STATE OF ILLINOIS
OFFICE OF THE
AUDITOR GENERAL
William G. Holland, Auditor General

SUMMARY REPORT DIGEST

STATE OF ILLINOIS

Statewide Financial Statement Audit
For the Year Ended: June 30, 2010

Release Date: July 21, 2011

Summary of Findings:	
Total this audit:	**8**
Total last audit:	**4**
Repeated from last audit:	**4**

INTRODUCTION

The Illinois Office of the State Comptroller prepares the State of Illinois Comprehensive Annual Financial Report (CAFR). The CAFR is the State's official annual report which provides the readers with the financial position of the State as of June 30, 2010, and results of operations during the fiscal year.

The financial section of the CAFR includes the Independent Auditors' Report on the basic financial statements, the management discussion and analysis, the basic financial statements, required supplementary information, and individual fund statements and schedules.

AUDITORS' OPINION

The June 30, 2010 financial statements of the State of Illinois are fairly presented in all material respects.

The financial statements reflect a continuing financial deficit. At June 30, 2010:

- The net assets of governmental activities continued to deteriorate and the deficit increased by $8.4 billion from FY09 to FY10. Overall, net assets of governmental activities are reported as a deficit of $37.9 billion. (Exhibit 1)

- The General Revenue Fund deficit increased by $1.8 billion from FY09 to FY10. The June 30, 2010 deficit was $9.2 billion. (Exhibit 2)

Due to the cash flow deficit, the State issued additional debt subsequent to June 30, 2010 and initiated a cash flow borrowing and general funds liquidity program involving transfers from various public funds.

Over time, increases and decreases in net assets measure whether the State's financial position is improving or deteriorating. A comparison of Illinois' financial position to other states is contained in Exhibit 3.

REPORT ON INTERNAL CONTROL OVER FINANCIAL REPORTING AND ON COMPLIANCE

In accordance with *Government Auditing Standards*, a report on our consideration of the State of Illinois' internal control over financial reporting and our tests of its compliance is also issued as part of our financial statement audit. This report is a separate document and is summarized in this document. Our report noted that the State's decentralized internal control system is not adequate. We also reported significant financial reporting deficiencies at several State agencies.

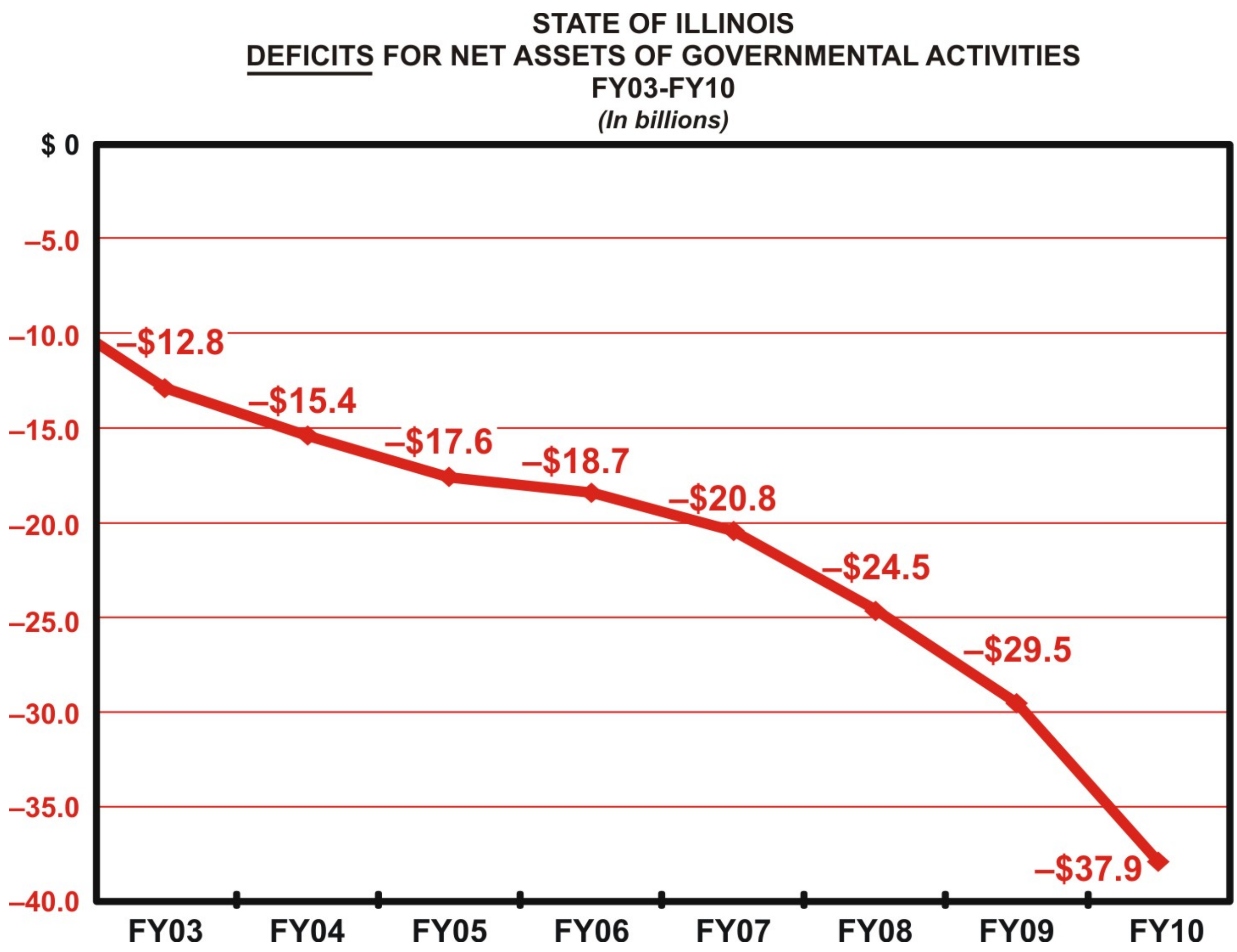
STATE OFFICIALS

Governor	Patrick Quinn
Comptroller (January 10, 2011 to Present)	Judy Baar Topinka
Comptroller (through January 9, 2011)	Daniel W. Hynes
Treasurer (January 10, 2011 to Present)	Dan Rutherford
Treasurer (through January 9, 2011)	Alexi Giannoulias
Speaker of the House	Michael J. Madigan
President of the Senate	John J. Cullerton

FINANCIAL ANALYSIS OF THE STATE

The net assets of the State's governmental activities declined $8.399 billion. The following condensed financial information was derived from the government-wide Statement of Net Assets and reflects the State's governmental activities financial position as of June 30 for fiscal years 2003 through 2010.

EXHIBIT 1



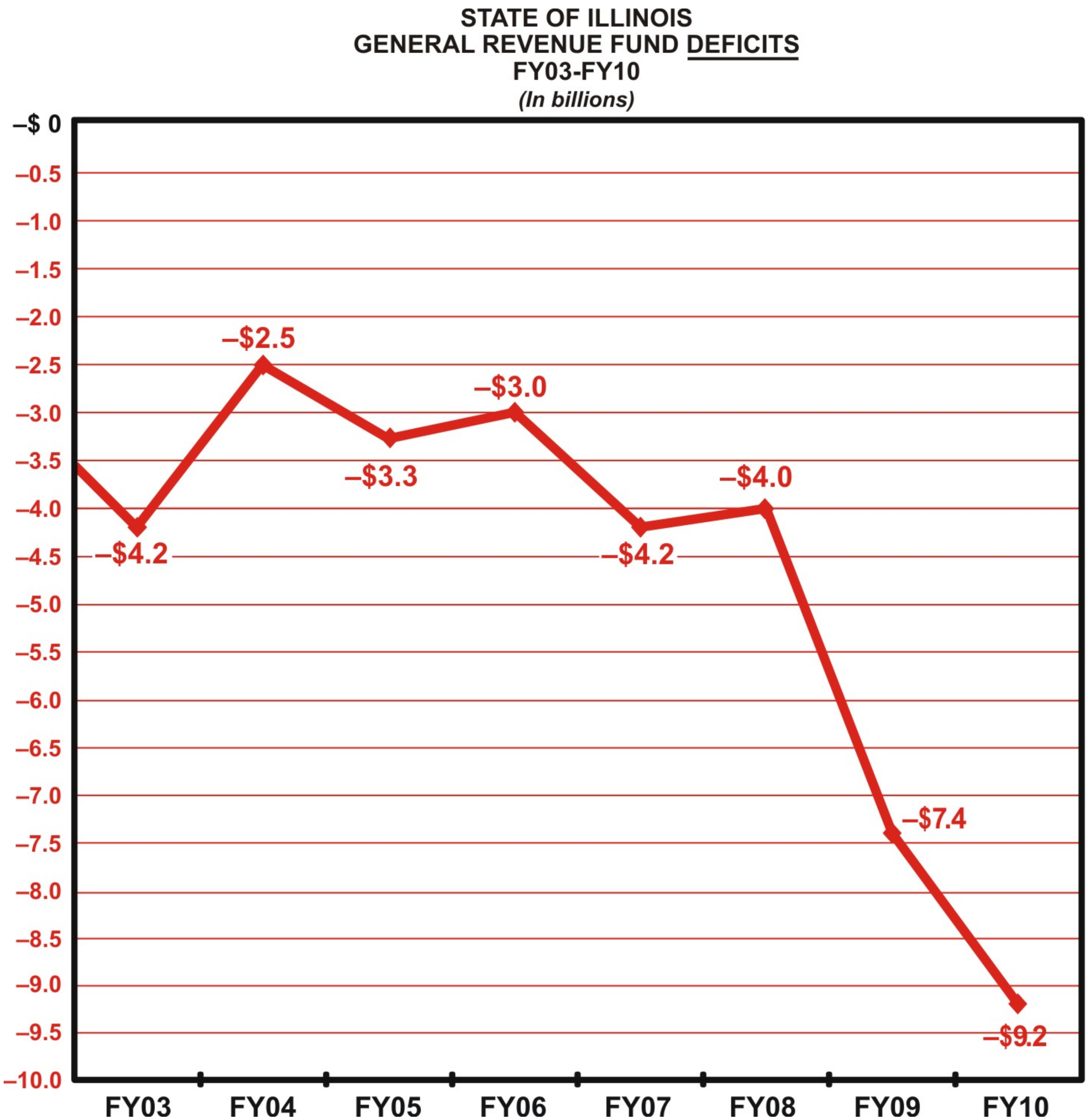
Source: Illinois' Comprehensive Annual Financial Report (2010)
Numbers reflect restatements.

The deficits reflected in Exhibit 1 are presented on an accrual basis and represent the excess of total liabilities over total assets at a given point in time. These deficits represent the deferral of current and prior year costs to future periods.

GENERAL REVENUE FUND

Many programs are accounted for in the General Fund. The GAAP basis financial position of the General Revenue Fund deficit increased at June 30, 2010 from June 30, 2009. The fund balance deficit in the State's General Revenue Fund increased by $1.817 billion on a GAAP basis (from a deficit of $7.422 billion, as restated, to a deficit of $9.239 billion). Exhibit 2 reflects the General Revenue Fund deficit for fiscal years 2003 through 2010.

EXHIBIT 2

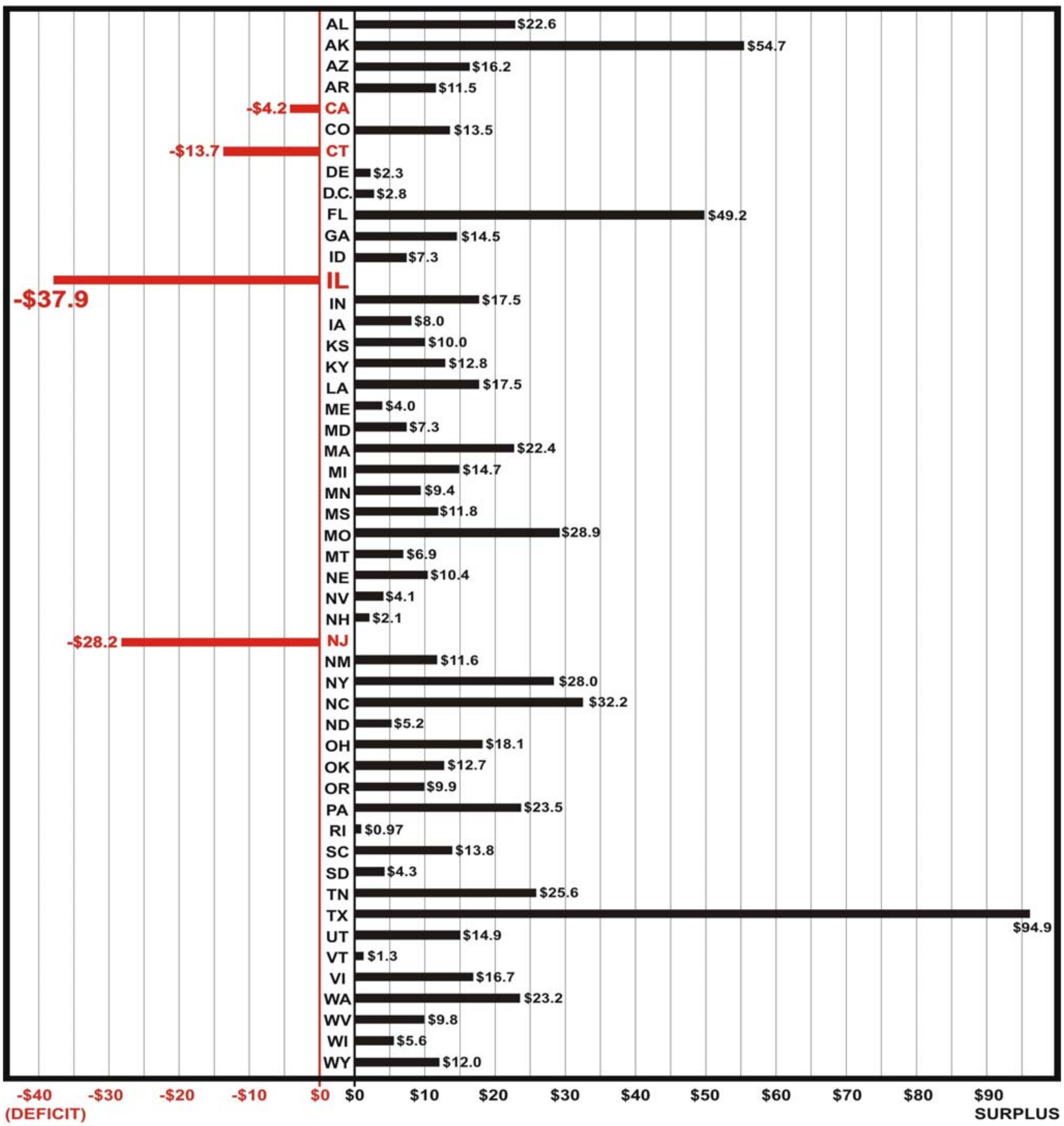


Source: Illinois' Comprehensive Annual Financial Report (2010)
Numbers reflect restatements.

STATE COMPARISON

Exhibit 3 provides an analysis of Illinois' Net Assets at June 30, 2010 compared to other States.

EXHIBIT 3
STATE COMPARISON OF NET ASSETS OF GOVERNMENTAL ACTIVITIES FOR FY10
(In billions)



Source: Compiled by Illinois Auditor General's Office from Comprehensive Annual Financial Reports (CAFR) for each state, excluding Hawaii, which was not available at June 30, 2010.

FINDINGS, CONCLUSIONS, AND RECOMMENDATIONS

INADEQUATE FINANCIAL REPORTING PROCESS

Process does not allow timely financial reporting

Financial statements completed 12 months after year end due to reporting issues at State agencies

The State of Illinois' current financial reporting process does not allow the State to prepare a complete and accurate Comprehensive Annual Financial Report (CAFR) or the Schedule of Expenditures of Federal Awards (SEFA) in a timely manner. Reporting issues at various individual agencies caused delays in finalizing the financial statements, which did not occur until June of the subsequent year for the past four fiscal years. The lack of timely financial reporting limits effective oversight of State finances, adversely affects the State's bond rating, and jeopardizes federal funding.

Financial reporting problems continue even after numerous findings issued

Accurate and timely financial reporting problems continue to exist even though the auditors have: 1) continuously reported numerous findings on the internal controls (material weaknesses and significant deficiencies), 2) commented on the inadequacy of the financial reporting process of the State, and 3) regularly proposed adjustments to financial statements year after year. These findings have been directed primarily toward the Office of the Comptroller (IOC) and major State agencies under the organizational structure of the Office of the Governor.

Financial reporting problems not resolved

Financial reporting process dependent on post audits

The State has not solved these problems or made substantive changes to the system to effectively remediate these financial reporting weaknesses. The process is overly dependent on the post audit program being a part of the internal control for financial reporting even though the Illinois Office of the Auditor General has repeatedly informed State agency officials that the post audit function **is not and should not** be an internal control mechanism for any operational activity related to financial reporting. (Finding 1, pages 7-10)

We recommended the Office of the Governor and the Office of the State Comptroller work together to resolve the State's inability to produce timely and accurate GAAP basis financial information and a Statewide SEFA.

Governor's Office agreed with the finding and is working to solve some of the problems

The Governor's Office agreed with the finding and reported the State has been working with the Senate Committee on State Government and Veterans Affairs to solve some of these problems, although without adequate funding, correcting this will be difficult. The Governor's Office further responded that the Governor's Office, the Governor's Office of Management and Budget and the Office of the Comptroller have developed a timeline for short-term, mid-term, and long range plans, and the response provided further details of these plans.

IOC will assist the Governor's Office in their efforts to increase the quality of the GAAP packages

The Comptroller's Office response stated the IOC will assist the Governor's Office in their efforts to increase the quality of the GAAP packages by providing training and technical assistance to State Agencies.

FINANCIAL REPORTING WEAKNESSES

13 of 26 agencies with 45 internal control findings over financial reporting

The State of Illinois did not have adequate controls to assess the risk that information reported by individual agencies of the primary government would not be fairly stated and compliant with generally accepted accounting principles. The Office of the Auditor General performs audits at 26 agencies of the primary government, including five pension systems and the State Board of Investments. During these audits, we noted at 13 agencies there were a total of 15 material weaknesses and 30 significant deficiencies related to the internal controls over the financial reporting process.

Internal control deficiencies extend financial reporting timelines

Material weaknesses and significant deficiencies further extend financial reporting timelines since additional measurements and reporting is required. Completion or substantial completion of these audits is necessary in order for the Auditor General to issue an opinion on the State's basic financial statements.

In addition to the deficiencies noted above, restatements and material errors were noted during our audits, which are as follows:

Beginning balances restated

- The beginning balances in the financial statements of the primary government were restated due to the correction of four errors. The restatements ranged from $26 million to $525 million.

Material misstatements identified

- Material misstatements were identified by the auditors at seven agencies. The misstatements ranged from $13 million to $128 million.

Incorrect expenditure allocation

- $3.5 billion in expenditures needed to be reclassified to the appropriate expenditure functions. (Finding 10-2, pages 11-15)

We recommended the State implement additional internal control procedures in order to assess the risk of material misstatements to the financial statements and to identify such misstatements during the financial statement preparation process. The internal control procedures should include a formal evaluation of prior problems and implementation of procedures to reduce the risk of these problems reoccurring.

Governor's Office agreed, noting the need for an entity-wide financial reporting system

The Governor's Office agreed with the finding and responded that if the State had an entity-wide financial reporting system, internal controls would be in place to lessen the risk that statements are not accurately presented.

IOC will assist the Governor's Office in their efforts to increase the quality of the GAAP packages

The Comptroller's Office response stated the IOC will assist the Governor's Office in their efforts to increase the quality of the GAAP packages by providing training and technical advice to State agencies.

WEAKNESSES IDENTIFIED IN THE SECURITIES LENDING PROGRAM

Securities lending weaknesses

During testing of the Illinois Office of the Treasurer's (Office) securities lending program, auditors identified a number of weaknesses.

At June 30, 2010 the Office had $3,095,533,634 of securities on loan. The auditors identified the following issues while testing the Office's securities lending program:

Written policies and procedures not developed

All internal audit requirements not covered

Approval to lend securities not provided

Specific investment policy not created

Securities lending reports not properly reviewed

- The Office has not developed written policies and procedures covering each of the requirements listed in the Federal Financial Institution Examination Council (FFIEC) guidelines for securities lending as required by FFIEC guidelines.
- Periodic internal audits have not been performed covering all internal audit requirements outlined in the FFIEC guidelines for securities lending.
- The Office could not provide documentation of approval from the Governor to lend securities as required by the Act.
- The Office has not created a specific investment policy for the governance of securities lending as set forth in the Office's Investment Policy.
- 8 of 33 (24%) daily securities lending reports tested were not reviewed by Office personnel.
- 1 of 33 (3%) daily securities lending reports tested did not contain adequate notations to support review by Office personnel.
- 2 of 33 (6%) daily securities lending reconciliations were approved by a Banking Division Supervisor 7 and 9 business days after they were completed. The Office strives to complete their reviews on a daily basis. (Finding 10-5, pages 20-22)

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

Treasurer's Office agreed and has implemented or will be implementing changes

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

FINANCES INCREASE RISKS

Insufficient controls over the State's finances

Increased risk that liabilities will not be recorded properly

The State of Illinois did not have sufficient controls over its finances to ensure obligations are paid timely and funds are used for their original intended purpose. This condition increases the risk that liabilities will not be properly recorded and funds will be used in a manner that violates agreements with outside parties. This condition also diminishes the usefulness of the fund financial statements. We noted the following during our financial audit of the State's financial statements and our financial audits at various Departments.

$5.281 billion of approved payments on hand at June 30, 2010

The State had transactions, totaling $5.281 billion, on hand at June 30, 2010 that had been approved for payment by the State, but remained unpaid at year end due to the State's cash flow difficulties. Of this amount, nearly $4 billion was owed to external parties, the remaining balance was related to intra-governmental transactions.

$1.4 billion owed to taxpayers and businesses

During our audit of the Illinois Department of Revenue (IDOR), the auditors reported that there was a deficit balance totaling $1.4 billion in the Income Tax Refund Fund, a sub account of the General Revenue Fund, because the State did not allocate sufficient income tax revenues into the Income Tax Refund Fund.

State borrowing from taxpayers

Large deficits in the Income Tax Refund Fund indicate that the State is essentially borrowing from taxpayers (individuals and businesses) since overpayments of taxes are not revenue to the State when accounted for in accordance with generally accepted accounting principles (GAAP). Delays in paying tax refunds generates additional adjustments to convert cash basis amounts to GAAP basis. These necessary adjustments, due to lack of cash payment, increases the risk that liabilities will not be recognized in the proper period.

State transferred $356 million from other funds to General Revenue Fund

Pursuant to Public Act 96-44 (Act) $356 million was transferred out of other funds and into the General Revenue Fund during fiscal year 2010 in order to improve stability of the General Revenue Fund. According to the Act, the transfers shall be made notwithstanding any other provision of State law to the contrary.

The following table details by fund type the total transfers out made for this purpose.

Fund Type	Number of Funds	Total Transfers Out
Special Revenue	181	$ 304,843,502
General	8	$ 29,745,061
Internal Service	3	$ 15,922,190
Agency	2	$ 659,000
Enterprise	3	$ 3,795,520
Private Purpose Trust	1	$ 503,700
Capital Projects	1	$ 320,000
Permanent Trust	1	$ 250,000
Total	**200**	**$ 356,038,973**

Several legal cases filed

There have been several legal cases filed against the State that challenge the constitutionality of legislation that allowed the broader use of fee proceeds that are deposited into special funds. General use of resources originally designated as Capital Projects, Permanent Trust, Private Purpose Trust, Agency, and Enterprise increases the risk that covenants with outside parties will be violated. (Finding 10-7, pages 25-28)

The Governor should work with the General Assembly to improve the State's control over State finances in a manner that eliminates significant payment delays including refunds to taxpayers

We recommended the Governor work with the General Assembly to improve the State's control over State finances in a manner that eliminates significant payment delays including refunds due to taxpayers. We also recommended that the Governor work with the General Assembly to ensure fund transfers are made in conformity with law and other applicable governing agreements.

Governor's Office does not feel balances owed are a result of the administration's insufficient controls over finances

The Governor's Office's response noted that the Office recognizes that significant balances are owed at year-end but does not feel that this is the result of the administration's insufficient controls over finances. The Office attributed the unpaid bills as a result of the economic downturn and diminished revenues. The Office further noted that if the State had a consolidated accounting system with a general ledger, these liabilities could be properly reported.

Governor's Office agreed that the refund rate is insufficient to pay tax refunds

The Governor's Office and GOMB agreed that the refund rate is insufficient to pay tax refunds and will work with the General Assembly to pay these outstanding refunds by recommending refund rates that are sufficient to pay refunds in the year they are due.

With one exception, the Governor's Office is unaware of transfers violating covenants

The Governor's Office responded that Public Act 96-44 required transfers to be made from other state funds to the General Revenue Fund and the Office is not aware of legal challenges to any of these transfers. The Governor's Office also responded that except for the transfer from the fund mentioned in finding 10-4 that GOMB is trying to correct, the Governor's Office is unaware of any transfers violating covenants with outside parties.

Auditors comment that held payments of $5.281 billion at the end of FY10 created additional risks for liability recognition

In an auditors' comment we noted that the unprecedented amount of held payments of $5.281 billion at the end of FY10 created an additional risk that material liabilities would not be recorded in the proper period. The held payments had legal authorization for payment and were unpaid due to a lack of resources. Attributing the cause of this additional weakness to a lack of control over State finances is reasonable since the State essentially follows a cash basis budget process. As noted in the finding, we do agree that economic conditions are relevant to the cause of the condition.

Auditors comment that legal challenges have been made in the past and being "unaware" of a covenant violation does not eliminate the audit concern

The auditors' comment also noted that although no legal challenges have been made for the FY10 transfers, challenges have occurred in the past. The classification of funds as Agency, Private Purpose Trust, and Permanent Trust indicates a degree of fiduciary responsibility for the State. Simply being "unaware" of a covenant violation does not eliminate the audit concern that such transfers did or could violate covenants with outside parties.

OTHER FINDINGS

The remaining findings included three noncompliance issues and one finding related to the CAFR compilation process. We will review the State's progress towards the implementation of our recommendations in our next audit.

WILLIAM G. HOLLAND
Auditor General

WGH:pp