STATE OF ILLINOIS

OFFICE OF THE AUDITOR GENERAL

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

For the Year Ended June 30, 2012

WILLIAM G. HOLLAND

AUDITOR GENERAL

STATE OF ILLINOIS
COMPREHENSIVE ANNUAL FINANCIAL REPORT
FINANCIAL AUDIT
For the Year Ended June 30, 2012

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The annual financial statements of the State of Illinois for the year ended June 30, 2012 were issued under a separate cover.

STATE OF ILLINOIS
COMPREHENSIVE ANNUAL FINANCIAL REPORT
FINANCIAL AUDIT
For the Year Ended June 30, 2012

STATE OFFICIALS

Governor	Patrick Quinn
Comptroller	Judy Baar Topinka
Speaker of the House	Michael J. Madigan
President of the Senate	John J. Cullerton

SUMMARY

The audit of the State of Illinois' financial statements was performed in accordance with *Government Auditing Standards*. This report is an integral part of that audit.

SUMMARY OF FINDINGS

Number of	Current Report	Prior Report
Findings	5	5
Repeated findings	5	5
Prior recommendations implemented or not repeated	0	3

SCHEDULE OF FINDINGS

Item No.	Page	Description	Finding Type
		FINDINGS (*GOVERNMENT AUDITING STANDARDS*)	
12-1	7	Inadequate Financial Reporting Process	Material Weakness
12-2	11	Financial Reporting Weaknesses	Material Weakness
12-3	15	Late Payment of Statutorily Mandated Transfers	Noncompliance
12-4	17	Debt Covenant Violation	Noncompliance
12-5	19	Finances Increase Risks	Material Weakness

EXIT CONFERENCE

The Office of the State Comptroller and the Office of the Governor have waived an exit conference.

AGENCY RESPONSES

Responses to the findings and recommendations were provided as follows:

Ms. Roma Larson, Deputy General Counsel, Governor's Office of Management and Budget on June 5, 2013.

Mr. Tracy Allen, Chief Internal Auditor, Office of the State Comptroller on June 6, 2013.

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OFFICE OF THE AUDITOR GENERAL
WILLIAM G. HOLLAND

INDEPENDENT AUDITORS' 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 Michael J. Madigan, Speaker of the House
Honorable John J. Cullerton, President of the Senate
Members of the General Assembly
Honorable Patrick Quinn, Governor
Honorable Judy Baar Topinka, Comptroller

We have audited the financial statements of the governmental activities, the business-type activities, the aggregate discretely presented component units, each major fund, and the aggregate remaining fund information of the State of Illinois as of and for the year ended June 30, 2012 as listed in the Table of Contents for Section II of the Illinois Comprehensive Annual Financial Report, which collectively comprise the State of Illinois' basic financial statements and we have issued our report thereon dated May 31, 2013. Our report was modified to include a reference to other auditors and included an explanatory paragraph which stated that as discussed in Note 2, the financial statements have been restated as of July 1, 2011 for prior year reporting errors and the implementation of GASB Statement 64, *Derivative Instruments: Application of Hedge Accounting Termination Provisions, an amendment of GASB Statement No. 53*. Our report also included an explanatory paragraph which stated "The deficit for net assets of the governmental activities in Fiscal Year 2012 continued to increase by $2,965,234,000 from $43,608,726,000 at June 30, 2011 to $46,573,960,000 at June 30, 2012. This deficit, which is presented on an accrual basis, is the excess of total liabilities over total assets and represents a deferral of current and prior year costs to future periods."

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. For purposes of this report, our consideration of internal control over financial reporting and our tests of compliance with certain provisions of laws, regulations, contracts, and grant agreements, and other matters did not include the State's discretely presented component units. Separate reports have been issued for these entities. The findings, if any, included in those reports are not included herein.

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Internal Control Over Financial Reporting

Management of the State of Illinois is responsible for establishing and maintaining effective internal control over financial reporting. In planning and performing our audit, we considered the State of Illinois' internal control over financial reporting as a basis for designing our auditing procedures for the purpose of expressing our opinions on the financial statements, but not for the purpose of expressing an opinion on the effectiveness of the State of Illinois' internal control over financial reporting. Accordingly, we do not express an opinion on the effectiveness of the State of Illinois' internal control over financial reporting.

Our consideration of the internal control over financial reporting was for the limited purpose described in the preceding paragraph and was not designed to identify all deficiencies in the internal control over financial reporting that might be significant deficiencies or material weaknesses and therefore, there can be no assurance that all deficiencies, significant deficiencies, or material weaknesses have been identified. However, as described in the accompanying schedule of findings and responses, we identified certain deficiencies in internal control over financial reporting that we consider to be material weaknesses.

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. We consider the deficiencies described in the accompanying schedule of findings and responses as items 12-1, 12-2, and 12-5 to be material weaknesses.

Compliance and Other Matters

As part of obtaining reasonable assurance about whether the State of Illinois' financial statements are free of 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 instances of noncompliance or other matters that are required to be reported under *Government Auditing Standards* and which are described in the accompanying schedule of findings and responses as items 12-3 and 12-4.

The Office of the Governor's and the Office of the State Comptroller's responses to the findings identified in our audit are described in the accompanying schedule of findings and responses. We did not audit these responses and, accordingly, we express no opinion on the responses.

This report is intended solely for the information and use of the Auditor General, the General Assembly, the Legislative Audit Commission, the Governor, the Comptroller, the State's Management and federal awarding agencies and pass-through entities and is not intended to be and should not be used by anyone other than these specified parties.

WILLIAM G. HOLLAND
Auditor General
State of Illinois

Bruce L. Bullard

BRUCE L. BULLARD, CPA
Director of Financial and Compliance Audits
Office of the Auditor General

Springfield, Illinois
May 31, 2013

12-1. **FINDING** (Inadequate Financial Reporting Process)

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. See also finding 12-2 for additional detail. The lack of timely financial reporting limits effective oversight of State finances, adversely affects the State's bond rating, and jeopardizes federal funding.

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 State Comptroller and major State agencies under the organizational structure of the Office of the Governor.

The Office of the State Comptroller has made significant changes to the system used to compile financial information and agencies have submitted their financial information in a more timely manner; however, the State has not solved all the problems 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.

The State of Illinois has a highly decentralized financial reporting process. The system requires State agencies to prepare a series of complicated financial reporting forms (SCO forms) designed by the Office of the State Comptroller to prepare the CAFR. For the most part, these SCO forms are completed for each of the State's 844 primary government/fiduciary funds and 26 component units. The forms are completed by accounting personnel within each State agency who have varying levels of knowledge, experience, and understanding of Generally Accepted Accounting Principles (GAAP) and of the State's accounting policies and procedures. Agency personnel involved with this process are not under the organizational control or jurisdiction of the Office of the State Comptroller. Further, some of these agency personnel lack the qualifications, time, support, and training necessary to timely and accurately report year end accounting information to assist the Office of the State Comptroller in the preparation of the Statewide financial statements in accordance with Generally Accepted Accounting Principles (GAAP).

Although these SCO forms are subject to review by the Office of the State Comptroller's financial reporting staff during the CAFR preparation process, audit adjustments and significant internal control deficiencies relative to the financial statements have been identified during the last eleven audits of the CAFR. Additionally, beginning balances related to the primary government have been restated for 9 of the last 11 years.

The Illinois Office of the Auditor General released a management audit in February 2011 that further assessed the State's financial reporting system. The survey of 88 of 90 primary units of government revealed that 263 different financial reporting systems are used by primary government agencies. Furthermore, the agencies reported that only 16 percent of these financial reporting systems are compliant with GAAP, which drastically increases the amount of time spent by agencies during the year-end GAAP conversion process. In addition, fifty-three percent of the financial reporting systems are not interrelated which consequently requires manual intervention to convert data increasing the likelihood of errors and causing further reporting delays.

In an effort to improve the financial reporting system, the Office of the State Comptroller started the process to develop and implement a new financial reporting system (System) in March 2011. During Fiscal Year 2011, there were delays in regard to State agencies being able to provide the Office of the State Comptroller with financial data due to the implementation of this new System. We noted no similar delays during Fiscal Year 2012.

Although the deficiencies relative to the CAFR and SEFA financial reporting processes have been reported by the auditors for a number of years, problems continue with the State's ability to provide accurate and timely external financial reporting. Corrective action necessary to remediate these deficiencies continues to be problematic; however, two recent Public Acts have the potential to positively affect the financial reporting process. Public Act 97-408, effective August 16, 2011, established a statutory deadline of October 31 of each year for State agencies to report financial information for the previous June 30 to the State Comptroller. If a State agency has not submitted the required financial information by October 31, the State Comptroller must serve a written notice to the appropriate agency head about the delinquency or inadequacy of the financial information. Under certain circumstances, agency heads are required to provide an action plan to bring the agency into compliance and the State Comptroller is required to post the action plan on the Comptroller's website. Public Act 97-1055, effective August 23, 2012, established the Financial Reporting Standards Board (Board). The purpose of the Board is to "assist the State in improving the timeliness, quality, and processing of financial reporting for the State."

Concepts Statement of the Governmental Accounting Standards Board (GASBCS 1, paragraph 66) states, "if financial reports are to be useful, they must be issued soon enough after the reported events to affect decisions."

According to OMB Circular A-133 §__.300(d) and (e), a recipient of Federal awards is required to prepare appropriate financial statements, including the Schedule of Expenditures of Federal Awards and to ensure that audits required by this part are properly performed and submitted when due. Additionally, the A-102 Common Rule requires that non-Federal entities receiving Federal awards establish and maintain internal control designed to reasonably ensure compliance with Federal laws, regulations, and program compliance requirements.

The Office of the State Comptroller's management indicated that delays at the departmental level were caused by a lack of sufficient internal control processes in State agencies for the accumulation and reporting of financial information used to prepare the financial statements.

Failure to establish effective internal controls at all State agencies regarding financial reporting for the preparation of the CAFR and the SEFA prevents the State from completing an audit in accordance with timelines set forth in OMB Circular A-133, which may result in the suspension of Federal funding. Delays in financial reporting decreases the usefulness of such information. (Finding Code No. 12-1, 11-1, 10-1, 09-2, 08-2, 07-2)

RECOMMENDATION

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

AGENCY RESPONSES

Office of the Governor:

> The Governor's Office agrees with this recommendation. The Governor's Office and the Governor's Office of Management and Budget (GOMB) are and will continue to work cooperatively with the Office of the Comptroller to address these challenges with effective solutions.
>
> Governor Quinn signed into law SB 3794, an initiative of the Governor's Office, in order to create a statutory framework to begin to address the basic issues with the State's financial reporting capabilities. The legislation has several components. First it creates a Financial Reporting Standards Board ("Board") composed of appointees of the Governor and the Comptroller. The Board is required to facilitate timely completion of financial reporting through additional training, assistance and communication among the parties involved. Second, the Board is mandated to participate in the development of a new financial accounting system for the State. We anticipate it will provide leadership and a forum for project management and collaboration going forward. Third, the bill modified the State's personnel code to allow accelerated and targeted hiring of highly skilled employees to perform financial

reporting, accounting, and project management activities for the annual financial reporting cycle. These include personnel to help improve the speed of the current process as well as other professionals who will help to design and implement an overhaul of the technology and establish a unified statewide system. Governor Quinn approved the bill on August 23, 2012 at which point the bill became law and is now codified as Public Act #97-1055.

The Governor's Office has notified agencies of this new provision and encouraged its responsible utilization. In addition, the Governor's Office and GOMB continue to work with the Department of Central Management Services to develop job descriptions to allow agencies to hire employees skilled in financial statement and single audit preparation for positions that remain subject to the Personnel Code.

GOMB and the Governor's Office have been primarily responsible for developing a plan for a statewide financial accounting system. This statewide financial accounting system would also include a grants management module. The State Chief Information Officer, a team of Governor's Office and GOMB representatives has reviewed the information available from work by prior consultants. Currently a request for proposals (RFP) is being developed to secure a consultant. This consultant will develop the necessary statewide accounting requirements and develop an RFP for software and implementation services to address the state's need. In addition, due to a September 2012 debt issuance of 10-year notes aimed at technology modernization, the State has allotted some capital money for this project. These resources will be a significant help in getting the project underway.

The Governor's Office will continue working with the agencies to improve the State's performance both in the short term and the long term.

Office of the State Comptroller:

The Office accepts the recommendation. The 2012 CAFR opinion was signed on May 31, 2013. The General Assembly enacted P.A. 97-0732, which extended lapse period from August 31 to December 31, 2012. As a result of the extension the preparation and completion of budget to actual financial schedules was delayed. Further, a significant delay in the completion of the CAFR was due to the delays in several departmental audits.

The Office will continue to assist the Governor's Office in their efforts to increase the quality of GAAP packages and provide training and technical assistance to State agencies. In addition, the Office will work with the newly created Financial Accounting Standards Board in their mission to improve the timeliness, quality and processing of financial reporting for the State.

12-2. **FINDING** (Financial Reporting Weaknesses)

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. As reported in Finding 12-1 the State has a decentralized financial reporting process. Primarily in response to this decentralized process, we perform audits at 27 agencies of the primary government, including the five pension systems and the State Board of Investments. During these audits, we noted deficiencies that were either material weaknesses or significant deficiencies related to the internal controls over the financial reporting process.

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 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.

The chart below summarizes the number of material weaknesses and significant deficiencies we reported for each agency.

Agency	Material Weaknesses	Significant Deficiencies	Combined Total
General Assembly Retirement System	0	1	1
Judges' Retirement System	0	1	1
Secretary of State	0	1	1
Department of Central Management Services	1	1	2
Department of Children and Family Services	1	0	1
Department of Corrections	4	4	8
Department of Employment Security	0	2	2
Department of Human Services	4	3	7
Department of the Lottery	2	0	2
Department of Healthcare and Family Services	1	1	2
Department of Revenue	2	7	9
Department of Transportation	2	3	5
Capital Development Board	0	1	1
Environment Protection Agency	0	1	1
Illinois Gaming Board	4	0	4
Illinois State Board of Education	1	0	1
State Employees' Retirement System	0	1	1
Total	22	27	49

Details of each material weakness and significant deficiency are reported in each of the agency's financial audit for the year ended June 30, 2012 (reports are available on the Auditor General's web-site). 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, we identified two categories of material errors during our audit of the Office of the State Comptroller's compilation process. Summary information regarding these errors is provided below.

Restatements – Correction of Prior Errors

Description of Error	Amount (in thousands)*	Responsible Agency
Overstatement of net other postemployment benefits obligation	$102,332	Department of Healthcare and Family Services
Overstatement of interfund balances	$69,901	Department of the Lottery
Deferred Prize Winners' Trust Fund incorrectly classified	$38,940	Department of the Lottery

Misstatements Identified During the Audit Process

In addition to the restatement described above, the following chart indicates adjustments identified during our audits.

Opinion Unit	Amount (in thousands)*	Responsible Agency
Governmental Activities	$14,986	Department of Central Management Services
Governmental Activities	$6,016	Department of Children and Family Services
Governmental Activities	$45,443	Department of Human Services
Governmental Activities	$169,775	Department of Healthcare and Family Services
Business-type Activities	$259,306	Department of the Lottery
Business-type Activities	$147,186	Illinois Student Assistance Commission
General Fund	$45,443	Department of Human Services
General Fund	$67,443	Department of Healthcare and Family Services
Prepaid Tuition Fund	$147,002	Illinois Student Assistance Commission
Aggregate Remaining Fund Information	$6,016	Department of Children and Family Services
Aggregate Remaining Fund Information	$14,986	Department of Central Management Services
Aggregate Remaining Fund Information	$401,680	Department of the Lottery
Aggregate Remaining Fund Information	$184	Illinois Student Assistance Commission

* *Amounts resulted in one adjustment or a series of adjustments for the opinion unit. The dollar amount reported is the largest account type adjusted.*

The State's decentralized reporting system and related decentralized internal control system is not adequate to reduce the likelihood that a material misstatement of the State's financial statements could occur and not be detected during the normal course of business. Audit adjustments were routinely identified for the primary government's State agencies required to prepare financial statements that were not deemed material by agency management and were not posted to the financial statements. In working with the Office of the State Comptroller to finalize the State's financial statements, it is necessary to accumulate all of the uncorrected adjustments and evaluate these adjustments in total to ensure that they do not materially misstate the State's financial statements. Because of the volume of these passed adjustments, there is a continual risk that the State's financial statements may be materially misstated until this accumulation and evaluation process is completed. In addition, these uncorrected adjustments require continued accumulation and evaluation in the subsequent year.

The Office of the State Comptroller's management stated the misstatements at the departmental level were caused by a lack of sufficient internal control processes in State agencies for the accumulation and reporting of financial information used to prepare the financial statements. The Office of the State Comptroller has the statutory authority to develop and prescribe accounting policies for the State but does not have the statutory authority to monitor adherence to these policies as performed by State agencies.

In accordance with the Fiscal Control and Internal Auditing Act (30 ILCS 10/1002), each State agency's Chief Executive Officer maintains statutory responsibility for the establishment and continuous monitoring of the internal control function for accounting and other operating policies of the Officer's agency. (Finding Code No.12-2, 11-2, 10-2, 09-1, 08-1, 07-1, 06-1, 05-1, 04-1, 03-1, 02-1)

RECOMMENDATION

We recommend the State continue their efforts to improve 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.

AGENCY RESPONSES

Office of the Governor:

> The Governor's Office agrees with this recommendation. The strategic, technical and managerial steps set forth in the response to finding 12-1 also address finding 12-2. The Governor's Office has focused on solving this problem by implementing a centralized financial accounting system as described in the response to finding 12-1. If the State had an enterprise-wide financial accounting system it would incorporate standard internal controls to lessen the risk of inaccuracy by preemptively detecting and facilitating resolution of any material weaknesses or deficiencies.

Office of the State Comptroller:

> The Office accepts the recommendation. The Office will continue to assist the Governor's Office in their efforts to increase the quality of GAAP packages and provide training and technical assistance to State agencies. In addition, the Office will work with the newly created Financial Accounting Standards Board in their mission to improve the timeliness, quality and processing of financial reporting for the State.

12-3. **FINDING** (Late Payment of Statutorily Mandated Transfers)

The Office of the State Comptroller (Comptroller) did not make all statutorily mandated transfers from the General Revenue Fund within established timeframes, as required.

The Comptroller had a system in place to identify and record inter-fund transfers it was required to make. During the fiscal year ended June 30, 2012, the Comptroller timely recorded within the Statewide Accounting Management System (SAMS) the receivables and related payables for transfers of money in the State Treasury to be made between State of Illinois' funds. However, not all transfers were made timely. During Fiscal Year 2012, we noted 398 transfers from the General Revenue Fund to various other funds that were made greater than 30 days after the statutorily mandated transfer date. Transfers that were made between one and 30 days after the statutorily mandated transfer date were excluded from the information provided in this finding. The following summary concerning late payment of statutorily mandated transfers from the General Revenue Fund highlights the increase in delays of making such transfers in Fiscal Year 2012 compared to Fiscal Years 2011 and 2010:

	Fiscal Year 2012	Fiscal Year 2011	Fiscal Year 2010
• Number of late transfers	398 transfers	327 transfers	289 transfers
• Range of days transfers were late	34 to 529 days	31 to 454 days	31 to 525 days
• Total volume of late transfers, in dollars	$2.45 billion	$2.21 billion	$2.0 billion
• Late transfers outstanding at June 30, paid during lapse period*	$1.11 billion	$889 million	$941.8 million

* (Lapse period for Fiscal Years 2012, 2011 and 2010 were from July 1 through December 31.)

Comptroller management stated that the late payment of transfers occurred because of cash management decisions and prioritization that was required due to the lack of available cash in the State Treasury. Further, some statutory provisions relating to transfers contain language such as "as soon as practicable" or "as soon as possible." The Office of the State Comptroller states that approximately 112 of the FY12 transfers totaling $794 million contain this type of language.

Failure to make inter-fund transfers within applicable timeframes represents noncompliance with State law, and untimely transfers of monies may have delayed the receiving fund's use of appropriated funds. (Finding Code No. 12-3, 11-3, 10-3, 09-3)

RECOMMENDATION

We recommend the Office of the State Comptroller make transfers within timeframes established by applicable statute. While we realize that lack of available funds in the State Treasury requires prioritization and cash management decisions, we recommend the Office of the State Comptroller continue in its efforts to make transfers in as timely manner as possible.

AGENCY RESPONSE

Office of the State Comptroller:

> The Office accepts the recommendation. Taking into account the financial condition of State funds the Office will continue in its efforts to make transfers in the timeliest manner possible.

12-4. **FINDING** (Debt Covenant Violation)

The Illinois Student Assistance Commission (Illinois Designated Account Purchase Program) was not in compliance with two of the covenants relating to the agency's revolving line of credit agreement.

During the audit of the agency's June 30, 2009 financial statements, the Illinois Designated Account Purchase Program (IDAPP) management discovered that they had potentially violated one of the covenants relating to the agency's revolving credit line (loan) agreement with a bank. The noncompliance pertained to the "Coverage condition ratio" covenant. According to the line of credit agreement with the bank, the "Forbearance Excess Amount," defined as the aggregate value of all eligible student loans that are subject to forbearance, is to be used in the calculation of the Coverage condition ratio covenant. When IDAPP completed the report, created by the bank, and as instructed by the bank, the report produced an inaccurate calculation of the amount for the loans in forbearance. Once the error was discovered and the Coverage condition ratio was recalculated, it resulted in noncompliance with the Coverage condition ratio by IDAPP. The minimum Coverage condition ratio required by the line of credit agreement is 104% and the current ratio as of June 30, 2012 was 101.30%.

During the audits of the agency's June 30, 2010 and 2011 financial statements, we noted that IDAPP was in violation of the same covenant noted above. In addition, the agency was in violation of another covenant, the "Default ratio." According to the line of credit agreement with the bank, the Default ratio is defined as "the annualized percentage of the aggregate principal balance of all student loans which have become defaulted pledged student loans during such settlement period." IDAPP is required to maintain a maximum Default ratio of 6.25%. As of June 30, 2012, IDAPP's Default ratio was 8.36%, resulting in noncompliance with the Default ratio by IDAPP.

As a result of the violation, the bank has certain remedies available to it under the terms of the loan agreement, principal of which would be rights to call the loan and take possession of the collateral (the underlying student loan portfolio). The bank has been made aware of the event of default and has not communicated to IDAPP any intent to exercise the remedies available to it under the terms of the loan agreement. Management believes the bank would have little incentive to call the line of credit and begin servicing the student loans itself, particularly because IDAPP has made all of its required payments in a timely fashion. The balance of the line of credit with the bank was $275,956,827 at June 30, 2012.

According to Commission management, the Coverage condition ratio and default issues are due to the increased level of delinquent accounts in the portfolio. The level has increased due to the poor global economic conditions.

Failure to comply with debt covenants could result in the debt becoming due and payable in advance of scheduled retirement dates. As a result of the violation, the bank may have certain remedies under the terms of the loan agreements, principal of which would be the right to call the loan and take possession of the collateral (the underlying student loan portfolio of IDAPP). (Finding Code No. 12-4, 11-4, 10-6, 09-3)

RECOMMENDATION

We recommend IDAPP continue to monitor these loan covenant violations and continue seeking remedies from the lender involved.

AGENCY RESPONSE

Office of the Governor:

> The Governor's Office agrees with this recommendation. The Illinois Designated Account Purchase Program (IDAPP) will continue to monitor these loan covenants and will work with its external servicers to try to bring the coverage condition and default ratios back into compliance.
>
> This credit facility matured on July 27, 2010. Due to the tight credit markets for student loans and the performance of the portfolio, neither Citibank nor ISAC have been able to refinance the facility. ISAC management has been in regular contact with the lender and continues to explore options on the refinancing. At this time however, there are no imminent plans to refinance the facility.

12-5. **FINDING** (Finances Increase Risks)

The State of Illinois did not have sufficient controls over its finances to ensure obligations are paid. This condition increases the risk that liabilities will not be properly recorded. We noted the following during our financial audit of the State's financial statements.

As disclosed in Footnote 18 B, the State had transactions, totaling $4.475 billion, on hand at June 30, 2012 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, approximately $3 billion was owed to external parties, the remaining balance was related to intra-governmental transactions and statutorily mandated transfers. The external parties include State vendors, State Universities, local schools and local governments. The majority of these "held-payments" were payable from the General Revenue Fund.

The State's inadequate financial reporting process as described in Finding 12-1 was designed in 1981 under the assumption that cash payments would be made at the time the expenditures were processed by the Comptroller. Since this was not the case at year-end, extra effort was required by the accountants and the auditors to ensure the "held-payments" were appropriately accounted for. In addition, due to the State not being able to pay external vendors in a timely manner, the State paid approximately $136 million in interest payments during Fiscal Year 2012.

Economic conditions as well as years of unbalanced budgets appear to be the cause of the above condition.

Sound business practices require sufficient controls to ensure liabilities are paid timely. (Finding Code No. 12-5, 11-5, 10-7)

RECOMMENDATION

We recommend the Governor work with the General Assembly to improve the State's control over State finances in a manner that eliminates significant payment delays and unnecessary interest payments to State vendors.

AGENCY RESPONSE

Office of the Governor:

The Governor's Office agrees with this recommendation. While we agree with the findings of the audit, measures have been taken to prevent future findings in this area. The following steps have been taken:

1. GOMB works with the Department of Revenue to estimate income tax refund demand in the coming fiscal year. The income tax refund fund diversion rate recommended in the Governor’s budget reflects the DOR recommendation.
2. GOMB and DOR present the recommended refund fund diversion rate to the House Revenue and Finance Committee. The presentation discloses all risks to the forecast. COGFA presents their recommended refund fund diversion rates at the same hearing.
3. Based on the information presented by DOR, GOMB and COGFA, the House members decide on a refund fund diversion rate for their revenue resolution.
4. The diversion rates adopted in the House resolution are then codified in statute for the coming fiscal year via the BIMP.

The above approach was adopted for FY2013 and continued in the budget development for FY2014. As a result, the entire income tax refund backlog has been paid. According to the Comptroller the fund cash surplus on June 4, 2013 is $317.137M.