are described in the accompanying Schedule of Findings as item 2020-001.

**Internal Control Over Financial Reporting**

Management of the Department is responsible for establishing and maintaining effective internal control over financial reporting of the Fund (internal control).

In planning and performing our audit of the financial statements, we considered the Department’s 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 Department’s internal control. Accordingly, we do not express an opinion on the effectiveness of the Department’s 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 have not been 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 2020-001 that we consider to be a significant deficiency.

### **Department's Response to the Finding**

The Department's response to the finding identified in our audit is described in the accompanying Schedule of Findings. The Department's 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 entity's internal control or on compliance. This report is an integral part of an audit performed in accordance with *Government Auditing Standards* in considering the entity's internal control and compliance. Accordingly, this communication is not suitable for any other purpose.

**SIGNED ORIGINAL ON FILE**

Springfield, Illinois  
May 6, 2021

STATE OF ILLINOIS  
DEPARTMENT OF CENTRAL MANAGEMENT SERVICES  
LOCAL GOVERNMENT HEALTH INSURANCE RESERVE FUND  
FINANCIAL AUDIT  
For the Year Ended June 30, 2020

**SCHEDULE OF FINDINGS**

CURRENT FINDINGS – Government Auditing Standards

**2020-001. FINDING** (Inadequate Review of External Service Providers)

The Department of Central Management Services (Department) did not conduct adequate independent internal control reviews over its external service providers' System and Organization Control (SOC) reports utilized by the Local Government Health Insurance Plan (Plan).

The Department currently receives copies of the SOC reports from 11 different external service providers and performs an independent internal control review of each SOC report to determine whether any areas of concern are noted for the Plan. In total the Department received 14 SOC reports during the audit period for the Plan.

These service providers provide:

- Medical plan coverage and payments
- Claims processing
- Benefits solutions
- Plan administration
- IT hosting

During testing of the 14 SOC reports, we noted:

- Fourteen of 14 (100%) SOC reports identified Complementary User Entity Controls (CUEC) necessary for the Service Organization's system which relies on the Department to implement the CUECs in order to achieve the Service Organization's control objectives. The Department did not perform an assessment to determine if it had implemented the CUECs for each.
- Ten of 14 (71%) SOC external service provider reports identified additional subservice organizations used by the service organization that were carved out of the SOC report. These subservice organizations required additional CUECs and the service provider relied on the subservice organizations to implement the CUECs in order to achieve the Service Organization's control objectives. The Department did not perform additional assessments on the subservice organizations to determine if the CUECs had been implemented.

STATE OF ILLINOIS  
DEPARTMENT OF CENTRAL MANAGEMENT SERVICES  
LOCAL GOVERNMENT HEALTH INSURANCE RESERVE FUND  
FINANCIAL AUDIT  
For the Year Ended June 30, 2020

**2020-001. FINDING** (Inadequate Review of External Service Providers) – Continued

- Eight of 14 (57%) SOC reports had qualified opinions due to deficiencies noted by the SOC auditors. The Department did not perform an analysis on whether they could rely on the external service providers' controls due to the deficiencies noted in the SOC reports with qualified opinions. Through our assessment of the types of deficiencies noted by the SOC auditors, and the substantive testing we performed in other areas of our audit, we were able to rely on the testing and assurance provided by the SOC reports.

The National Institute of Standards and Technology (NIST), Special Publication 800-35, Guide to Information Technology Security Services, states the organization should ensure operational success by consistently monitoring service providers and organizational security performance against identified requirements, periodically evaluating changes in risks and threats to the organization and ensuring the organizational security solution is adjusted as necessary to maintain an acceptable security posture. As such, reviews of assessments, audits and inspections should be completed to determine the controls are in place at all vendors, service providers and subservice providers.

The Fiscal Control and Internal Auditing Act (30 ILCS 10/3001) requires State agencies to establish and maintain a system, or systems, of internal fiscal administrative controls, to provide assurance that 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 to maintain accountability over the State's resources. Strong management controls, due diligence, and fiduciary responsibility require adequate supervision of external service providers.

Department management stated the Department increased its efforts to improve oversight of its external service providers but was unable to implement a corrective action plan due to the brief amount of time between audit periods.

The SOC reports which include CUECs and subservice organization CUECs specifically assume the user entities will apply complementary controls included in the reports. The system descriptions within the SOC reports are designed considering these controls will be implemented by the user entities and doing so is necessary to fully achieve the control objectives covered by the SOC reports. The failure of the Department to consider the application of the complementary user controls to itself lessens the effectiveness of relying on the SOC reports as an element of its financial reporting internal control structure.

The qualified opinions in the SOC reports indicate deficiencies in the service organizations' control environment, which could potentially impact the Department and result in inaccurate data or the loss of data. (Finding Code No. 2020-001)

STATE OF ILLINOIS  
DEPARTMENT OF CENTRAL MANAGEMENT SERVICES  
LOCAL GOVERNMENT HEALTH INSURANCE RESERVE FUND  
FINANCIAL AUDIT  
For the Year Ended June 30, 2020

**2020-001. FINDING** (Inadequate Review of External Service Providers) – Continued

**RECOMMENDATION**

We recommend the Department:

- Monitor and document the operation of the Complementary User Entity Controls (CUECs) relevant to the Department's operations.
- Either obtain and review SOC reports for subservice organizations, if applicable to the Department's internal control environment, or perform alternative procedures to satisfy itself the usage of the subservice organizations would not impact the Department's internal control environment. Such review and procedures should be documented.
- Document its review of the SOC reports and review all significant issues with third-party service providers and subservice organizations to ascertain if a corrective action plan exists and when it will be implemented, any impacts to the Department, and any compensating controls.

**DEPARTMENT RESPONSE**

While all service providers' SOC reports were reviewed by the Department and Illinois Department of Innovation and Technology (DoIT), the Department agrees additional assessments on Complementary End User Controls (CEUCs), subservice organizations and qualified opinions, as identified in the audit, were not properly documented. The Department has worked with DoIT and our external service providers to update our SOC review process and documentation to address the concerns identified in the audit. The new process includes the following:

- 1) SOC reports are sent to the DoIT Compliance team, who then completes an initial review for each SOC report;
- 2) A call is scheduled to discuss, assess and document the risk of any opinions, identify subservice organizations and ensure CEUCs are in place;
- 3) When needed, follow-up meetings are held with the service provider and artifacts are provided to DoIT;
- 4) DoIT sends the documented SOC review to the Department for approval and signoff; and
- 5) Completed forms are retained by DoIT Compliance and the Department.

STATE OF ILLINOIS  
DEPARTMENT OF CENTRAL MANAGEMENT SERVICES  
LOCAL GOVERNMENT HEALTH INSURANCE RESERVE FUND  
FINANCIAL AUDIT  
For the Year Ended June 30, 2020

**2020-001. FINDING**           (Inadequate Review of External Service Providers) – Continued

The Department works closely with external service providers to ensure internal controls are in place including a strong monitoring framework for 3rd party vendors. Monitoring of the vendors' service measures is done regularly through a multi-layer approach to take the appropriate action to reduce, mitigate, and manage the risk of an incident impact on the Department's financial statements. Contractually, external service providers are required to report on service measures and meet performance standards, called performance guarantees, and any deficiencies are reported and are remediated with the vendors as soon as possible. These measures may include claim processing accuracy, claim payment accuracy and financial accuracy, as well as claim timeliness, and customer service. In addition, quarterly eligibility audits are required by each vendor – reconciling enrollments between our system of record and our 3<sup>rd</sup> party vendors, to ensure we are paying premiums or administrative fees and claims for the correct members. Rates are confirmed internally with procurement against contracts to ensure they match, rates are loaded into our system of record and verified prior to the effective date, and rates in carrier payment reports (self-billing reports from which payments are made) are checked in the period when new rates are introduced, to ensure we are paying the correct amounts. Carrier payment reports are accompanied each month by a separate file that details the successful Quality Assurance reporting for that month on the carrier payment reports, to ensure the reports have generated correctly. These administrative controls provide the Department with assurance that revenues, expenditures, and transfers of assets, resources, or funds applicable to operations are properly recorded and accounted for, mitigating the risk of an incident impacting the Department's financial statements.