

**STATE OF ILLINOIS
ILLINOIS WORKERS' COMPENSATION COMMISSION**

**FINANCIAL AUDIT
SELF-INSURERS SECURITY FUND
For the Year Ended June 30, 2017**

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

STATE OF ILLINOIS
ILLINOIS WORKERS' COMPENSATION COMMISSION
FINANCIAL AUDIT
SELF-INSURERS SECURITY FUND
For the Year Ended June 30, 2017

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**STATE OF ILLINOIS
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COMMISSION OFFICIALS

Chair	Joann Fratianni
Chief Fiscal Officer (10/01/17 – Present)	Paul Fichtner
Chief Fiscal Officer (Acting) (08/04/17 – 09/30/17)	Brendan O'Rourke
Chief Fiscal Officer (07/01/16 – 08/03/17)	Darlene Senger
General Counsel	Ronald Rascia

SELF-INSURERS ADVISORY BOARD¹

Chair	Joann Fratianni
Public Member	Paul Bergmann
Member	Gerald Cooper, Jr.
Member	Alex Alexandrou
Member	David Taylor
Member	Joan Vincenz
Member (08/01/18 – Present)	Michael Castro
Member (07/01/16 – 07/31/18)	John Rittenhouse

¹ The Workers' Compensation Act (Act) (820 ILCS 305/4a-3) requires the Board consist of the Chair of the Commission and six members who are experts in self-insurance for workers' compensation liabilities appointed by the Chair, one of whom is a member of the public. Under the Act (820 ILCS 305/4a-1), the Board provides for the continuation of benefits due from and unpaid by insolvent self-insurers and reviews and recommends a disposition on all initial and renewal applications to self-insure by private entities.

**STATE OF ILLINOIS
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FINANCIAL AUDIT
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COMMISSION OFFICES

The Commission's offices are located at:

100 W. Randolph Street
Suite 8-200
Chicago, Illinois 60601

1803 Ramada Boulevard
Suite B201
Collinsville, Illinois 62234

4500 S. Sixth Street Frontage Road
Springfield, Illinois 62703

200 S. Wyman Street
Rockford, Illinois 61101

401 Main Street
Suite 640
Peoria, Illinois 61602

**STATE OF ILLINOIS
ILLINOIS WORKERS' COMPENSATION COMMISSION
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For the Year Ended June 30, 2017**

FINANCIAL STATEMENT REPORT

SUMMARY

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

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

SUMMARY OF FINDINGS

The auditors identified matters involving the Commission's internal control over financial reporting that they considered to be a material weakness. This material weakness is described in the accompanying Schedule of Findings on pages 50-53 of this report as item 2017-001, *Inadequate Control over Financial Reporting*.

EXIT CONFERENCE

The finding and recommendation appearing in this report was discussed with Commission personnel at an exit conference on February 8, 2019.

Attending were:

Illinois Workers' Compensation Commission

Joann Fratianni – Chair

Paul Fichtner – Chief Fiscal Officer

Ronald Rascia – General Counsel

Mark Kimmet, CPA, CIA, CFE – Fiscal Operations

Maria Sarli-Dehlin – Office of Self-Insurance Manager

Office of the Auditor General

Daniel J. Nugent, CPA – Senior Audit Manager

E.C. Ortiz & Co., LLP

Epifanio R. Sadural III, CPA, CGMA – Partner

Charlou P. Rodriguez – Manager

The response to the recommendation was provided by Paul Fichtner, Chief Fiscal Officer, in a letter dated February 15, 2019.



INDEPENDENT AUDITOR'S REPORT

Honorable Frank J. Mautino
Auditor General
State of Illinois

and

Self-Insurers Security Board
State of Illinois, Illinois Workers' Compensation Commission

Report on the Financial Statements

As Special Assistant Auditors for the Auditor General, we have audited the accompanying financial statements of the Self-Insurers Security Fund of the State of Illinois, Illinois Workers' Compensation Commission, as of and for the year ended June 30, 2017, and the related notes to the 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 qualified audit opinion.

Opinion

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of the Self-Insurers Security Fund of the State of Illinois, Illinois Workers' Compensation Commission 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 Matters

As discussed in Note 2(A) to the financial statements, the financial statements present only the Self-Insurers Security Fund and do not purport to, and do not, present fairly the financial position of the State of Illinois or the State of Illinois, Illinois Workers' Compensation Commission, as of June 30, 2017, the 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.

In addition, as discussed in Note 15 to the financial statements, the Self-Insurers Security Fund had a total net position (deficit) of (\$3,428,465) as of June 30, 2017. This deficit, which is presented on an accrual basis, is the excess of total liabilities and deferred inflows of resources over total assets and deferred outflows of resources. Management of the State of Illinois, Illinois Workers' Compensation Commission stated that, subject to Board approval, future assessments will be used to meet the Fund's obligations in the future.

Additionally, as discussed in Note 2(R) to the financial statements, the State of Illinois, Illinois Workers' Compensation Commission adopted GASB Statement No. 68, *Accounting and Financial Reporting for Pensions – an amendment of GASB Statement No. 27*, for the Self-Insurers Security Fund during the year ended June 30, 2017. This statement established standards for measuring and recognizing liabilities, deferred outflows of resources, deferred inflows of resources, and expenses. In addition, as discussed in Note 2(R) to the financial statements, the State of Illinois, Illinois Workers' Compensation Commission adopted GASB Statement No. 71, *Pension Transition for Contributions Made Subsequent to the Measurement Date—an amendment of GASB Statement No. 68*, which addresses an issue regarding the application of the transition provisions of GASB Statement No. 68. The statement clarifies the accounting for contributions to a defined benefit pension plan after the measurement date of a government's beginning net pension liability. The provisions of this statement were incorporated with the implementation of GASB Statement No. 68. As discussed in Note 16(B) to the financial statements, the adoption of these statements required the State of Illinois, Illinois Workers' Compensation Commission to restate the Self-Insurers Security Fund's net position by (\$296,419) at June 30, 2016.

Further, as discussed in Note 16(A) to the financial statements, the State of Illinois, Illinois Workers' Compensation Commission has elected to change its method of accounting for (1) excess insurance recoveries, (2) security deposits, and (3) unpaid claims liabilities as of July 1, 2016. As discussed in Note 16(B) to the financial statements, the adoption of these statements required the State of Illinois, Illinois Workers' Compensation Commission to restate the Self-Insurers Security Fund's net position by (\$14,455,440) at June 30, 2016.

Finally, the State of Illinois' self-insurance program administered by the State of Illinois, Illinois Workers' Compensation Commission consists of two funds: the Self-Insurers Administration Fund and the Self-Insurers Security Fund. Pursuant to the Workers' Compensation Act (820 ILCS 305/4a-4 and 820 ILCS 305/4a-6.1), the Self-Insurers Administration Fund collects a \$500 application fee from each private self-insurer applying for or seeking renewal of the self-insurance privilege, which is available only for paying the salaries and benefits of the employees and the operating costs of the Self-Insurers Advisory Board within the State of Illinois, Illinois Workers' Compensation Commission. During our audit, we noted the Self-Insurers Administration Fund's expenses have exceeded revenues recognized for a significant period of time. According to the State of Illinois, Illinois Workers' Compensation Commission's unaudited accrual basis financial reports filed with the State of Illinois, Office of the Comptroller, the Self-Insurers Administration Fund's net loss was \$157 thousand, \$132 thousand, and \$86 thousand during Fiscal Year 2015, Fiscal Year 2016 and Fiscal Year 2017, respectively. Without operational changes and/or a legislative remedy, the continuing negative trend will eventually consume the Self-Insurers Administration Fund's remaining net position, which the State of Illinois, Illinois Workers' Compensation Commission's unaudited accrual basis financial reports filed with the Office of the State Comptroller reported was \$304 thousand at June 30, 2017.

Our opinion is not modified with respect to these matters.

Other Matters

Required Supplementary Information

Management has omitted management's discussion and analysis and budgetary comparison information for the Self-Insurers Security Fund that accounting principles generally accepted in the United States of America require to be presented to supplement the financial statements. Such missing 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. Our opinion on the financial statements is not affected by this missing information.

Other Reporting Required by Government Auditing Standards

In accordance with *Government Auditing Standards*, we have also issued our report dated February 26, 2019, on our consideration of the State of Illinois, Illinois Workers' Compensation Commission's internal control over financial reporting of the Self-Insurers Security 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 State of Illinois, Illinois Workers' Compensation Commission'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 State of Illinois, Illinois Workers' Compensation Commission's internal control over financial reporting of the Self-Insurers Security Fund and its compliance.

SIGNED ORIGINAL ON FILE

Chicago, Illinois
February 26, 2019

**STATE OF ILLINOIS
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**Statement of Net Position (Deficit)
June 30, 2017**

Assets

Current Assets

Restricted Cash Equity in the State Treasury	\$ 19,774,204
Restricted Cash and Cash Equivalents	53,094
Restricted Assessments Receivable	4,037
Restricted Accrued Interest Receivable	19,542
Restricted Excess Insurance Receivable	218,170
Securities Lending Collateral Equity with the State Treasurer	<u>6,386,000</u>
Total Current Assets	<u>26,455,047</u>

Total Assets	<u>26,455,047</u>
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Deferred Outflows of Resources

Pension	<u>504,565</u>
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Total Assets and Deferred Outflows of Resources	<u><u>\$ 26,959,612</u></u>
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The accompanying notes to the financial statements are an integral part of these statements.

**STATE OF ILLINOIS
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**Statement of Net Position (Deficit)
June 30, 2017**

Liabilities

Current Liabilities

Accounts Payable	\$ 28,271
Obligations Under Securities Lending of the State Treasurer	6,386,000
Security Deposits	1,198,303
Unearned Security Deposits	-
Unpaid Claims	606,633
Total Current Liabilities	8,219,207

Noncurrent Liabilities

Unearned Security Deposits	13,833,750
Compensated Absences	19,868
Unpaid Claims	7,381,567
Net Pension Liability	853,635
Total Noncurrent Liabilities	22,088,820

Total Liabilities 30,308,027

Deferred Inflows of Resources

Pension	80,050
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Total Liabilities and Deferred Inflows of Resources 30,388,077

Net Position (Deficit)

Expendable Restricted Net Position	-
Unrestricted Net Position (Deficit)	(3,428,465)
Total Net Position (Deficit)	(3,428,465)

**Total Liabilities, Deferred Inflows of Resources and
Net Position (Deficit)** \$ 26,959,612

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

**STATE OF ILLINOIS
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**Statement of Revenues, Expenses, and Changes in Net Position (Deficit)
Year Ended June 30, 2017**

Operating Revenues	
Assessments	\$ -
Security Deposits Drawn	(180,579)
Total Operating Revenues	<u>(180,579)</u>
 Operating Expenses	
Personal Services	83,667
Social Security Contribution	5,618
Group Insurance	32,278
Pension Expense	169,128
Benefit Claims	(249,982)
Total Operating Expenses	<u>40,709</u>
Operating Income (Loss)	<u>(221,288)</u>
 Nonoperating Revenues	
Interest Income	47,335
Total Nonoperating Revenues	<u>47,335</u>
Change in Net Position (Deficit)	<u>(173,953)</u>
Net Position, Beginning of the Year, as Previously Reported	11,497,347
Prior Period Adjustments (See Note 16)	(14,751,859)
Net Position (Deficit), Beginning of the Year, as Restated	<u>(3,254,512)</u>
Net Position (Deficit), End of the Year	<u><u>\$ (3,428,465)</u></u>

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

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**Statement of Cash Flows
Year Ended June 30, 2017**

Cash Flows from Operating Activities	
Cash Received from Assessments and Excess Insurance Recoveries	\$ 655,460
Payments to Employees and Other Personal Services	(156,475)
Refund of Assessment Overpayment	(2,274)
Benefit Payments	(989,287)
Net Cash Used in Operating Activities	(492,576)
 Cash Flows from Investing Activities	
Interest and Dividends on Investments	157,241
Net Cash Provided by Investing Activity	157,241
Net Decrease in Cash Equity in the State Treasury and Cash and Cash Equivalents	(335,335)
Cash Equity in the State Treasury and Cash and Cash Equivalents, Beginning of the Year	20,162,633
Cash Equity in the State Treasury and Cash and Cash Equivalents, End of the Year	\$ 19,827,298

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

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ILLINOIS WORKERS' COMPENSATION COMMISSION
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**Statement of Cash Flows
Year Ended June 30, 2017**

Reconciliation of Operating Loss to Net Cash Used in Operating Activities:

Operating Income (Loss)	\$ (221,288)
Adjustments to Reconcile Operating Income (Loss) to Net Cash Provided (Used) by Operating Activities:	
Changes in Assets and Liabilities:	
Assessment Receivable	72,117
Excess Insurance Receivable	129,886
Accounts Payable	2,226
Due to Other Funds	(2,858)
Unearned Security Deposits (excluding interest earned)	180,579
Compensated Absences	1,943
Unpaid Claims	(787,882)
Net Pension Liability	405,504
Deferred Outflows of Resources - Pension	(243,824)
Deferred Inflows of Resources - Pension	(28,979)
Net Cash Provided (Used) by Operating Activities	<u>\$ (492,576)</u>

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

**STATE OF ILLINOIS
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**Notes to the Financial Statements
June 30, 2017**

(1) Organization

The Illinois Workers' Compensation Commission (Commission) is a part of the executive branch of the State of Illinois (State). The Self-Insurers Advisory Board (Board) established within the Commission administers the Self-Insurers Security Fund (Fund), a non-shared proprietary (enterprise) fund. A non-shared fund is a fund in which a single State agency is responsible for administering substantially all financial transactions of a fund.

The Fund was established pursuant to the Workers' Compensation Act (Act) (820 ILCS 305/4a-5) to provide for the continuation of benefits due from and unpaid by insolvent self-insurers for any type of injury or occupational disease which is compensable under the Act or the Workers' Occupational Diseases Act, and all claims for related administrative fees, operating costs of the Board, attorneys fees, and other costs reasonably incurred by the Board.

Pursuant to the Act (820 ILCS 305/4a-5), the Fund is not subject to annual appropriation and, therefore, the Fund does not operate under a budget approved by the General Assembly. Instead, the Board annually establishes an informal budget and monitors the Fund's activity and anticipated future events during its quarterly meetings. Activities of the Commission, Board, and Fund are subject to the authority of the Governor, the State's chief executive officer, and other officers and agencies of the executive and legislative branches of the State's government (such as the Department of Central Management Services, the Governor's Office of Management and Budget, the Department of Innovation and Technology, the State's Treasurer, and the State's Comptroller).

Pursuant to the Act (820 ILCS 305/4a-7(a)), the Commission may, upon the direction of the Board from time to time, assess each of the private self-insurers a pro rata share of the funding reasonably necessary to carry out its activities.

Financial Reporting Entity

As defined by generally accepted accounting principles in the United States of America (GAAP), promulgated by the Governmental Accounting Standards Board (GASB), the financial reporting entity consists of the primary government, as well as its component units, which are legally separate organizations for which the elected officials of the government are financially accountable.

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Financial accountability is defined as:

- 1) the 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 dependency on the primary government.

Based on these criteria, the Fund has no component units and is not a component unit of any other entity. However, because the Fund is not legally separate from the State, the financial statements of the Fund are included within the State's financial statements. The State's Comprehensive Annual Financial Report (CAFR) may be obtained by writing to the State Comptroller's Office, Division of Financial Reporting, 325 W. Adams Street, Springfield, Illinois 62704 or by accessing its website at www.illinoiscomptroller.gov.

(2) Summary of Significant Accounting Policies

The financial statements of the Fund have been prepared in accordance with GAAP, as prescribed by GASB. To facilitate understanding data included in the financial statements, summarized below are more significant accounting policies of the Fund.

A. Basis of Accounting and Presentation

In government, the basic accounting and reporting entity is a fund. A fund is an independent fiscal and accounting entity with a self-balancing set of accounts recording cash and/or other resources together with all related liabilities, obligations, reserves, and equities which are segregated for the purpose of carrying on specific activities or attaining certain objectives in accordance with special regulations, restrictions, or limitations.

The financial statements of the Fund are intended to present the financial position, changes in financial position, and cash flows of only that portion of the activities of the State attributable to the Fund's specific transactions administered by the Board established within the Commission. They do not purport to, and do not, present fairly the financial position of the State or the Commission as of June 30, 2017, or the changes in financial

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position and cash flows for the year then ended, in conformity with GAAP.

The Fund is a proprietary (enterprise) fund, as it charges a fee to external users for its services. The Fund is reported using the economic resources measurement focus and the accrual basis of accounting. Revenues are recorded when earned and expenses are recorded at the time liabilities are incurred, regardless of when the related cash flow takes place.

B. Cash and Cash Equivalents

Cash equivalents are defined as short-term, highly liquid investments readily convertible to cash within maturities of less than 90 days at the time of purchase. Cash and cash equivalents include "Cash Equity in the State Treasury", cash on hand and in transit to the State Treasury, and a petty cash account.

C. Inventory Items

The Fund does not maintain any significant inventory items and associated balances.

D. Capital Assets

Capital assets, which consist of equipment items, are reported at historical cost and depreciated using the straight-line method. The capitalization threshold for equipment is \$5,000 and the estimated useful lives range from 36 to 300 months. As of June 30, 2017, the Fund did not have any capital assets.

E. Assessments and Assessments Receivable

Pursuant to the Act (820 ILCS 305/4a-7(a)), the Commission may, upon the direction of the Board from time to time, assess the private self-insurers a pro rata share of the funding reasonably necessary to carry out its activities. For any individual assessment, the Board is limited to charging a maximum assessment of 0.6% upon a private self-insurer's workers' compensation payments made during the prior calendar year, less any hospital, surgical, and rehabilitation payments. During any calendar

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year, the Board may not impose total assessments in excess of 1.2% of a private self-insurer's workers' compensation payments made during the prior calendar year, less any hospital, surgical, and rehabilitation payments.

Each private self-insurer calculates its amount due after the Board declares an assessment. This amount is subject to review by the Commission.

Assessment revenue is recognized by the Fund on the date when the Board approves an assessment. This revenue is recorded net of an allowance for doubtful accounts, which is based on an analysis of the historical collection experience of the Fund's assessments, the age of the assessment receivable, and general economic conditions. Assessments receivable consists of two parts: known unpaid assessments and management's estimation of the amount due from private self-insurers that have not yet admitted its liability as of the date of the financial statements.

Under the Act (820 ILCS 305/4a-7(a)), if an assessment is not paid within 30 days after the private self-insurer receives notice, the Commission, at the direction of the Board, "shall proceed in circuit court for judgment against that private self-insurer which judgment shall include the amount of the assessment, the costs of suit, interest and reasonable attorneys' fees." In accordance with GASB Statement No. 33, *Accounting and Financial Reporting for Nonexchange Transactions*, any receivables and revenue from the costs of the suit, interest, and reasonable attorneys' fees are recognized when the Fund has a legal, enforceable claim to these amounts, net of an allowance for doubtful accounts and estimated refunds on appeal, or when the resources are received, whichever occurs first.

F. Accrued Interest Receivable

Pursuant to the Act (820 ILCS 305/4a-5), the State Treasurer must deposit any interest accruing on the Fund's Cash Equity within the State Treasury to the Fund. Currently, the Treasurer deposits any interest and investment income earned during a given month during the subsequent month.

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G. Excess Insurance Receivable

In general, excess insurance is an insurance policy where the underwriter's liability does not arise until the loss exceeds a stated amount. After reaching the stated amount, all future payments must be made by the underwriting insurer. In some cases, private self-insurers purchased excess insurance policies to limit their losses arising from a benefit claim under the Act or the Workers' Occupational Diseases Act. In the event a private self-insurer becomes insolvent and the excess insurance limit has been exceeded, the Fund ensures the injured worker's benefits are paid when due. If the Fund pays the injured worker, the Fund records an excess insurance receivable and seeks reimbursement from the excess insurer. For these receivables, the Fund does not recognize any revenue or expenses, as the Fund is merely acting as an intermediary as the benefit due is the obligation of the insurer.

Counterparty Risk

Counterparty risk, also known as default risk, is the risk that one party to a contract will not fulfill its contractual obligations. In the excess insurance context, the Fund will continue to ensure injured workers receive benefits due on a timely basis, regardless of whether the excess insurer fulfills its responsibility to cover its share of the loss. Under GASB Statement No. 62, *Codification of Accounting and Financial Reporting Guidance Contained in Pre-November 30, 1989, FASB and AICPA Pronouncements*, Fund management will adjust its excess insurance receivable amount if (1) information is available prior to the date of the financial statements which indicates it is probable the excess insurance receivable has been impaired where future events will confirm the fact of loss and (2) the amount can be reasonably estimated. As such, the Fund records its excess insurance receivables net of an allowance for doubtful accounts, which is based on Fund management's analysis of the historical collection experience of the Fund's assessments, ratings of the insurer by third parties, the age of the assessment receivable, and general economic conditions.

Correspondingly, when Fund management expects an excess insurer will not fulfill its contractual obligations, the Fund will increase its total unpaid claims liability to reflect benefit amounts previously expected to be paid by the excess insurer will now be borne by the Fund.

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**Notes to the Financial Statements
June 30, 2017**

H. Interfund Transactions

The Fund could experience the following types of interfund transactions between the Commission's funds and the funds of other State agencies:

- 1) *Transfers*: These transactions occur when a flow of assets (either cash and/or goods) from one fund to another fund occurs without an equivalent flow of assets in return and without a requirement for repayment. Transfers are reported after nonoperating revenues and expenses. Unpaid amounts are reported as due to (interfund payables) and due from (interfund receivables) in the statement of net position (deficit).
- 2) *Interfund Loans*: These transactions occur when a flow of assets (either cash and/or goods) from one fund to another fund occurs with a requirement for repayment. Unpaid amounts are reported as due to and due from in the statement of net position (deficit).
- 3) *Interfund Reimbursements*: These transactions occur when the fund responsible for the expense repays the cost of the expense to the fund that initially paid the cost, which will eliminate the expense from the initial payor fund's records. Unpaid amounts are reported as due to and due from in the statement of net position (deficit).
- 4) *Services Provided and Used*: The transactions occur when sales purchases of goods and/or services occur between funds for a price approximating the transaction's external exchange value. Interfund services provided and used are reported as revenues in seller funds and expenses/expenditures in purchaser funds. Unpaid amounts are reported as due to and due from in the statement of net position (deficit).

I. Security

To help provide assurance each private self-insurer fulfills its obligations under the Act and the Workers' Occupational Diseases Act, the Board, if deemed necessary, will require each private self-insurer to post a letter of credit, surety bond, or other acceptable security. The Commission, on

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behalf of the Board, will not draw down upon these securities unless a significant risk exists the private self-insurer is either unable or unwilling to fulfill its obligations under the Act and the Workers' Occupational Diseases Act. As such, the Fund will not recognize assets or liabilities for a posted security until it is converted or drawn down upon on behalf of the Board by the Commission.

J. Security Deposits

Security deposits consist of proceeds from securities collected by the Commission where the Fund has not yet assumed responsibility for paying the private self-insurer's injured workers' claims. Each individual company's balance within this account includes an allocation of interest and investment income earned on the private self-insurer's moneys deposited within the Fund by the Treasurer. This balance may be returned to the company (or its surety) either (1) when the risk the self-insurer would not fulfill its obligations passes or (2) one year after its last claim has been paid, provided the claim application filing period has expired.

K. Unearned Security Deposits

Unearned security deposits consist of proceeds from securities collected by the Commission where the private self-insurer's obligations have become the responsibility of the Fund. The portion of a company's collected securities in excess of the company's related claims expense and administrative costs incurred by the Fund, net of any amounts that are reimbursable from excess insurance carriers, is considered unearned by the Fund. In accordance with the Fund's security agreements, this excess security may be returned to the company (or its surety) one year after its last claim has been paid, provided the claim application filing period has expired.

L. Compensated Absences

The liability for compensation absences reported in the statement of net position (deficit) for the Fund consists of unpaid, accumulated vacation and sick leave balances for Fund employees. The liability has been calculated using the vesting method, in which leave amounts for both employees who are currently eligible to receive termination payments and

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other employees who are expected to become eligible in the future to receive termination payments upon termination are included. The liability has been calculated based on the employee's current salary level and includes salary-related costs (e.g., Social Security and Medicare taxes).

Legislation that became effective January 1, 1998, capped the paid sick leave for all State Employees' Retirement System (SERS) 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 January 1, 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.

M. Unpaid Claims

Unpaid claims liabilities were determined from an actuarial analysis based upon claims history, medical reports, awarded benefits, legal pleadings, life expectancy, inflation, and other factors for determining an estimate of the Fund's anticipated indemnity and medical payments, as well as legal and administrative costs associated with handling claims.

Fund management has adopted the net method of accounting for unpaid claims liabilities of the Fund. Under this method, expenses are reported for the full amount of estimated future claims, net of the portion expected to be reimbursed by excess insurance carriers, when the Fund assumes responsibility for paying a private self-insurer's benefits due under the Act and the Workers' Occupational Diseases Act.

Securities collected before the Fund assumes responsibility for paying the private self-insurer's claims are reported as security deposits. At the time when the Fund assumes responsibility for paying the claims, the Fund records (1) revenue for the portion of any security collected to the extent it is required to cover the self-insurer's claims and (2) unearned security deposits for the portion of any security collected that exceeds the private self-insurer's outstanding claims.

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Contingencies for Self-Insurers under Bankruptcy Protection

Pursuant to GASB Statement No. 62, *Codification of Accounting and Financial Reporting Guidance Contained in Pre-November 30, 1989, FASB and AICPA Pronouncements*, the Fund does not report any unpaid claims liabilities on its statement of net position (deficit) associated with private self-insurers under bankruptcy protection which continue to pay their claims through the date when the Fund's financial statements are issued.

The Fund will only pay these claims, along with any other claims arising while the entity was a private self-insurer, if the self-insurer stops paying its claims. As it is both not known if or when this event will occur and what the magnitude of these liabilities will be when the entity stops paying its claims, these claims are not reported on the Fund's statement of net position (deficit). However, these cases are disclosed within the Fund's notes to the financial statements where there is, at least, a reasonable possibility the Fund could become responsible for paying these claims.

Subsequent Events

In accordance with GASB Statement No. 56, *Codification of Accounting and Financial Reporting Guidance Contained in the AICPA Statements on Auditing Standards*, events occurring subsequent to the statement of net position (deficit) which do not provide additional evidence with respect to conditions existing on the date of the statement of net position (deficit) are considered nonrecognized events. Typically, the Fund's nonrecognized events occur when a beneficiary unexpectedly passes away or takes an unexpected action that disqualifies the beneficiary from receiving benefits. The Fund discloses any known nonrecognized events within the Fund's subsequent events footnote.

N. Pensions

In accordance with GASB Statement No. 68, *Accounting and Financial Reporting for Pensions – an amendment of GASB Statement No. 27*, the net pension liability, deferred outflows of resources, deferred inflows of resources, and pension expense have been recognized in the Fund's financial statements.

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The net pension liability is calculated as the difference between the actuarially calculated value of the projected benefit payments attributed to past periods of service and the plans' fiduciary net position. The total pension expense is comprised of the service cost or actuarial present value of projected benefit payments attributed to the valuation year, interest on the total pension liability, plan administrative expenses, current year benefit changes, and other changes in plan fiduciary net position less employee contributions and projected earnings on plan investments. Additionally, the total pension expense includes the annual recognition of outflows and inflows of resources due to pension assets and liabilities.

For purposes of measuring the net pension liability, deferred outflows of resources, deferred inflows of resources, and pension expense associated with the Fund's contribution requirements, information about the fiduciary net position of the SERS and additions to/deductions from the SERS' fiduciary net position have been determined on the same basis as they are reported within the separately issued SERS financial statements. For this purpose, benefit payments (including refunds of employee contributions) are recognized when due and payable in accordance with terms of the plan. Investments are reported at fair value.

O. Net Position (Deficit)

In the statement of net position (deficit), the Fund's equity is displayed in three components (as applicable).

- 1) *Invested in Capital Assets:* This balance consists of capital assets, net of accumulated depreciation, reduced by outstanding balances for bonds, notes, and other forms of debt which is attributed to the acquisition, construction, or improvement of those assets.

At June 30, 2017, the Fund did not have any investment in capital assets net position.

- 2) *Restricted:* This balance consists of resources legally restricted by either outside parties or by law through constitutional provisions or enabling legislation. This balance is divided between expendable resources and nonexpendable resources which must be retained in perpetuity. When both restricted and unrestricted resources are

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available for use, it is generally the Fund's policy to use restricted resources first and then use unrestricted resources when needed.

Under GASB Statement No. 63, *Financial Reporting of Deferred Outflows of Resources, Deferred Inflows of Resources, and Net Position*, this balance is intended to portray, as of the date of the statement of net position (deficit), the extent to which the Fund has assets that can only be used for specific purposes reduced by liabilities and deferred inflows of resources related to those assets. Further, under GASB Implementation Guide No. 2015-1, negative amounts should not be reported for any category of restricted net position. Therefore, if the related liabilities and deferred inflows of resources exceed the restricted assets, the "shortfall" by default is covered by unrestricted assets.

At June 30, 2017, the Fund did not have any restricted net position.

- 3) *Unrestricted*: This balance consists of net position (deficit) that does not meet the definition of "invested in capital assets" or "restricted".

At June 30, 2017, the Fund reported an unrestricted net position (deficit) of (\$3,428,465).

P. Classification of Revenues and Expenses

The Fund classifies its revenues and expenses as either nonoperating or operating in the statement of revenues, expenses, and changes in net position (deficit) according to the following criteria:

Revenue

Operating revenues – such as assessments and security deposits earned when the Fund fulfills a private self-insurer's benefit obligations and incurs any associated administrative costs – result from exchange transactions associated with the principal activity of the Fund. Exchange transactions are those transactions in which each party receives and gives up essentially equal values. Given this policy, any revenue reported from collected security deposits will not exceed the estimated unpaid claims

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expense associated with the collected security deposits. Nonoperating revenues, such as interest and investment income, result from certain nonexchange transactions or ancillary activities.

Expenses

All expenses incurred by the Fund are considered operating, as they result from exchange transactions associated with the principal activity of the Fund.

Q. Use of Estimates

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

Actuarial Disclaimer

The actuary used by the Fund disclosed the following disclaimer related to its estimation of the unpaid claims liability:

Evaluating loss and loss expense reserves involves the estimation of the outcome of future uncertain events. As such, they are subject to variation from expected values. Due to the nature and degree of uncertainty involved in projecting reserves, there can be no guarantee that our independent estimates will prove adequate or not excessive. However, the assumptions and methods we have employed in our analysis are, in our opinion, reasonable under the circumstances.

R. Current Adoption of GASB Statements

Effective for the year ending June 30, 2017, the Fund adopted GASB Statement No. 68, *Accounting and Financial Reporting for Pensions—an amendment of GASB Statement No. 27*, which establishes standards for measuring and recognizing liabilities, deferred outflows of resources,

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deferred inflows of resources, and expenses. The statement identifies the methods and assumptions that should be used to project benefit payments, discount projected benefit payments to their actuarial present value, and attribute that present value to periods of employee service. Implementation of GASB Statement No. 68 significantly impacted the Fund's financial statements and related footnote disclosures and resulted in a restatement of the Fund's beginning net position.

Effective for the year ending June 30, 2017, the Fund adopted GASB Statement No. 71, *Pension Transition for Contributions Made Subsequent to the Measurement Date—an amendment of GASB Statement No. 68*, which addresses an issue regarding the application of the transition provisions of GASB Statement No. 68. The statement clarifies the accounting for contributions to a defined benefit pension plan after the measurement date of a government's beginning net pension liability. The provisions of this statement were incorporated with the implementation of GASB Statement No. 68.

Effective for the year ending June 30, 2017, the Fund adopted GASB Statement No. 73, *Accounting and Financial Reporting for Pensions and Related Assets That Are Not within the Scope of GASB Statement 68, and Amendments to Certain Provisions of GASB Statements 67 and 68*, which addresses the accounting and reporting requirements for the financial reports of governments with pensions and pension plans not administered through trusts that meet the criteria in Statement No. 68. The implementation of this statement had no financial impact on the Fund's net position or results of operations.

Effective for the year ending June 30, 2017, the Fund adopted GASB Statement No. 74, *Financial Reporting for Postemployment Benefit Plans Other Than Pension Plans*, which establishes standards for the financial reports of defined benefit OPEB plans administered through trusts that meet specified criteria. The standard requires plans that are administered through a trust that meet the specified criteria to present a statement of fiduciary net position, as well as a statement of changes in net position. The standard also requires more extensive note disclosures and required supplementary information ("RSI") related to significant assumptions and other inputs used in the measurement of OPEB liabilities for which assets have been accumulated and information about the annual money-weighted

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return on plan investments. The implementation of this statement had no financial impact on the Fund's net position or results of operations.

Effective for the year ending June 30, 2017, the Fund adopted GASB Statement No. 77, *Tax Abatement Disclosures*, which requires governments that enter into tax abatement agreements to disclose specific information about the nature and magnitude of the agreements to make these transactions more transparent to financial statement users. A tax abatement results from an agreement between a government and an individual or entity in which the government promises to forgo tax revenues, and the individual or entity promises to subsequently take a specific action that contributes to economic development or otherwise benefits the government or its citizens. The statement provides users of financial statements the ability to understand how tax abatements affect a government's future ability to raise resources and meet its financial obligations and the impact those abatements have on a government's financial position and economic condition. The implementation of this statement had no financial impact on the Fund's net position or results of operations.

Effective for the year ending June 30, 2017, the Fund adopted GASB Statement No. 78, *Pensions Provided through Certain Multiple-Employer Defined Benefit Pension Plans*, which amends the scope of GASB Statement No. 68 to exclude pensions provided by certain multi-employer defined benefit pension plans that are not state or local government plans. The implementation of this statement had no financial impact on the Fund's net position or results of operations.

Effective for the year ending June 30, 2017, the Fund adopted GASB Statement No. 80, *Blending Requirements for Certain Component Units – an amendment of GASB Statement No. 14*, which amends the blending requirements for the financial statement presentation of component units of all state and local governments. The additional criterion requires blending of a component unit incorporated as a not-for-profit corporation in which the primary government is the sole corporate member. The implementation of this statement had no financial impact on the Fund's net position or results of operations.

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Effective for the year ending June 30, 2017, the Fund adopted GASB Statement No. 82, *Pension Issues – An Amendment of GASB Statements No. 67, No. 68, and No. 73*, which addresses certain issues which have been raised with respect to Statements No. 67, No. 68 and No. 73. The Statement clarifies the presentation of payroll-related measures in required supplementary information, the selection of assumptions and the treatment of deviations from the guidance in the Actuarial Standard of Practice for financial reporting purposes, and the classification of payments made by employers to satisfy employee or plan member contribution requirements. The implementation of this statement had no financial impact on the Fund's net position or results of operations.

S. Future Adoption of GASB Statements

Effective for the year ending June 30, 2018, the Fund will adopt GASB Statement No. 75, *Accounting and Financial Reporting for Postemployment Benefits Other Than Pensions*, which establishes standards for measuring and recognizing liabilities, deferred outflows of resources, deferred inflows of resources, and expenses, and identifies the note disclosure and RSI reporting requirements. This statement requires the Fund to report a liability on the face of the financial statements for the other postemployment benefits (OPEB) it provides and identifies the methods and assumptions that are required to be used to project benefit payments, discount projected benefit payments to their actuarial present value and attribute that present value to periods of employee service. Implementation of GASB Statement No. 75 is expected by Commission management to significantly impact the Fund's financial statements and related footnote disclosures.

Effective for the year ending June 30, 2018, the State will adopt GASB Statement No. 81, *Irrevocable Split-Interest Agreements*, which improves the accounting and financial reporting for irrevocable split-interest agreements by providing recognition and measurement guidance. A split-interest agreement is a type of giving agreement used by donors to provide resources to two or more beneficiaries, including governments. Split-interest agreements can be created through trusts or other legally enforceable agreements with characteristics that are equivalent to split interest agreements, in which a donor transfers resources to an intermediary to hold and administer for the benefit of a government and at

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least one other beneficiary. The Commission does not expect a material impact on the Fund's financial statements as a result of adopting this statement.

Effective for the year ending June 30, 2019, the Fund will adopt GASB Statement No. 83, *Certain Asset Retirement Obligations*, which establishes standards for the accounting and financial reporting for certain asset retirement obligations (AROs). An ARO is a legally enforceable liability associated with the retirement or permanent removal of a tangible capital asset from service such as from sale, abandonment, recycling, or disposal. The statement provides uniform criteria for governments to recognize and measure certain AROs including the timing and pattern of recognition of the liability and the corresponding deferred outflow of resources. The Commission does not expect a material impact on the Fund's financial statements as a result of adopting this statement.

Effective for the year ending June 30, 2020, the Fund will adopt GASB Statement No. 84, *Fiduciary Activities*, the objective of which is to improve guidance regarding the identification of fiduciary activities for accounting and financial reporting purposes, the recognition of liabilities to beneficiaries, and how fiduciary activities should be reported. The statement redefines the fiduciary fund types focusing on the resources to be reported within each. The types include pension (and other employee benefit) trust funds, investment trust funds, private-purpose trust funds, and custodial funds. A statement of fiduciary net position will be used to report assets, deferred outflows of resources, liabilities, deferred inflows of resources and fiduciary net position of pension (and other employee benefit) trust funds, investment trust funds, private-purpose trust funds, and custodial funds. A statement of changes in fiduciary net position will be required to report additions to and deductions from the four fiduciary fund types including the presentation of investment earnings, investment costs, net investment earnings and deductions, disaggregated by type. The Commission has not yet determined the impact on the Fund's financial statements as a result of adopting this statement.

Effective for the year ending June 30, 2018, the State will adopt GASB Statement No. 85, *Omnibus 2017*, the objective of which is to address practice issues identified during the implementation and application of certain GASB statements. The statement addresses a variety of topics

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including issues related to blending component units, goodwill, fair value measurement and application and postemployment benefits (pensions and other postemployment benefits). The Commission has not yet determined the impact on the Fund's financial statements as a result of adopting this statement.

Effective for the year ending June 30, 2018, the State will adopt GASB Statement No. 86, *Certain Debt Extinguishment Issues*, which establishes uniform guidance for derecognizing debt that is defeased in-substance, regardless of how cash and other monetary assets placed in an irrevocable trust for the purpose of extinguishing debt were acquired. The statement will also improve consistency in financial reporting of prepaid insurance related to debt that has been extinguished. The Commission does not expect a material impact on the Fund's financial statements as a result of adopting this statement.

Effective for the year ending June 30, 2021, the State will adopt GASB Statement No. 87, *Leases*, which is intended to improve accounting and financial reporting for leases by governments to better meet the information needs of financial statement users. The Statement increases the usefulness of governments' financial statements by requiring recognition of certain lease assets and liabilities for leases that previously were classified as operating leases and recognized as inflows of resources or outflows of resources based on the payment provisions of the contract. It establishes a single model for lease accounting based on the foundational principle that leases are financings of the right to use an underlying asset. The Commission has not yet determined the impact on the Fund's financial statements as a result of adopting this statement.

Effective for the year ending June 30, 2019, the Fund will adopt GASB Statement No. 88, *Certain Disclosures Related to Debt, including Direct Borrowings and Direct Placements*, which establishes standards to improve the information that is disclosed in notes to government financial statements related to debt, including direct borrowings and direct placements. It also clarifies which liabilities governments should include when disclosing information related to debt. The Commission does not expect a material impact on the Fund's financial statements as a result of adopting this statement.

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Effective for the year ending June 30, 2021, the Fund will adopt GASB Statement No. 89, *Accounting for Interest Cost Incurred before the End of a Construction Period*, which establishes accounting requirements for interest cost incurred before the end of a construction period. This statement requires interest cost incurred before the end of a construction period be recognized as an expense in the period in which the cost is incurred for financial statements prepared using the economic resources measurement focus. As a result, interest cost incurred before the end of a construction period will not be included in the historical cost of a capital asset reported in a business-type activity or enterprise fund. The Commission does not expect a material impact on the Fund's financial statements as a result of adopting this statement.

Effective for the year ending June 30, 2020, the Fund will adopt GASB Statement No. 90, *Majority Equity Interests—an amendment of GASB Statements No. 14 and No. 61*, which defines a majority equity interest and specifies that a majority equity interest in a legally separate organization should be reported as an investment if a government's holding of the equity interest meets the definition of an investment. A majority equity interest that meets the definition of an investment should be measured using the equity method, unless it is held by a special-purpose government engaged only in fiduciary activities, a fiduciary fund, or an endowment (including permanent and term endowments) or permanent fund. Those governments and funds should measure the majority equity interest at fair value. The Commission does not expect a material impact on the Fund's financial statements as a result of adopting this statement.

(3) Deposits and Investments

The State's Treasurer is the custodian of the Fund's deposits and investments for funds maintained in the State Treasury. These amounts are classified as "Cash Equity in the State Treasury" on the statement of net position (deficit). The Commission independently manages deposits and investments maintained outside of the State Treasury.

A. Deposits

Deposits in the custody of the Treasurer, totaling \$19,774,204 at June 30, 2017, are pooled and invested with other State funds in accordance with

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the Deposit of State Moneys Act (15 ILCS 520/11). Funds held by the Treasurer have not been categorized as to credit risk because the Fund does not own individual securities. Details on the nature of these deposits and investments are available within the State's CAFR.

B. In-Transit Cash and Cash Equivalents

At June 30, 2017, the Commission was holding \$52,994 of in-transit cash and cash equivalents for the Fund awaiting deposit into the State Treasury. The Fund has not incurred any losses on these amounts and considers the risk minimal, as the Commission deposited these moneys into the State Treasury and ordered them into the Fund after June 30, 2017.

C. Petty Cash Account

The Commission maintains a petty cash fund of \$100 for the Fund in strict adherence with the provisions of the Statewide Accounting Management System established by the State's Comptroller. This account is maintained in physical cash on an imprest basis, where cash on hand, vendor's invoices not reimbursed, and reimbursement vouchers in transit must always equal \$100. At June 30, 2017, the Commission was holding \$100 in cash and did not have any unreimbursed vendor invoices or reimbursement vouchers in transit.

(4) Securities Lending Transactions

The State's Treasurer lends securities to broker-dealers and other entities for collateral that will be returned for the same securities in the future. The Treasurer has, through a Securities Lending Agreement, authorized Deutsche Bank AG to lend the Treasurer's securities to broker-dealers in 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%.

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The Treasurer did not impose any restrictions during Fiscal Year 2017 on loan amounts of available and eligible securities. In the event of borrower default, Deutsche Bank AG provides the Treasurer with counterparty default indemnification. In addition, Deutsche Bank AG is obligated to indemnify the Treasurer if Deutsche Bank AG loses any securities, collateral or investments of the Treasurer in Deutsche Bank AG's custody. Moreover, there were no losses during Fiscal Year 2017 resulting from a default of the borrowers or Deutsche Bank AG.

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 Treasurer had no credit risk because 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 Treasurer as of June 30, 2017, were \$3,522,922,500 and \$3,475,790,990, respectively.

In accordance with paragraph 9 of GASB Statement No. 28, *Accounting and Financial Reporting for Securities Lending Transactions*, the Treasurer may allocate assets and obligations arising from securities lending agreements to the various funds of the State. The securities lending collateral invested in repurchase agreements allocated to the Fund was \$6,386,000 on June 30, 2017.

(5) Interfund Balances and Activity

The Fund did not have any interfund balances or activity during the fiscal year ended June 30, 2017.

(6) Capital Assets

The Fund did not have any capital assets or related activity during the fiscal year ended June 30, 2017.

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(7) Assessment Receivables

At June 30, 2017, the Fund had outstanding assessment receivables of \$4,037, net of an allowance for doubtful accounts of \$0.

(8) Excess Insurance Receivables

At June 30, 2017, the Fund had excess insurance receivables of \$218,170, net of an allowance for doubtful accounts of \$0. All excess insurance companies had an AM Best rating of "A" or better as of June 30, 2017, and all excess insurance receivables were collected in cash by the Fund before December 1, 2017.

(9) Long-Term Obligations

A. Changes in Long-Term Obligations

The Fund's changes in long-term obligations for compensated absences and unpaid claims during the year ended June 30, 2017, were as follows:

	Compensated Absences	Unpaid Claims
Balance on July 1, 2016	\$ 17,925	\$ 8,776,083
Change in Estimate and/or Claim Development	-	(365,772)
Additions	1,943	115,790
Deletions	-	(537,901)
Balance on June 30, 2017	<u>\$ 19,868</u>	<u>\$ 7,988,200</u>
Amounts Due Within One Year	\$ -	\$ 606,633
Amounts Due Beyond One Year	19,868	7,381,567
Total	<u>\$ 19,868</u>	<u>\$ 7,988,200</u>

The change in estimate and/or claim development occurring within Fiscal Year 2017 was due to the Commission settling two outstanding claims and three beneficiaries who unexpectedly passed away.

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B. Benefit Claims Expense

The Fund's benefit claims expense consisted of (1) settlements reached by the Commission and claimants in five cases not previously recognized of \$16,644, (2) expenses related to new claims of \$99,146, and (3) a change in estimate and/or claim development of (\$365,772), totaling (\$249,982).

(10) Pension Plan

Plan Description

Substantially all of the Fund's full-time employees who are not eligible for participation in another State-sponsored retirement plan participate in SERS, which is a single-employer defined benefit pension trust fund in the State's reporting entity. SERS is governed by Article 14 of the Illinois Pension Code (40 ILCS 5/1, et al.). The Plan consists of two tiers of contribution requirements and benefit levels based on when an employee was hired. Members who first become an employee and participate under any of the State's retirement plans on or after January 1, 2011, are members of Tier 2, while Tier 1 consists of employees hired before January 1, 2011, or those who have service credit prior to January 1, 2011. The provisions below apply to both Tier 1 and 2 members, except where noted. The SERS issues a separate CAFR available at www.srs.illinois.gov or that may be obtained by writing to the SERS, 2101 South Veterans Parkway, Springfield, Illinois, 62794-9255.

Benefit Provisions

SERS provides retirement benefits based on the member's final average compensation and the number of years of credited service that have been established. The retirement benefit formula available to general State employees is 1.67% for each year of covered service and 2.2% for each year of noncovered service. The maximum retirement annuity payable is 75% of final average compensation as calculated under the regular formula. The minimum monthly retirement annuity payable is \$15 for each year of covered employment and \$25 for each year of noncovered employment.

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Participants in SERS under the regular formula Tier 1 and Tier 2 receive the following levels of benefits based on the respective age and years of service credits.

Regular Formula Tier 1	Regular Formula Tier 2
<p>A member must have a minimum of eight years of service credit and may retire at:</p> <ul style="list-style-type: none"> • Age 60, with 8 years of service credit. • Any age, when the member's age (years & whole months) plus years of service credit (years & whole months) equal 85 years (1,020 months) (Rule of 85) with eight years of credited service. • Between ages 55-60 with 25-30 years of service credit (reduced 1/2 of 1% for each month under age 60). <p>The retirement benefit is based on final average compensation and credited service. Final average compensation is the 48 highest consecutive months of service within the last 120 months of service.</p> <p>Under the Rule of 85, a member is eligible for the first 3% increase on January 1 following the first full year of retirement, even if the member is not age 60. If the member retires at age 60 or older, he/she will receive a 3% pension increase every year on January 1, following the first full year of retirement.</p>	<p>A member must have a minimum of 10 years of credited service and may retire at:</p> <ul style="list-style-type: none"> • Age 67, with 10 years of credited service. • Between ages 62-67 with 10 years of credited service (reduced 1/2 of 1% for each month under age 67). <p>The retirement benefit is based on final average compensation and credited service. For regular formula employees, final average compensation is the average of the 96 highest consecutive months of service within the last 120 months of service. The retirement benefit is calculated on a maximum salary of \$106,800. This amount increases annually by 3% or one-half of the Consumer Price Index, whichever is less.</p> <p>If the member retires at age 67 or older, he/she will receive a pension increase of 3% or one-half of the Consumer Price Index for the preceding calendar year, whichever is less, every year on January 1, following the first full year of retirement. The calendar year 2016 rate is \$111,572.</p>

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Regular Formula Tier 1 (continued)	Regular Formula Tier 2 (continued)
If the member retires before age 60 with a reduced retirement benefit, he/she will receive a 3% pension increase every January 1 after the member turns age 60 and has been retired at least one full year. These pension increases are not limited by the 75% maximum.	If the member retires before age 67 with a reduced retirement benefit, he/she will receive a pension increase of 3% or one-half of the Consumer Price Index for the preceding calendar year, whichever is less, every January 1 after the member turns age 67 and has been retired at least one full year. These pension increases are not limited by the 75% maximum.

Additionally, the Plan provides an alternative retirement formula for State employees in high-risk jobs, such as State police, fire fighters, and security employees. Employees qualifying for benefits under the alternative formula may retire at an earlier age depending on membership in Tier 1 or Tier 2. The retirement formula is 2.5% for each year of covered service and 3.0% for each year of non-covered service. The maximum retirement annuity payable is 80% of final average compensation as calculated under the alternative formula.

SERS also provides occupational and nonoccupational (including temporary) disability benefits. To be eligible for nonoccupational (including temporary) disability benefits, an employee must have at least eighteen months of credited service to the System. The nonoccupational (including temporary) disability benefit is equal to 50% of the monthly rate of compensation of the employee on the date of removal from the payroll. Occupational disability benefits are provided when the member becomes disabled as a direct result of injuries or diseases arising out of and in the course of State employment. The monthly benefit is equal to 75% of the monthly rate of compensation on the date of removal from the payroll. This benefit amount is reduced by workers' compensation or payments under the Workers' Occupational Diseases Act.

Occupational and nonoccupational death benefits are also available through the System. Certain nonoccupational death benefits vest after eighteen months of credited service. Occupational death benefits are provided from the date of employment.

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Contributions

Contribution requirements of active employees and the State are established in accordance with Chapter 40, Section 5/14-133 of the Illinois Compiled Statutes. Member contributions are based on fixed percentages of covered payroll ranging between 4.00% and 12.50%. Employee contributions are fully refundable, without interest, upon withdrawal from State employment. Tier 1 members contribute based on total annual compensation. Tier 2 members contribute based on an annual compensation rate not to exceed \$106,800 with limitations for future years increased by the lesser of 3% or one-half of the annual percentage increase in the Consumer Price Index. For 2017, this amount was \$112,408.

The State is required to make payment for the required departmental employer contributions, all allowances, annuities, any benefits granted under Chapter 40, Article 5/14 of the Illinois Compiled Statutes and all administrative expenses of the System to the extent specified in the Illinois Compiled Statutes. State law provides that the employer contribution rate be determined based upon the results of each annual actuarial valuation.

For Fiscal Year 2017, the required employer contributions were computed in accordance with the State's funding plan. This funding legislation provides for a systematic 50-year funding plan with an ultimate goal to achieve 90% funding of the Plan's liabilities. In addition, the funding plan provided for a 15-year phase-in period to allow the State to adapt to the increased financial commitment. Since the 15-year phase-in period ended June 30, 2010, the State's contribution will remain at a level percentage of payroll for the next 35 years until the 90% funded level is achieved. For Fiscal Year 2017, the employer contribution rate was 44.568%. The Fund's contribution amount for Fiscal Year 2017 was \$36,427.

Pension Liability, Deferred Outflows of Resources, Deferred Inflows of Resources, and Expense Related to Pensions

At June 30, 2017, the Fund reported a liability of \$853,635 for its proportionate share of the State's net pension liability for SERS on the statement of net position (deficit). The net pension liability was measured as of June 30, 2016 (current year measurement date), and the total pension liability used to calculate the net pension liability was determined by an actuarial valuation as of that date.

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The Fund's portion of the net pension liability was based on the Fund's proportion of employer contributions relative to all employer contributions made to the Plan during the year ended June 30, 2016.

For the year ended June 30, 2017, the Fund recognized pension expense of \$169,128. At June 30, 2017, the Fund reported deferred outflows and deferred inflows of resources related to the pension liability, as of the measurement date of June 30, 2016, from the following sources:

	<u>Deferred Outflows of Resources</u>	<u>Deferred Inflows of Resources</u>
Differences between expected and actual experience	\$ 1,307	\$ 20,875
Changes of assumptions	131,213	-
Net difference between projected and actual investment earnings on pension plan investments	18,123	-
Changes in proportion	317,495	59,175
Fund contributions subsequent to the measurement date	36,427	-
Total	<u>\$ 504,565</u>	<u>\$ 80,050</u>

The Fund reported \$36,427 as deferred outflows of resources related to pensions resulting from Fund contributions subsequent to the measurement date. These will be recognized as a reduction of the net pension liability in the year ended June 30, 2018. Other amounts reported as deferred outflows of resources and deferred inflows of resources related to pensions will be recognized as pension expense as follows:

Fiscal Year Ended June 30, 2018	\$ 107,287
Fiscal Year Ended June 30, 2019	115,227
Fiscal Year Ended June 30, 2020	112,291
Fiscal Year Ended June 30, 2021	53,283
Total	<u>\$ 388,088</u>

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Actuarial Methods and Assumptions

The total pension liability was determined by an actuarial valuation as of June 30, 2016, using the following actuarial assumptions, applied to all periods included in the measurement:

Mortality: 105% of the RP-2014 Healthy Annuitant mortality table, sex distinct, with rates projected to 2015; generational mortality improvement factors were added.

Inflation: 2.75%

Investment Rate of Return: 7.00%, net of pension plan investment expense, including inflation.

Salary increases: Salary increase rates based on age related productivity and merit rates plus inflation.

Post-retirement benefit increases of 3.00%, compounded, for Tier 1 and the lesser of 3.00% or one-half of the annual increase in the Consumer Price Index for Tier 2.

Retirement Age: Experience-based table of rates specific to the type of eligibility condition. Table was last updated for the June 30, 2014, valuation pursuant to an experience study of the period July 1, 2009 to June 30, 2013.

The long-term expected real rate of return on pension plan investments was determined based on the simulated average 20-year annualized geometric return for each major asset class. These returns are combined to produce the long-term expected rate of return by weighting the expected future real rates of return by the target asset allocation percentage. For each major asset class that is included in the pension plan's target asset allocation, calculated as of the measurement date of June 30, 2016, the best estimates of the geometric real rates of return are summarized in the following table:

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<u>Asset Class</u>	<u>Target Allocation</u>	<u>Long-Term Expected Real Rate of Return</u>
U.S. Equity	23%	5.80%
Developed Foreign Equity	13%	6.10%
Emerging Market Equity	7%	8.50%
Private Equity	9%	7.40%
Hedge Funds	3%	3.60%
Intermediate Investment Grade Bonds	11%	1.60%
Long-term Government Bonds	3%	1.60%
TIPS	5%	1.30%
High Yield and Bank Loans	5%	4.80%
Opportunistic Debt	4%	4.80%
Emerging Market Debt	2%	4.10%
Real Estate	10%	4.50%
Infrastructure	5%	5.90%
Total	100%	5.04%

Discount Rate

A discount rate of 6.64% was used to measure the total pension liability as of the measurement date of June 30, 2016, as compared to a discount rate of 7.02% used to measure the total pension liability as of the prior year measurement date. The June 30, 2016, single blended discount rate was based on the expected rate of return on pension plan investments of 7.00% and a municipal bond rate of 2.85%, based on an index of 20 year general obligation bonds with an average AA credit rating as published by the Federal Reserve. The projection of cash flows used to determine this single discount rate assumed that plan member contributions will be made at the current contribution rate and that contributions will be made based on the statutorily required rates under Illinois law. Based on these assumptions, the pension plan's fiduciary net position and future contributions will be sufficient to finance the benefit payments through the year 2072. As a result, the long-term expected rate of return on pension plan

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investments was applied to projected benefit payments through the year 2072, and the municipal bond rate was applied to all benefit payments after that date.

Sensitivity of the Net Pension Liability to Changes in the Discount Rate

The net pension liability for the plan was calculated using the stated discount rate, as well as what the net pension liability would be if it were calculated using a discount rate that is 1-percentage point lower or 1-percentage point higher than the current rate as shown below:

	1% Decrease	Discount Rate	1% Increase
	<u>5.64%</u>	<u>6.64%</u>	<u>7.64%</u>
Fund's proportional share of the net pension liability	\$ 1,030,257	\$ 853,635	\$ 709,506

Payables to the Pension Plan

At June 30, 2017, the Fund did not report any payables to the SERS for any outstanding amount of contributions to the Plan required for the year ended June 30, 2017.

(11) Postemployment Benefits

The State provides health, dental, vision, and life insurance benefits for retirees and their dependents in a program administered by the Department of Central Management Services (CMS). Substantially all State employees become eligible for postemployment 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 healthcare plan. 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.

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The total cost of the State's portion of health, dental, vision, and life insurance benefits of all members, including postemployment health, dental, vision, and life insurance benefits, is recognized as an expense by the State in the State's CAFR. 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 postemployment 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 financial statements of CMS, which may be obtained by writing to CMS, 401 S. Spring Street, Springfield, Illinois 62706.

(12) Risk Management

The Fund is exposed to various risks of loss related to torts; theft of, damage to, and destruction of assets; errors and omissions; workers' compensation; and natural disasters. The State retains the risk of loss (i.e., self-insured) for these risks.

The Fund's risk management activities are financed through appropriations to CMS and are accounted for in the State's general fund. As the claims are not considered to be a liability of the Fund, they have not been reported in the Fund's financial statements for the year ended June 30, 2017.

(13) Commitments

The Fund had no significant commitments at June 30, 2017.

(14) Contingencies

A. Black Lung Cases

As of June 30, 2017, the Fund could incur significantly higher claims for unreported black lung cases associated with two formerly self-insured coal companies. Black lung death cases may be filed by a worker's dependent up to three years after the worker's death, with each claim carrying a total

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maximum exposure of \$500,000. All of the following conditions must be proved to establish a compensable claim for a black lung death:

- The deceased died of black lung that arose out of and in the course of the decedent's coal mining employment.
- The deceased worked for one of the two formerly self-insured coal companies from January 1974 through January 2001 or from April 1983 through January 2001 (depending on the company) and the formerly self-insured company was the decedent's last coal-related employer.
- At the time of death, the decedent had either a spouse or qualified dependents.
- The claim was filed within three years of the decedent's death.

Given these requirements, possible claims will decrease over time as the three-year statute of limitations expires. The Fund has had 17 black lung death claims since the Fund assumed the formerly self-insured companies' liabilities in 2003, including only one claim that has been filed after 2015.

B. Self-Insurers under Bankruptcy Protection

As of June 30, 2017, estimated contingent liabilities for unpaid claims of self-insurers under bankruptcy protection, net of excess insurance, were \$1,045,755 (\$135,903 current and \$909,852 noncurrent). On behalf of the Board, the Commission would collect the self-insurer's security if the Fund became responsible for paying these claims. As of June 30, 2017, there was sufficient posted security from each self-insurer to cover its portion of the estimated claims.

C. Excess Insurance Counterparty Risk

As of June 30, 2017, all excess insurance companies had an AM Best rating of "A" or better for the Financial Strength Rating (FSR). According to *Understanding Best's Credit Ratings* (dated May 10, 2018), the FSR "is an independent opinion of an insurer's financial strength and ability to meet its ongoing insurance policy and contract obligations" and "A" or

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higher rating indicates a given insurance company has, in Best's opinion, an excellent ability to meet its ongoing insurance obligations. Based upon this independent analysis and the continued payment of excess insurance claims, Fund management has concluded counterparty risk is low and does not require the recognition of additional liabilities and reduction in assets as of the date when these financial statements were available to be issued.

(15) Deficit

At June 30, 2017, the Fund has a deficit of (\$3,428,465) because the liabilities of the Fund, including actuarially-determined claims liabilities, postemployment benefits, security deposits, and unearned security deposits, exceed the Fund's assets. Subject to Board approval, future assessments will be used to meet the Fund's obligations in the future.

(16) Prior Period Adjustments, Accounting Changes, and Error Corrections

A. Changes in Accounting Methods

Excess Insurance Recoveries

Beginning in Fiscal Year 2017, the Fund adopted the net methodology for determining its unpaid claims liabilities. As such, benefit claims paid by the Fund that were reimbursable from excess insurance carriers were no longer recorded as an operating revenue, but were instead recorded as a reduction in benefit claims operating expense.

Estimate for Unpaid Claims Liabilities

During prior years, Fund management internally calculated the Fund's unpaid claims liability based upon historical costs and a claimant's life expectancy. During Fiscal Year 2017, an actuary was retained to help calculate the Fund's unpaid claims liability at both July 1, 2016, and June 30, 2017. The unpaid claims liability, including incurred-but-not-reported (IBNR) claims, increased 14.6% at July 1, 2016, from the reported amount at June 30, 2016, primarily due to adding an inflation factor for medical claims and recognizing administrative/legal costs related with the claims.

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Security Deposits

During prior years, when a self-insurer's collected security exceeded its estimated unpaid claims, the Fund recorded the excess amount as revenue. During Fiscal Year 2017, Fund management began recording the excess amount as unearned security deposits based upon security contractual language that calls for the return of excess security one year after the last claim is paid, provided the claim application period had expired.

B. Prior Period Adjustments

The Fund's net position (deficit) was restated at July 1, 2016, due to the following:

Error Corrections

- 1) An adjustment was posted to record certain collected securities as security deposits, rather than revenue, because the private self-insurer's claims were not yet the responsibility of the Fund, which decreased the Fund's net position and increased security deposits by \$102,503.
- 2) An adjustment was posted to record a reduction in a security deposit when the Fund took responsibility for paying the claims of a private self-insurer that would have reduced the Fund's benefit claims expense under the Fund's prior accounting policies, which increased the Fund's net position and decreased security deposits by \$201,987.
- 3) An adjustment was posted to record excess insurance receivables from claims paid prior to Fiscal Year 2017, which increased the Fund's net position and increased excess insurance receivable by \$30,542.
- 4) An adjustment was posted to record assessment revenue earned during Fiscal Year 2016 and recognized in the wrong accounting period, which increased net position and increased assessments receivable by \$76,154.

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- 5) An adjustment was posted to adopt GASB Statement No. 68 late and recognize the Fund's portion of pension balances and activity related to its employees participation in SERS, which decreased net position by \$296,419, increased the Fund's net pension liability by \$448,131, increased deferred outflows of resources related to pensions by \$260,741, and increased deferred inflows of resources related to pensions by \$109,029.

Changes in the Fund's Accounting Policies

- 6) An adjustment was posted to reclassify revenues recognized during prior periods to unearned security deposits for private self-insurers whose security collected by the Commission and deposited into the Fund exceeded their estimated unpaid claims liabilities, which decreased net position and increased unearned security deposits by \$13,541,684.
- 7) An adjustment was posted to change the estimate of unpaid claims liabilities based upon an actuarial analysis, which decreased net position by \$1,119,936, decreased current unpaid claims liabilities by \$104,474 and increased noncurrent unpaid claims liabilities by \$1,224,410.

C. Net Impact of the Preceding Adjustments

A reconciliation of net position (deficit) as reported in the prior period's financial statements and the as restated net position (deficit) follows:

Net position, beginning of year, as previously reported	\$11,497,347
Correction of prior period accounting errors	206,180
Cumulative effect of change in accounting method	(13,541,684)
Cumulative effect of change in claims liability estimate	(1,119,936)
Adoption of GASB Statement No. 68	(296,419)
Net position, beginning of year, as restated	<u><u>(\$3,254,512)</u></u>

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(17) Subsequent Events

Subsequent to June 30, 2017, estimated unpaid claims liabilities reported within the statement of net position (deficit) are now known and were classified as nonrecognized events. \$806,427 in estimated liabilities (with \$42,026 classified as current liabilities and \$764,401 classified as noncurrent liabilities) will not be incurred due to one claimant passing away and another claimant reaching age 18 and choosing not to remain in school on a full-time basis. These events will be recognized in the Fund's Fiscal Year 2018 financial statements. \$796,205 in estimated liabilities will not be incurred due to settlements in Calendar Year 2018 that were in negotiation as of June 30, 2017. This would have increased current liabilities by \$37,312 and decreased noncurrent liabilities by \$833,517.

Subsequent to June 30, 2017, Sears and K-Mart, two former self-insured companies, entered bankruptcy. The two entities have combined estimated claims of \$1,691,039, with Sears' security being deficient by \$644,862. While Sears has been authorized to continue paying its workers' compensation claims and plans to continue to do so, the Fund's potential exposure to future claims is \$644,862.

Subsequent to June 30, 2017, the Circuit Court reversed a preceding order affirming the Commission's dismissal of a case that had previously been recorded within the Fund's actuarial analysis for unpaid claims liabilities at June 30, 2017, for \$5,650. The Commission has been advised by the Attorney General's Office that an estimated loss for this case ranges from \$6,515 to \$240,715, with further additional costs being incurred as the case proceeds. Commission management believes the first component of any future award is now probable, with an estimated loss between \$6,515 and \$54,866. Commission management believes the second component of any future award is remote, with an estimated potential loss of \$185,849 with further additional costs being incurred as the case proceeds.

Commission management is not aware of any additional facts, decisions, or conditions that might be expected to have a significant effect on the Fund's financial position or results of operations during this and future fiscal years.



E.C. ORTIZ & CO., LLP
CERTIFIED PUBLIC ACCOUNTANTS

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

and

Self-Insurers Security Board
State of Illinois, Illinois Workers' Compensation Commission

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 Self-Insurers Security Fund of the State of Illinois, Illinois Workers' Compensation Commission, as of and for the year ended June 30, 2017, and the related notes to the financial statements, and have issued our report thereon dated February 26, 2019.

Internal Control Over Financial Reporting

In planning and performing our audit of the financial statements, we considered the State of Illinois, Illinois Workers' Compensation Commission's internal control over financial reporting (internal control) of the Self-Insurers Security Fund 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, Illinois Workers' Compensation Commission's internal control. Accordingly, we do not express an opinion on the effectiveness of the State of Illinois, Illinois Workers' Compensation Commission'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. We did identify certain deficiencies in internal control, described in the accompanying schedule of findings as item 2017-001, which we consider to be a material weakness.

Compliance and Other Matters

As part of obtaining reasonable assurance about whether the State of Illinois, Illinois Workers' Compensation Commission's Self-Insurers Security Fund's 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*.

State of Illinois, Illinois Workers' Compensation Commission's Response to Finding

The State of Illinois, Illinois Workers' Compensation Commission's response to the finding identified in our audit is described in the accompanying schedule of findings. The State of Illinois, Illinois Workers' Compensation Commission'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 State of Illinois, Illinois Workers' Compensation Commission'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 State of Illinois, Illinois Workers' Compensation Commission's internal control and compliance. Accordingly, this communication is not suitable for any other purpose.

SIGNED ORIGINAL ON FILE

Chicago, Illinois
February 26, 2019

STATE OF ILLINOIS
ILLINOIS WORKERS' COMPENSATION COMMISSION
SELF-INSURERS SECURITY FUND
SCHEDULE OF FINDINGS
CURRENT FINDING – GOVERNMENT AUDITING STANDARDS
For the Year Ended June 30, 2017

2017-001. **FINDING** (Inadequate Control over Financial Reporting)

The Illinois Workers' Compensation Commission (Commission) failed to ensure its draft financial statements of the Self-Insurers Security Fund (Fund) provided to us were both complete and properly presented in accordance with accounting principles generally accepted in the United States of America (U.S. GAAP).

During testing, we noted the following:

- The Commission improperly reported the Fund's deficit of (\$3,428,465) at June 30, 2017, as negative restricted net position. Commission management corrected this error by charging the deficit to unrestricted net position in the Fund's final financial statements.

Governmental Accounting Standards Board (GASB) Implementation Guide No. 2015-1 states that negative amounts should not be reported for any category of restricted net position. If liabilities and deferred inflows of resources that relate to specific restricted assets exceed those assets, no restricted component of net position should be reported as the net negative amount should reduce unrestricted net position.

Commission officials indicated this condition was due to oversight, as this was the first year the Fund reported a deficit net position.

- The Commission did not record the Fund's net pension liability or related flows. Commission management corrected this error by posting an adjusting entry at July 1, 2017, which decreased the Fund's net position by \$296,419, increased the Fund's net pension liability by \$448,131, increased the Fund's deferred outflows of resources related to pensions by \$260,741, and increased the Fund's deferred inflows of resources related to pensions by \$109,029 in the Fund's final financial statements.

GASB Statement No. 68 (Paragraph 136), *Accounting and Financial Reporting for Pensions - an amendment of GASB Statement No. 27*, required the Fund to adopt GASB Statement No. 68 for the fiscal year ended June 30, 2015.

Commission officials indicated they were unaware of the need for the Fund's financial statements to reflect pension activity under GASB Statement No. 68.

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2017-001. **FINDING** (Inadequate Control over Financial Reporting) (continued)

- The Commission did not ensure its internal accounting records supporting the Fund's financial statements were complete and accurate. We noted the following errors during our audit, which were corrected by Commission management in the Fund's final financial statements:
 - We found certain cash in-transit amounts, totaling \$51,714, were also recorded as excess insurance receivables, which resulted in an overstatement of the Fund's assets.
 - We noted Fiscal Year 2016 assessment revenue was recognized in Fiscal Year 2017, totaling \$76,154.
 - We identified an overstatement of the benefit claims expense and security deposits drawn revenue accounts, totaling \$180,579, due to an incomplete reconciliation of benefit claims.

The Fiscal Control and Internal Auditing Act (30 ILCS 10/3001) requires the Commission to establish and maintain a system, or systems, of internal fiscal and administrative controls to provide assurance funds applicable to operations are properly accounted for to permit the preparation of accounts and reliable financial reports and to maintain accountability over the State's resources. Good internal controls over financial reporting include ensuring collections on receivables are recorded when cash is received, transactions are recorded within the correct period, and reconciliations are timely and thoroughly performed on all accounts to ensure transactions are properly reflected in the accounting records.

Commission officials indicated these errors were due to oversight during its process to modify its financial reporting and accounting procedures to correct prior period errors.

- During testing, we noted the Commission has not sought a judgment in circuit court against six self-insurers who collectively owe \$4,037 dating back to Fiscal Year 2009. Further, we noted the Commission had not developed a reasonable estimation of uncollectible assessments receivable.

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2017-001. **FINDING** (Inadequate Control over Financial Reporting) (continued)

The Workers' Compensation Act (Act) (820 ILCS 305/4a-7(a)) requires, if an assessment is not paid within 30 days after the private self-insurer receives notice, the Commission, at the direction of the Board, "shall proceed in circuit court for judgment against that private self-insurer which judgment shall include the amount of the assessment, the costs of suit, interest and reasonable attorneys' fees." Additionally, the Statewide Accounting Management System (Procedure 26.20.20) provides guidelines for estimating uncollectible accounts receivable because "as a debt ages, the probability of collection normally declines."

Commission officials indicated this error was due to oversight, although four of the six noted self-insurers continue to have a security deposit which will not be returned until these past due amounts are paid.

Failure to ensure financial statements are complete and fairly present the activities of the Fund in accordance with U.S. GAAP could have, if not detected and corrected, resulted in a material misstatement of the Fund's financial statements and represents noncompliance with the Fiscal Control and Internal Auditing Act. In addition, failure to pursue the collection of past due assessments by proceeding in circuit court for a judgement represents noncompliance with the Act. Finally, failure to develop a reasonable estimation methodology for uncollectible accounts receivable reduces the reliability of Statewide financial reporting. (Finding Code No. 2017-001)

RECOMMENDATION

We recommend the Commission ensure its staff members involved in preparing and reviewing financial activity reported in accordance with U.S. GAAP have sufficient training and knowledge to prevent, or detect and correct, misstatements on a timely basis. Additionally, we recommend the Commission implement controls to identify and review recently released GASB guidance, at least on an annual basis, for any impact on the Fund's financial reporting process. In addition, we recommend the Commission implement controls to ensure transactions are properly recorded within the correct fiscal period and all accounts reconcile and balance with each other. Finally, we recommend the Commission ensure assessments receivable are pursued in accordance with the Act and an allowance for uncollectible accounts is developed.

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For the Year Ended June 30, 2017

2017-001. **FINDING** (Inadequate Control over Financial Reporting) (continued)

COMMISSION RESPONSE

The Commission agrees with the recommendation. Since submitting its draft financial statements to the auditors, the Commission updated, and continues to update, its written accounting policies and procedures to prevent these types of errors. The Commission's Fiscal Department has collected \$786 of the \$4,037 since the audit finding. The remaining \$3,251 does not meet the threshold for seeking a judgement in Circuit Court, as the Attorney General's Office has a \$5,000 minimum on each payee to enable a judgement in Circuit Court. The Commission has security for each of these companies and this will be used as leverage to collect the remaining amount when/if a company's security is due to be released.

**STATE OF ILLINOIS
ILLINOIS WORKERS' COMPENSATION COMMISSION
SELF-INSURERS SECURITY FUND
SCHEDULE OF FINDINGS
PRIOR FINDINGS NOT REPEATED
For the Year Ended June 30, 2017**

A. **FINDING** (Inadequate Financial Accounting and Reporting)

During the financial audit as of and for the year ended June 30, 2016, the Illinois Workers' Compensation Commission (Commission) did not exercise adequate internal control over its financial reporting for the Self-Insurers Security Fund (Fund).

During the current audit, we noted the Commission (1) adopted written accounting policies, (2) developed an appropriate process to estimate the Fund's unpaid claims liability, and (3) developed a process for properly handling an insolvent self-insurer's security collected by the Fund. However, we continued to note financial reporting problems identified during the post audit process, which is reported as Finding No. 2017-001. (Finding Code No. 2016-001)

B. **FINDING** (Inadequate Process to Determine Claims Liabilities)

During the financial audit as of and for the year ended June 30, 2016, the Illinois Workers' Compensation Commission (Commission) had an inadequate process to determine the claims liabilities of the Self-Insurers Security Fund (Fund).

During the current audit, we noted the Commission adopted a new methodology that calls for an actuary to calculate an estimate of the Fund's unpaid claims liabilities on the accrual basis of accounting. (Finding Code No. 2016-002)

C. **FINDING** (Uncertainty Regarding Statutory Interpretation)

During the financial audit as of and for the year ended June 30, 2016, the proper accounting treatment for an insolvent self-insurer's security collected by the Illinois Workers' Compensation Commission (Commission) was not determinable due to two different irreconcilable interpretations of the Workers' Compensation Act (820 ILCS 305).

During the current audit, we noted the Commission adopted a new accounting policy for security collected by the Commission and any associated unpaid claims assumed by the Fund as described in Note 2(I), Note 2(J), Note 2(K), and Note 2(M) to the Fund's financial statements. This policy change appears consistent with the Workers' Compensation Act and the Commission's written security agreements. (Finding Code No. 2016-003)