

# McGladrey & Pullen

Certified Public Accountants

## State of Illinois Department of Employment Security

Individual Nonshared Governmental Funds  
Individual Nonshared Proprietary Fund  
Financial Audits  
For the Year Ended June 30, 2006

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

State of Illinois  
Department of Employment Security

Financial Audits  
For the Year Ended June 30, 2006

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State of Illinois  
Department of Employment Security

Financial Audits  
For the Year Ended June 30, 2006

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State of Illinois  
Department of Employment Security

Agency Officials  
June 30, 2006

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Director	Ms. Brenda A. Russell
Deputy Director, Administration Previous to November 1, 2005 February 1, 2006 to present	Ms. Grace Chan McKibben Ms. Elizabeth Nicholson
Deputy Director, Operations Previous to April 17, 2006 June 1, 2006 to present	Mr. Don Davis Mr. Keith Chambers
Chief Financial Officer	Mr. Jon Gingrich
Chief Information Services Officer	Mr. Thomas Revane
Manager, Revenue Division	Ms. Lois Cuevas
Deputy Director, Field Operations Previous to December 1, 2005 February 1, 2006 to present	Ms. Marsha Ross-Jackson Ms. Virginia Long
General Counsel	Mr. Joseph P. Mueller
Manager, Accounting Services Division	Mr. L. Briant Coombs
Deputy Director, Workforce and Career Information (Economic Information and Analysis)	Mr. Henry L. Jackson
Manager, General Services Division	Mr. John Rogers
Manager, Human Resources Previous to February 1, 2006	Ms. Elizabeth Nicholson
Deputy Director Human Resources February 1, 2006 to present	Mr. Ken Santiago
Manager, Unemployment Insurance Division	Ms. Carolyn Vanek
Manager, Employment Services Division Previous to February 1, 2006 February 1, 2006 to present	Mr. Less Boucher Mr. Bennett Krause

State of Illinois  
Department of Employment Security

Agency Officials  
June 30, 2006

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Deputy Director, Strategic Planning

Ms. Georgina Heard-LaBonne

Equal Opportunity Officer

Mr. Carlos Charneco

The Department's Administrative offices are located at:

33 South State Street  
Chicago, IL 60603-2802  
(312) 793-5700

850 East Madison Street  
Springfield, IL 62702-5603  
(217) 785-5069

STATE OF ILLINOIS  
DEPARTMENT OF EMPLOYMENT SECURITY

Individual Nonshared Governmental Funds

Financial Audits

For the Year Ended June 30, 2006

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

State of Illinois  
Department of Employment Security

Financial Statements  
For the Year Ended June 30, 2006

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**FINANCIAL STATEMENT REPORT SUMMARY**

The audit of the accompanying individual nonshared governmental fund financial statements of the State of Illinois, Department of Employment Security was performed by McGladrey & Pullen, LLP.

Based on their audits, the auditors expressed unqualified opinions on the Department's individual nonshared governmental fund financial statements.

# McGladrey & Pullen

Certified Public Accountants

## Independent Auditor's Report

Honorable William G. Holland  
Auditor General  
State of Illinois

As Special Assistant Auditors for the Auditor General, we have audited the accompanying financial statements of the Title III Social Security and Employment Services Fund, Unemployment Compensation Special Administration Fund, Employment Security Administrative Fund and Special Programs Fund (Nonshared Governmental Funds) of the State of Illinois, Department of Employment Security (Department), as of and for the year ended June 30, 2006, as listed in the table of contents. These financial statements are the responsibility of the Department's management. Our responsibility is to express opinions on these financial statements based on our audit.

We conducted our audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and the significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audit provides a reasonable basis for our opinions.

As discussed in Note 2, the financial statements present only the Nonshared Governmental Funds and do not purport to, and do not, present fairly the financial position of the State of Illinois, Department of Employment Security as of June 30, 2006, and its changes in financial position for the year then ended in conformity with accounting principles generally accepted in the United States of America.

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of the Nonshared Governmental Funds of the Department, as of June 30, 2006, and the changes in financial position thereof for the year then ended in conformity with accounting principles generally accepted in the United States of America.

In accordance with *Government Auditing Standards*, we have also issued a report dated November 22, 2006 on our consideration of the Department's internal control over financial reporting of the Nonshared Governmental Funds and on our tests of the Department's compliance with certain provisions of laws, regulations, contracts and, grant agreements and other matters. The purpose of that report is to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing and not to provide an opinion on the internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* and should be considered in assessing the results of our audit.



The Department has not presented a management's discussion and analysis and budgetary comparison information for the Nonshared Governmental Funds that the Governmental Accounting Standards Board has determined is necessary to supplement, although not required to be part of, the financial statements.

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, Department 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.

*McGladrey & Pullen, LLP*

Schaumburg, Illinois  
November 22, 2006

State of Illinois  
 Department of Employment Security

Individual Nonshared Governmental Funds

Balance Sheets

June 30, 2006

(Amounts in \$000's)

	Title III Social Security and Employment Services Fund	Unemployment Compensation Special Administration Fund	Employment Security Administrative Fund	Special Programs Fund
<b>Assets</b>				
Cash and cash equivalents	\$ 17,862	\$ 15,658	\$ -	\$ -
Intergovernmental receivables	7,289	-	-	100
Other receivables	70	63	-	-
Due from other State funds	10,409	5,287	-	-
Inventories	1,555	-	-	-
Total assets	<u>\$ 37,185</u>	<u>\$ 21,008</u>	<u>\$ -</u>	<u>\$ 100</u>
<b>Liabilities and Fund Balances</b>				
Liabilities:				
Accounts payable and accrued liabilities	\$ 5,618	\$ 202	\$ -	\$ 1,434
Intergovernmental payables	274	-	-	7
Due to other State funds	4,893	10,000	-	-
Due to component units of the State	63	-	-	-
Deferred revenues	53	-	-	-
Other liabilities	-	-	-	6,371
Total liabilities	<u>10,901</u>	<u>10,202</u>	<u>-</u>	<u>7,812</u>
Fund Balances:				
Reserved for inventories	1,555	-	-	-
Reserved for encumbrances	99	-	-	-
Unreserved - undesignated	24,630	10,806	-	(7,712)
Total fund balances	<u>26,284</u>	<u>10,806</u>	<u>-</u>	<u>(7,712)</u>
Total liabilities and fund balances	<u>\$ 37,185</u>	<u>\$ 21,008</u>	<u>\$ -</u>	<u>\$ 100</u>

See Notes to Financial Statements.

State of Illinois  
 Department of Employment Security

Individual Nonshared Governmental Funds  
 Statements of Revenue, Expenditures, and Changes in Fund Balances  
 Year Ended June 30, 2006  
 (Amounts in \$000's)

	Title III Social Security and Employment Services Fund	Unemployment Compensation Special Administration Fund	Employment Security Administrative Fund	Special Programs Fund
<b>Revenues</b>				
Federal government	\$ 168,851	\$ -	\$ -	\$ 20,267
Other revenues	1,585	-	-	-
Licenses and fees	186	-	-	-
Interest and investment income	905	445	-	-
Total revenues	<u>171,527</u>	<u>445</u>	<u>-</u>	<u>20,267</u>
<b>Expenditures</b>				
Employment and economic development	184,267	2,457	-	27,979
Capital outlays	538	-	-	-
Total expenditures	<u>184,805</u>	<u>2,457</u>	<u>-</u>	<u>27,979</u>
Deficiency of revenues over (under) expenditures	<u>(13,278)</u>	<u>(2,012)</u>	<u>-</u>	<u>(7,712)</u>
<b>Other financing sources (uses)</b>				
Transfers in	10,016	17,276	-	-
Transfers out	-	(10,000)	(3)	-
Total other financing sources (uses)	<u>10,016</u>	<u>7,276</u>	<u>(3)</u>	<u>-</u>
Net changes in fund balances	(3,262)	5,264	(3)	(7,712)
Fund balances, July 1, 2005	<u>29,546</u>	<u>5,542</u>	<u>3</u>	<u>-</u>
Fund balances, June 30, 2006	<u>\$ 26,284</u>	<u>\$ 10,806</u>	<u>\$ -</u>	<u>\$ (7,712)</u>

See Notes to Financial Statements.

State of Illinois  
Department of Employment Security

Individual Nonshared Governmental Funds  
Notes to Financial Statements  
June 30, 2006  
(Amounts in 000's)

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1. Description of Funds

The Department of Employment Security (the Department) administers the nonshared governmental funds described below. A nonshared fund is a fund in which a single State agency is responsible for administering substantially all financial transactions of the fund. The nonshared funds administered by the Department are summarized below.

- (a) **Title III Social Security and Employment Services Fund** - The Department is organized to administer grant and program activities under various federal mandates, statutes and regulations. This fund accounts for all general disbursements for the everyday operation of the Department of Employment Security.
- (b) **Unemployment Compensation Special Administration Fund** - This fund accounts for collections of interest and penalties from employers and judgment interest from claimants. Funds are used as provided by law as necessary for the proper administration of the Unemployment Insurance Act or transferred to the Unemployment Compensation Trust Fund.
- (c) **Employment Security Administrative Fund** – Funds are used as provided by law as necessary for the proper administration of the Unemployment Insurance Act. This fund was closed during the fiscal year and the remaining amounts were transferred to the Unemployment Compensation Trust Fund.
- (d) **Special Programs Fund** - This fund accounts for paying unemployment benefits under the Trade Readjustment Act program (TRA), Alternative Trade Adjustment Assistance (ATAA), and Disaster Unemployment Assistance (DUA).

2. Summary of Significant Accounting Policies

The financial statements of the individual nonshared governmental funds administered by the Department have been prepared in accordance with accounting principles generally accepted in the United States of America (GAAP), as prescribed by the Governmental Accounting Standards Board (GASB). To facilitate the understanding of data included in the financial statements, summarized below are the more significant accounting policies.

(a) Reporting Entity

As defined by GAAP, 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 primary government are financially accountable.

State of Illinois  
Department of Employment Security

Individual Nonshared Governmental Funds  
Notes to Financial Statements  
June 30, 2006  
(Amounts in 000's)

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2. Summary of Significant Accounting Policies, continued

(a) Reporting Entity - Continued

Financial Accountability is defined as:

- (1) Appointment of a voting majority of the component unit's board and either (a) the primary government's ability to impose its will, or (b) the possibility that the component unit will provide financial benefit to or impose a financial burden on the primary government; or
- (2) Fiscal dependency on the primary government.

Based upon the required criteria, none of the individual nonshared governmental funds have component units, nor is any one a component unit of any other entity. However, because the individual nonshared governmental funds are not legally separate from the State of Illinois, they are included in the financial statements of the State as governmental funds. The State of Illinois' Comprehensive Annual Financial Report may be obtained by writing to the State Comptroller's Office, Financial Reporting Department, 325 West Adams Street, Springfield, Illinois, 62704-1871.

The financial statements present only the Title III Social Security and Employment Services, Unemployment Compensation Special Administration, Employment Security Administrative and Special Program Funds administered by the State of Illinois, Department of Employment Security and do not purport to, and do not, present fairly the financial position of the State of Illinois, Department of Employment Security as of June 30, 2006, and changes in its financial position for the year then ended in conformity with accounting principles generally accepted in the United States of America.

(b) Basis of Presentation

In government, the basic accounting and reporting entity is a fund. A fund is defined as 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. A balance sheet and statement of revenues, expenditures, and changes in fund balances has been presented for each individual nonshared governmental fund administered by the Department.

State of Illinois  
Department of Employment Security

Individual Nonshared Governmental Funds  
Notes to Financial Statements  
June 30, 2006  
(Amounts in 000's)

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2. Summary of Significant Accounting Policies, continued

(b) Basis of Presentation, continued

Each of the nonshared governmental funds are special revenue funds. Transactions related to resources obtained from specific revenue sources (other than for expendable trusts) that are legally restricted for specified purposes are accounted for in special revenue funds. Special revenue funds are not shared with other State agencies. The Department administers grant and program activities under various federal mandates, statutes and regulations. The major federally funded administrative activities conducted by the Department are accounted for in the Title III Social Security and Employment Services Fund. The Unemployment Compensation Special Administration Fund accounts for collections of interest and penalties from employers and judgment interest from claimants and funds are used as provided by law as necessary for the administration of the Unemployment Insurance Act. The Special Programs Fund accounts for paying unemployment benefits under various federal programs.

All Special Revenue Funds are held in the State Treasury, except for the Special Programs Fund which is held locally. The funds are appropriated by the General Assembly, except for certain expenditures of the Unemployment Compensation Special Administration Fund, which are excluded from appropriation by the Illinois Unemployment Insurance Act, and the unemployment benefits paid from the Special Programs Fund.

(c) Basis of Accounting

The individual nonshared governmental funds are reported using the current financial resources measurement focus and the modified accrual basis of accounting.

Revenues are recognized as soon as they are both measurable and available. Nonexchange transactions, in which the Department gives (or receives) value without directly receiving (or giving) equal value in exchange, include grants from the federal and other state governments. Revenue from grants, entitlements, and similar items is recognized in the fiscal year in which all eligibility requirements imposed by the provider have been met and the resources are available. Revenues are considered to be available when they are collectible within the current period or soon enough thereafter to pay liabilities of the current period. For this purpose, the State considers revenues to be available if they are collected within 60 days of the end of the current fiscal year.

Expenditures generally are recorded when a liability is incurred, as under accrual accounting. However, principal and interest on long-term debt obligations, claims and judgments, and compensated absences are recorded only when payment is due. General capital asset acquisitions are reported as expenditures. Proceeds of long-term debt obligations and acquisitions under capital leases are reported as other financing sources.

Significant revenue sources of the individual nonshared governmental funds which are susceptible to accrual include grants from the federal government. All other revenue sources including fees, interest, and investment income are considered to be measurable and available only when cash is received.

State of Illinois  
Department of Employment Security

Individual Nonshared Governmental Funds  
Notes to Financial Statements  
June 30, 2006  
(Amounts in 000's)

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2. Summary of Significant Accounting Policies, continued

(d) Cash and Cash Equivalents

Cash and cash equivalents consist principally of deposits held in the State Treasury. Cash and cash equivalents also include cash on hand; cash in banks for locally held funds, and pooled investments funds held by other governmental agencies with a maturity of three months or less.

(e) Inventories

Inventories, consisting primarily of printed forms and supplies, are valued at cost, principally on the first-in, first-out (FIFO) method. Inventories for each fund are recorded as expenditures when consumed rather than when purchased.

(f) Interfund Transactions

The individual governmental nonshared funds have the following types of interfund transactions with other funds of the State:

**Services provided and used** - sales and purchases of goods and services between funds for a price approximating their external exchange value. Interfund services provided and used are reported as revenues in seller funds and expenditures or expenses in purchaser funds. Unpaid amounts are reported as interfund receivables and payables in the fund balance sheets or fund statements of net assets.

**Reimbursements** - repayments from the funds responsible for particular expenditures or expenses to the funds that initially paid for them. Reimbursements are reported as expenditures in the reimbursing fund and as a reduction of expenditures in the reimbursed fund.

**Operating transfers** - flows of assets (such as cash or goods) without equivalent flows of assets in return and without a requirement for repayment. Transfers are reported as other financing uses in the funds making the transfers and as other financing sources in the funds receiving transfers.

(g) Compensated Absences

A liability for unpaid, accumulated vacation and sick leave balances for the Department employees is reported in the nonshared funds only if they have matured, for example, as a result of employee resignations and retirements. There was no liability for compensated absences as of June 30, 2006.

(h) Fund Balances

The individual nonshared governmental funds report reservations of fund balance for amounts that are not available for appropriation or are legally restricted by outside parties for use for specific purpose. Designations of fund balances represent tentative State plans that are subject to change.

State of Illinois  
Department of Employment Security

Individual Nonshared Governmental Funds  
Notes to Financial Statements  
June 30, 2006  
(Amounts in 000's)

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2. Summary of Significant Accounting Policies, continued

(i) 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 expenditures during the reporting period. Actual results could differ from those estimates.

3. Deposits

The State Treasurer is the custodian of the State's cash and cash equivalents for funds maintained in the State Treasury. The Department independently manages cash and cash equivalents maintained outside the State Treasury.

Collateralized deposits include pooled securities held by the financial institution's trust department. These securities are held in the name of the financial institution and not that of the State.

Deposits in the custody of the State Treasurer (or in transit) and cash on hand at June 30, 2006, were as follows:

Fund	Deposits in Custody of State Treasurer	Cash On Hand
Title III Social Security and Employment Services	\$ 17,857	\$ 5
Unemployment Compensation Special Administration	15,658	-
	<u>\$ 33,515</u>	<u>\$ 5</u>

Deposits in the custody of the State Treasurer are pooled and invested with other State funds in accordance with the Deposit of State Moneys Act of Illinois Compiled Statutes (15 ILCS 520/11). Funds held by the State Treasurer have not been categorized as to credit risk because the Department does not own individual securities. Details on the nature of these investments are available within the State of Illinois' Comprehensive Annual Financial Report.



State of Illinois  
 Department of Employment Security

Individual Nonshared Governmental Funds  
 Notes to Financial Statements  
 June 30, 2006  
 (Amounts in 000's)

4. Interfund Balances and Activities

(a) Balances Due to/from Other Funds

The following balances at June 30, 2006 represent amounts due from other Department and State of Illinois funds.

Fund	Amount	Description/Purpose
Title III Social Security and Employment Services	\$ 10,000	Due from Unemployment Compensation Special Administration Fund representing discretionary transfers
	4	Due from Unemployment Compensation Trust Fund representing discretionary transfers of NSF fees
	383	Due from Department of Commerce and Economic Opportunity representing Workforce Investment Act (WIA) transfers
	17	Due from Illinois State Board of Education for Voc Ed-Perkins Title IIA
	5	Due from Department of Public Aid for weekly statistical services and monthly intercept of UI benefits
Total	<u>\$ 10,409</u>	
Unemployment Compensation Special Administration	\$ 5,287	Due from Unemployment Compensation Trust Fund representing discretionary transfers of penalties and interest
Total	<u>\$ 5,287</u>	

State of Illinois  
 Department of Employment Security

Individual Nonshared Governmental Funds  
 Notes to Financial Statements  
 June 30, 2006  
 (Amounts in 000's)

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4. Interfund Balances and Activities, continued

(a) Balances Due to/from Other Funds, continued

The following balances at June 30, 2006 represent amounts due to other Department and State of Illinois funds.

Fund	Amount	Description/Purpose
Title III Social Security and Employment Services	\$ 48	Due to Unemployment Compensation Trust Fund for reimbursement of unemployment benefits paid to former employees of the Department
	4,845	Due to other State funds for payment of services
Total	<u>\$ 4,893</u>	
Unemployment Compensation Special Administration	\$ 10,000	Due to Title III Social Security and Employment Services Fund for discretionary transfers
Total	<u>\$ 10,000</u>	

The following balances at June 30, 2006 represent amounts due to component units of the State of Illinois.

Fund	Amount	Description/Purpose
Title III Social Security and Employment Services	\$ 63	Due to Northern Illinois University relating to a grant contract
Total	<u>\$ 63</u>	

State of Illinois  
Department of Employment Security

Individual Nonshared Governmental Funds  
Notes to Financial Statements  
June 30, 2006  
(Amounts in 000's)

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4. Interfund Balances and Activities, continued

(b) Transfers to/from Other Funds

Interfund transfers in for the year ended June 30, 2006, were as follows:

Fund	Amount	Description/Purpose
Title III Social Security and Employment Services	\$ 10,000	Discretionary transfer of penalties and interest from Unemployment Compensation Special Administration Fund
	16	Discretionary transfer of NSF fees from Unemployment Compensation Trust Fund
Total	<u>\$ 10,016</u>	
Unemployment Compensation Special Administration	\$ 17,276	Discretionary transfer of penalties and interest from Unemployment Compensation Trust Fund
Total	<u>\$ 17,276</u>	

Interfund transfers out for the year ended June 30, 2006, were as follows:

Fund	Amount	Description/Purpose
Unemployment Compensation Special Administration	\$ 10,000	Discretionary transfer of funds to Title III Social Security and Employment Services Fund
	<u>\$ 10,000</u>	
Employment Security Administrative	\$ 3	Transfer of excess funds to the Unemployment Compensation Trust Fund
Total	<u>\$ 3</u>	

State of Illinois  
Department of Employment Security

Individual Nonshared Governmental Funds  
Notes to Financial Statements  
June 30, 2006  
(Amounts in 000's)

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**5. Liability to the Federal Government and Deficit Fund Balance**

On July 10, 2006, the Department and the United States Department of Labor, Employment and Training Administration entered into a settlement agreement to resolve allegations of overpayments of Trade Readjustment Allowance (TRA) benefits under the Federal Trade Act. The agreement directs the Department to deposit \$7,712 into its Special Programs Fund and use the funds for the payment of prospective TRA benefits. The entire settlement is included in the balance sheet as other liabilities in the amount of \$6,371 under the Special Programs Fund, which is \$7,712 net of outstanding benefits of \$1,341 issued as of June 30, 2006. The Department paid the first installment of \$712 into the fund on July 24, 2006 and anticipates the second (i.e. final) installment will be paid shortly after the General Assembly reconvenes in January 2007. IDES Management was granted an extension for the final payment to the U.S. Department of Labor until February 15, 2007 in order to give the General Assembly time to complete the necessary legislative action in January 2007 and transfer the funds necessary to repay the liability and to fund the deficit balance in the Special Programs Fund. IDES Management believes the other liabilities as currently recorded are correct.

**6. Pension Plan**

Substantially all of the Department's full-time employees who are not eligible for participation in another state-sponsored retirement plan participate in the State Employees' Retirement System (SERS), which is a pension trust fund in the State of Illinois reporting entity. The SERS is a single-employer defined benefit public employee retirement system (PERS) in which State employees participate, except those covered by the State Universities, Teachers', General Assembly, and Judges' Retirement Systems. The financial position and results of operations of the SERS for fiscal year 2006 are included in the State of Illinois' Comprehensive Annual Financial Report (CAFR) for the year ended June 30, 2006. The SERS issues a separate CAFR that may be obtained by writing to the SERS, 2101 South Veterans Parkway, Springfield, Illinois, 62794-9255.

A summary of SERS benefit provisions, changes in benefit provisions, employee eligibility requirements including eligibility for vesting, and the authority under which benefit provisions are established are included as an integral part of the SERS' CAFR. Also included is a discussion of employer and employee obligations to contribute and the authority under which those obligations are established.

The Department pays employer retirement contributions in the individual nonshared governmental funds based upon an actuarially determined percentage of their payrolls. For Fiscal year 2006, the employer contribution rate was 7.792%.

**7. Post-employment Benefits**

The State provides health, dental and life insurance benefits for certain retirees and their dependents. Substantially all State employees become eligible for post-employment benefits if they eventually become annuitants of one of the State sponsored pension plans. Health and dental benefits include basic benefits for annuitants under the State's self-insurance plan and insurance contracts currently in force. Life insurance benefits are limited to \$5,000 per annuitant.

State of Illinois  
Department of Employment Security

Individual Nonshared Governmental Funds  
Notes to Financial Statements  
June 30, 2006  
(Amounts in 000's)

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**7. Post-employment Benefits, continued**

Costs incurred for health, dental, and life insurance for annuitants and their dependents were not separated from benefits provided to active employees and their dependents for the year ended June 30, 2006. However, post-employment costs for the State as a whole for all State agencies/departments for dependent health, dental and life insurance for annuitants and their dependents are disclosed in the Illinois Comprehensive Annual Financial Report for the State.

Cost information for retirees by individual fund or State agency is not available. Payments are made on a "pay-as-you-go" basis.

**8. Risk Management**

The Department is exposed to various risks of loss related to torts; theft of, damage to, and destruction of assets; errors and omission; workers compensation and natural disasters. The State retains the risk of loss (i.e., self insured) for these risks. The Department's risk management activities for workers compensation are financed through appropriations to the Illinois Department of Central Management Services and are accounted for in the General Fund of the State. The claims are not considered to be a liability of the Department and accordingly, have not been reported in the Department's financial statements for the year ended June 30, 2006.

**9. Commitments and Contingencies**

(1) Federal Funding

The Department receives federal grants, which are subject to review and audit by federal grantor agencies. Certain costs could be questioned as not being an eligible expenditure under the terms of the grants. At June 30, 2006, there were no material questioned costs other than those disclosed in Note 5 above, that have not been resolved with the federal awarding agencies. However, questioned costs could still be identified during audits to be conducted in the future. Management of the Department believes there will be no material adjustments to the federal grants, other than those identified in Note 5 above, which were recorded in the financial statements as of June 30, 2006 and, accordingly, has not recorded a provision for possible repayment.

(2) Litigation

The Department is routinely involved in a number of legal proceedings and claims that cover a wide range of matters. In the opinion of management, the outcome of these matters is not expected to have any material adverse effect on the financial positions or results of operations of the Department.

State of Illinois  
Department of Employment Security

Individual Nonshared Governmental Funds  
Notes to Financial Statements  
June 30, 2006  
(Amounts in 000's)

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10. New Accounting Pronouncement

The Governmental Accounting Standards Board (GASB) has issued the following statement:

Statement No. 45 – *Accounting and Financial Reporting by Employers for Postemployment Benefits Plans Other Than Pensions*, which establishes standards for the measurement and display of OPEB expense/expenditures and related liabilities (assets), note disclosures, and if applicable, required supplementary information (RSI) in the financial reports of state and local government employers. This statement is effective for the period beginning July 1, 2007.

Management has not yet completed its assessment of the impact of this statement on the Department's financial statements.

# McGladrey & Pullen

Certified Public Accountants

## **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 William G. Holland  
Auditor General  
State of Illinois

As Special Assistant Auditors for the Auditor General, we have audited the Title III Social Security and Employment Service Fund, Unemployment Compensation Special Administration Fund, Employment Security Administrative Fund and Special Programs Fund (Individual Nonshared Governmental Funds) of the State of Illinois, Department of Employment Security (Department), as of and for the year ended June 30, 2006, and have issued our report thereon dated November 22, 2006. 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.

### **Internal Control Over Financial Reporting**

In planning and performing our audit, we considered the Department's internal control over financial reporting of the Individual Nonshared Governmental Funds in order to determine our auditing procedures for the purpose of expressing our opinions on the financial statements and not to provide an opinion on the internal control over financial reporting. Our consideration of the internal control over financial reporting would not necessarily disclose all matters in the internal control over financial reporting that might be material weaknesses. A material weakness is a reportable condition in which the design or operation of one or more of the internal control components does not reduce to a relatively low level the risk that misstatements caused by error or fraud in amounts that would be material in relation to the Individual Nonshared Governmental Fund's financial statements being audited may occur and not be detected within a timely period by employees in the normal course of performing their assigned functions. We noted no matters involving the internal control over financial reporting and its operation that we consider to be material weaknesses.

### **Compliance and Other Matters**

As part of obtaining reasonable assurance about whether the Department's 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 no instances of noncompliance or other matters that are required to be reported under *Government Auditing Standards*.

This report is intended solely for the information and use of the Auditor General, the General Assembly, the Legislative Audit Commission, the Governor, Department 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.

*McGladrey & Pullen, LLP*

Schaumburg, Illinois  
November 22, 2006

STATE OF ILLINOIS  
DEPARTMENT OF EMPLOYMENT SECURITY

Individual Nonshared Proprietary Fund

Financial Audit

For the Year Ended June 30, 2006

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



State of Illinois  
Department of Employment Security

Financial Audit  
For the Year Ended June 30, 2006

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**FINANCIAL STATEMENT REPORT SUMMARY**

The audit of the accompanying individual nonshared proprietary fund financial statements of the State of Illinois, Department of Employment Security was performed by McGladrey & Pullen, LLP.

Based on their audit, the auditors expressed an unqualified opinion on the Department's individual nonshared proprietary fund financial statements.

# McGladrey & Pullen

Certified Public Accountants

## Independent Auditor's Report

Honorable William G. Holland  
Auditor General  
State of Illinois

As Special Assistant Auditors for the Auditor General, we have audited the accompanying financial statements of the Unemployment Compensation Trust Fund (Individual Nonshared Proprietary Fund) of the State of Illinois, Department of Employment Security (Department), as of and for the year ended June 30, 2006, as listed in the table of contents. These financial statements are the responsibility of the Department's management. 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 of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and the significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audit provides a reasonable basis for our opinion.

As discussed in Note 2, the financial statements present only the Unemployment Compensation Trust Fund and do not purport to, and do not, present fairly the financial position of the State of Illinois, Department of Employment Security as of June 30, 2006, and its changes in financial position and cash flows for the year then ended in conformity with accounting principles generally accepted in the United States of America.

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of the Unemployment Compensation Trust Fund of the State of Illinois, Department of Employment Security, as of June 30, 2006, and the changes in financial position and cash flows thereof for the year then ended in conformity with accounting principles generally accepted in the United States of America.

In accordance with *Government Auditing Standards*, we have also issued a report dated November 22, 2006 on our consideration of the Department's internal control over financial reporting of the Unemployment Compensation Trust Fund and on our tests of the Department's compliance with certain provisions of laws, regulations, contracts and, grant agreements and other matters. The purpose of that report is to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing, and not to provide an opinion on the internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* and should be considered in assessing the results of our audit.

The Department has not presented a management's discussion and analysis for the Unemployment Compensation Trust Fund that the Governmental Accounting Standards Board has determined is necessary to supplement, although not required to be part of, the financial statements.

Our audit was conducted for the purpose of forming an opinion on the financial statements of the Unemployment Compensation Trust Fund (Individual Nonshared Proprietary Fund) of the State of Illinois, Department of Employment Security. The combining financial statements and interfund balances and activities, as listed in the table of contents, are presented for purposes of additional analysis and are not a required part of the basic financial statements. The combining financial statements and interfund balances and activities have been subjected to the auditing procedures applied in the audit of the financial statements and, in our opinion, are fairly stated in all material respects in relation to the financial statements taken as a whole.

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, Department 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.

*McGladrey & Pullen, LLP*

Schaumburg, Illinois  
November 22, 2006

State of Illinois  
 Department of Employment Security

Individual Nonshared Proprietary Fund

Statement of Net Assets

June 30, 2006

(Amounts in \$000's)

	Unemployment Compensation Trust Fund
<b>Current Assets</b>	
Cash and cash equivalents	\$ 10,000
Investments	1,137,136
Receivables, net:	
Taxes	505,595
Intergovernmental	27,844
Other	75,405
Due from State funds	3,563
Due from component units of the State of Illinois	151
	<hr/>
Total current assets	1,759,694
	<hr/>
<b>Current Liabilities</b>	
Accounts payable	5
Benefit payments payable	75,840
Intergovernmental payables	7,526
Due to other State funds	5,291
	<hr/>
Total current liabilities	88,662
	<hr/>
<b>Net Assets</b>	
Restricted for:	
Unemployment compensation benefits	1,664,132
Unrestricted	6,900
	<hr/>
Total net assets	\$ 1,671,032
	<hr/> <hr/>

See Notes to Financial Statements.

State of Illinois  
 Department of Employment Security

Individual Nonshared Proprietary Fund  
 Statement of Revenues, Expenses, and Changes in Net Assets  
 Year Ended June 30, 2006  
 (Amounts in \$000's)

	Unemployment Compensation Trust Fund
Operating revenues:	
Contributions - Unemployment taxes	\$ 2,647,627
Federal government	31,013
Total operating revenues	<u>2,678,640</u>
Operating expenses	
Benefit payments and refunds	<u>1,719,571</u>
Operating income	<u>959,069</u>
Nonoperating revenues (expenses)	
Interest and investment income	33,865
Interest and investment expense	(6,731)
Other expenses	(4,960)
Total nonoperating revenues (expenses)	<u>22,174</u>
Income before transfers:	981,243
Transfers in	3
Transfers out	<u>(17,292)</u>
Increase in net assets	963,954
Net assets, July 1, 2005	<u>707,078</u>
Net assets, June 30, 2006	<u><u>\$ 1,671,032</u></u>

See Notes to Financial Statements.

State of Illinois  
 Department of Employment Security

Individual Nonshared Proprietary Fund  
 Statement of Cash Flows  
 Year Ended June 30, 2006  
 (Amounts in \$000's)

	Unemployment Compensation Trust Fund
Cash flows from operating activities	
Contributions - Unemployment taxes received	\$ 2,661,900
Federal grants received	31,013
Unemployment benefits paid	(1,717,578)
<b>Net cash provided by operating activities</b>	<b>975,335</b>
Cash flows from noncapital financing activities	
Transfers in	1,105,978
Transfers out	(1,121,416)
Principal paid on revenue bonds	(668,100)
Interest paid on revenue bonds	(17,173)
Other noncapital financing activities	(901)
<b>Net cash (used in) noncapital financing activities</b>	<b>(701,612)</b>
Cash flows from investing activities	
Purchase of investment securities	(2,592,127)
Sale of investment securities	2,086,308
Interest and investment income	33,865
<b>Net cash (used in) investing activities</b>	<b>(471,954)</b>
Net decrease in cash and cash equivalents	(198,231)
Cash and cash equivalents, July 1, 2005	208,231
Cash and cash equivalents, June 30, 2006	\$ 10,000

State of Illinois  
Department of Employment Security

Individual Nonshared Proprietary Fund  
Statement of Cash Flows - Continued  
Year Ended June 30, 2006  
(Amounts in \$000's)

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	Unemployment Compensation Trust Fund
Reconciliation of operating income to net cash provided by operating activities	
Operating income	\$ 959,069
Adjustments to reconcile operating income to net cash provided by operating activities:	
Provision for uncollectible accounts	(10,730)
Changes in assets and liabilities	
Receivables	19,056
Intergovernmental receivables	1,576
Due from other funds	4,522
Due from component units	19
Benefit payments payable	3,222
Intergovernmental payables	(1,399)
<b>Net cash provided by operating activities</b>	<b>\$ 975,335</b>

See Notes to Financial Statements.

Individual Nonshared Proprietary Fund  
Notes to Financial Statements  
June 30, 2006  
(Amounts in \$000's)

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**1. Description of Fund**

The Department of Employment Security (the Department) administers the nonshared proprietary fund as described below. A Nonshared fund is a fund in which a single State agency is responsible for administering substantially all financial transactions of the fund.

The Unemployment Compensation Trust Fund accounts for assets held by the Department in a trustee capacity, for which the principal and income may be expended in the course of the fund's designated operations. The fund, a locally held fund, receives employer contributions and disburses money in the form of unemployment benefits paid to eligible claimants. This fund also receives federal funding to pay eligible claimants for any federally mandated benefit programs. The Unemployment Compensation Trust Fund is not appropriated by the General Assembly and is intended to be self-supporting.

The Master Bond Fund has been combined with the Unemployment Compensation Trust Fund for financial reporting purposes. The Master Bond Fund accounts for Fund Building Receipts which are used for the payment of obligations in connection with bond issues, including principal and interest and bond administrative expenses. The fund, a locally held fund, was established January 1, 2004 by an amendment to the Unemployment Insurance Act by the Authorizing Legislation (Public Act 93-0634, as supplemented by Public Act 93-0676) where employers' contributions attributable to the Fund Building rate shall be directed for deposit into the Master Bond Fund. The Authorizing Legislation authorizes the State to issue bonds to (1) repay principal of and interest on unpaid advances to the State's unemployment trust account within the Federal Unemployment Trust Fund; (2) pay unemployment benefits by depositing a portion of the proceeds in the State's unemployment trust account within the Federal Unemployment Trust Fund; and (3) pay costs of issuance with respect to the Series 2004 Bonds.

**2. Summary of Significant Accounting Policies**

The financial statements of the individual nonshared proprietary fund have been prepared in accordance with accounting principles generally accepted in the United States of America (GAAP), as prescribed by the Governmental Accounting Standards Board (GASB). To facilitate the understanding of data included in the financial statements, summarized below are the more significant accounting policies.

**(a) Reporting Entity**

As defined by GAAP, the financial reporting entity consists of a primary government, as well as its component units, which are legally separate organizations for which the elected officials of the primary government are financially accountable. Financial accountability is defined as:

- (1) Appointment of a voting majority of the component unit's board and either (a) the primary government's ability to impose its will, or (b) the possibility that the component unit will provide financial benefit to or impose a financial burden on the primary government; or
- (2) Fiscal dependency on the primary government.



**2. Summary of Significant Accounting Policies, continued**

**(a) Reporting Entity, continued**

Based upon the required criteria, the individual nonshared proprietary fund does not have component units, nor is it a component unit of any other entity. However, because the individual nonshared proprietary fund is not legally separate from the State of Illinois, it is included in the financial statements of the State as a proprietary fund. The State of Illinois' Comprehensive Annual Financial Report may be obtained by writing to the State Comptroller's Office, Financial Reporting Department, 325 West Adams Street, Springfield, Illinois, 62704-1871.

The financial statements include only the Unemployment Compensation Trust Fund administered by the State of Illinois, Department of Employment Security and do not purport to, and do not, present fairly the financial position of the State of Illinois, Department of Employment Security as of June 30, 2006, and changes in its financial position and cash flows for the year then ended in conformity with accounting principles generally accepted in the United States of America.

**(b) Basis of Presentation**

In government, the basic accounting and reporting entity is a fund. A fund is defined as 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. A statement of net assets, statement of revenues, expenses, and changes in net assets, and statement of cash flows have been presented for the nonshared proprietary fund administered by the Department.

The nonshared proprietary fund is an enterprise fund. Enterprise funds are used to report any activity for which a fee is charged to external users for goods and services. Activities are required to be reported as enterprise funds if any one of the following criteria is met when applied in the context of the activity's principal revenue sources: the activity is financed with debt that is secured solely by a pledge of net revenues from fees and charges of the activity, laws and regulations require that the activity's costs of providing service, including capital costs, be recovered with fees and charges, rather than taxes or similar revenues, or the pricing policy of the activity establishes fees and charges designed to recover its costs, including capital costs.

The Department administers the unemployment insurance program under various federal and state statutes and regulations. The Unemployment Trust Fund was established under Title IX of the Social Security Act to provide partial protection to workers against the loss of wages when they are out of work due to no fault of their own. To fund this program, the agency receives monies from employers to maintain the fund used to pay benefits to the unemployed workers who meet the eligibility requirements of the law.

These funds are held by the United States Treasury in an unemployment trust fund and are restricted to the payment of unemployment benefits. Unemployment benefits drawn from the fund are awarded to qualified former employees of covered Illinois employers. Employers required to contribute to the unemployment trust fund do so based on employees' wages and past experience level of unemployment caused by the employing unit. The overall rate used to determine contributions for the Illinois Unemployment Insurance

**2. Summary of Significant Accounting Policies, continued**

**(b) Basis of Presentation, continued**

Trust Fund is designed to recover the payment of unemployment benefits plus maintain a reasonable balance to protect the solvency of the fund if unemployment rates rise significantly.

Operating revenues, such as collections of unemployment tax contributions, result from exchange transactions associated with the principal activity of the fund. Exchange transactions are those in which each party receives and gives up essentially equal values. Nonoperating revenues, such as investment earnings, result from nonexchange transactions or ancillary activities.

**(c) Basis of Accounting**

The individual nonshared proprietary 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. Nonexchange transactions, in which the Department gives (or receives) value without directly receiving (or giving) equal value in exchange, include interest and investment income and expense. On an accrual basis, revenues from employer contributions are recognized in the fiscal year in which the underlying exchange transaction occurs. Revenues from grants, entitlements, and similar items are recognized in the fiscal year in which all eligibility requirements imposed by the provider have been met.

Private-sector standards of accounting and financial reporting issued prior to December 1, 1989, generally are followed in the individual nonshared proprietary fund financial statements to the extent that those standards do not conflict with or contradict guidance of the Governmental Accounting Standards Board. The State also has the option of following subsequent private-sector guidance for their business-type activities and enterprise fund, subject to this same limitation. The State has elected not to follow subsequent private-sector guidance for the individual nonshared proprietary fund administered by the Department.

**(d) Cash and Cash Equivalents**

Cash and cash equivalents consist principally of cash in banks for locally held funds, U.S. government securities, and pooled investment funds held by other governmental agencies with a maturity of three months or less.

**(e) Investments**

Investments are reported at fair value. Fair value is based on quoted market prices.

## 2. Summary of Significant Accounting Policies, continued

### (f) Interfund transactions

The individual nonshared proprietary fund has the following types of interfund transactions with other funds of the State:

**Reimbursements** - repayments from the funds responsible for particular expenditures or expenses to the funds that initially paid for them. Reimbursements are reported as expenditures in the reimbursing fund and as a reduction of expenditures in the reimbursed fund.

**Transfers** - flows of assets (such as cash or goods) without equivalent flows of assets in return and without a requirement for repayment. Transfers are reported after nonoperating revenues and expenses.

**Services provided and used** - sales and purchases of goods and services between funds for a price approximating their external exchange value. Interfund services provided and used are reported as revenues in seller funds and expenditures or expenses in purchaser funds. Unpaid amounts are reported as interfund receivables and payables in the fund balance sheets or fund statements of net assets.

### (g) Net Assets

Net assets consist of the following:

Restricted net assets consist of net assets that are legally restricted by outside parties or by law through constitutional provisions or enabling legislation.

Unrestricted net assets consist of net assets that do not meet the criteria of the preceding category.

When both restricted and unrestricted resources are available for use, generally it is the State's policy to use restricted resources first, then unrestricted resources when they are needed.

### (h) 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 could differ from those estimates.

State of Illinois  
Department of Employment Security

Individual Nonshared Proprietary Fund  
Notes to Financial Statements  
June 30, 2006  
(Amounts in \$000's)

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3. Deposits and Investments

Cash and investments as of June 30, 2006 have a carrying amount in the accompanying financial statements as follows:

Cash and cash equivalents	\$	10,000
Investments		<u>1,137,136</u>
	\$	<u><u>1,147,136</u></u>

At June 30, 2006, cash on deposit for locally held funds has a carrying amount of \$8,970 and the bank balance was \$8,970. These deposits are invested in the ABN AMRO Government Money Market Fund held by the Bond Trustee in accordance with the Master Indenture of Trust. Deposits in Illinois Funds and in the custody of the State Treasurer totaled \$1,030 and had a carrying amount of \$1,030 at June 30, 2006.

The State Treasurer is the custodian of the State's cash and cash equivalents for funds maintained in the State Treasury. The Department independently manages cash and cash equivalents maintained outside the State Treasury. The State of Illinois' Comprehensive Annual Financial Report may be obtained by writing to the State Comptroller's Office, Financial Reporting Department, 325 West Adams Street, Springfield, Illinois, 62704-1871.

Funds deposited in Illinois Funds and held by the State Treasurer are pooled and invested with other State funds in accordance with the Deposit of State Moneys Act of Illinois Compiled Statute (15 ILCS 520/11). These deposits have not been addressed as to credit risk because the Department does not own individual securities. Detail on the nature of these investments is available within the State of Illinois' Comprehensive Annual Financial Report.

Illinois Funds is not registered with the SEC as an investment company, but does operate in a manner consistent with Rule 2a7 of the Investment Company Act of 1940. Investments in Illinois Funds are valued at Illinois Fund's share price, which is the price the investment could be sold for.

Investments in the custody of the United States Treasury totaled \$1,137,136 at June 30, 2006. These investments are pooled and invested with other States' funds and are not rated as to credit risk because the Department does not own individual securities.

The Department is permitted by the Public Funds Investment Act (30 ILCS 235/2) to engage in a wide variety of investment activities including:

- (a) Notes, certificates of indebtedness, treasury bills or other securities guaranteed by the United States Government.
- (b) Short-term discount obligations of the Federal National Mortgage Association.
- (c) Interest bearing savings accounts, certificates of deposit, time deposits in banks or savings and loans insured by the FDIC and any deposits in excess of amounts insured by the FDIC that are collateralized.

State of Illinois  
Department of Employment Security

Individual Nonshared Proprietary Fund  
Notes to Financial Statements  
June 30, 2006  
(Amounts in \$000's)

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3. Deposits and Investments, continued

- (d) Short-term obligations of U.S. corporations with assets exceeding \$500,000,000 and rated investment grade and which mature not later than 180 days from the date of purchase, provided that such obligations do not exceed 10% of the corporation's outstanding obligations.
- (e) Money market mutual funds registered under the Investment Company Act of 1940 provided the portfolio is limited to either U.S. government or government-backed securities.
- (f) Shares or other forms of securities legally issued by savings banks or savings and loan associations, if such securities are insured by the FDIC.
- (g) Dividend-bearing share accounts, share certificate accounts or class of share accounts of chartered credit unions, if insured under applicable law.
- (h) The Illinois Funds investment pool.
- (i) A fund managed, operated, and administered by a bank, subsidiary of a bank, or subsidiary of a bank holding company or use the services of such an entity to hold and invest or advise regarding the investment.
- (j) Repurchase agreements of government securities that meet certain instrument and transactions requirements.

**Interest Rate Risk**

Interest rate risk is the risk that changes in interest rates will adversely affect the fair value of an investment. Generally, the longer the maturity of an investment, the greater the sensitivity of its fair value to changes in market interest rates. The Department does not have a policy regarding Interest Rate Risk.

As of June 30, 2006 the Weighted Average Maturity of the Department's investments were:

Investment Type	Fair Value	Investment Maturities Weighted Average (in Years)	
		Less Than 1	1-5
Deposits in custody of the U.S. Treasury	\$ 1,137,136	\$ -	\$ 1,137,136

State of Illinois  
Department of Employment Security

Individual Nonshared Proprietary Fund  
Notes to Financial Statements  
June 30, 2006  
(Amounts in \$000's)

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3. Deposits and Investments, continued

**Credit Risk**

Generally, credit risk is the risk that an issuer of a debt investment will not fulfill its obligation to the holder of the investment. This is measured by the assignment of a rating by a nationally recognized statistical rating organization. The Department does not have a policy regarding Credit Risk.

Presented below is the rating as June 30, 2006 for the Department's investments:

Investment Type	Total	Rating as of Year End
		Not Rated
Special Issue U.S. Treasury Bonds	\$ 1,137,136	\$ 1,137,136

**Concentration of Credit Risk**

Concentration of credit risk is the risk of loss attributed to the concentration of an entity's investment in a single issuer. The Department does not have a policy regarding Concentration of Credit Risk.

At year-end investments in any one issuer (other than U.S. Treasury securities, mutual funds, and external investment pools) did not represent 5% or more of the total Department investments.

**Custodial Credit Risk**

Custodial credit risk for deposits is the risk that, in the event of the failure of a depository financial institution, the Department will not be able to recover its deposits or will not be able to recover collateral securities that are in the possession of an outside party. The custodial credit risk for investments is the risk that, in the event of the failure of the counterparty to a transaction, the Department will not be able to recover the value of its investment or collateral securities that are in the possession of another party. The Department's investment policy requires that any deposits in excess of amounts insured by the FDIC be 100% collateralized.

As of June 30, 2006, \$434 of the Department's deposits with financial institutions in excess of federal depository limits was collateralized by pledged US Treasury Bonds in the name of the Department at the Federal Reserve Bank of New York.

The Illinois Funds is an external investment pool administered by the Illinois State Treasurer. The fair value of the Department's investment fund is the same as the value of the pool shares. Although not subject to direct regulatory oversight, the fund is administered in accordance with the provisions of the Illinois Public Investment Act, 30 ILCS 235.

The U.S. Treasury Unemployment Trust Fund is administered by the U.S. Treasurer. The fair value of the Department's investment fund is the same as the value of the pool shares. Although not subject to direct regulatory oversight, the fund is administered in accordance with U.S. Treasury Department regulations.

State of Illinois  
Department of Employment Security

Individual Nonshared Proprietary Fund  
Notes to Financial Statements  
June 30, 2006  
(Amounts in \$000's)

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3. Deposits and Investments, continued

Foreign Currency Risk

Foreign currency risk is the risk that changes in currency exchange rates will adversely affect the fair value of an investment. The Department is not exposed to foreign currency risk.

4. Taxes Receivable

Taxes receivable represent unemployment taxes, known as contributions, owed by private and non-governmental employers. The allowance for uncollectible taxes has been based on historical collection experience. Balances as of June 30, 2006, are as follows:

Taxes receivable:

Unemployment taxes	\$ 590,365
Interest and penalties receivable on taxes	<u>30,152</u>
Total taxes receivable	620,517
Less: allowance for uncollectible taxes	<u>(114,922)</u>
Taxes receivable	<u><u>\$ 505,595</u></u>

5. Intergovernmental Receivables

Intergovernmental receivables represent reimbursements due from other State and local governments for unemployment benefits paid to those government's ex-employees by the Trust Fund totaling \$27,844 as of June 30, 2006.

6. Other Receivables

Except for \$820 which is bank interest owed to the bond accounts, other receivables represent amounts due from claimants who received benefits, which exceeded the allowable amounts. The allowance for uncollectible accounts has been based on historical collection experience. Balances as of June 30, 2006 are as follows:

Other receivables	\$ 335,021
Less: allowance for uncollectible accounts	<u>(259,616)</u>
Other receivables	<u><u>\$ 75,405</u></u>

State of Illinois  
 Department of Employment Security

Individual Nonshared Proprietary Fund  
 Notes to Financial Statements  
 June 30, 2006  
 (Amounts in \$000's)

7. Interfund Balances and Activities

(a) Balances Due to/from Other Funds

The following balances at June 30, 2006 represent amounts due from other Department and State of Illinois funds.

Fund	Amount	Description/Purpose
Unemployment Compensation Trust Fund	\$ 2,775	Due from General Revenue Fund for reimbursement of unemployment benefits paid to employees of other State agencies
	740	Due from Road Fund for reimbursement of unemployment benefits paid to former employees of the Illinois Department of Transportation
	48	Due from Title III Social Security and Employment Services Fund for the reimbursement of unemployment benefits to former employees of the Department
Total	<u>\$ 3,563</u>	

Due from component units of the State of Illinois of which \$151 represents reimbursement of unemployment benefits paid to employees of State universities.

The following balances at June 30, 2006 represent amounts due to other Department and State of Illinois funds.

Fund	Amount	Description/Purpose
Unemployment Compensation Trust Fund	\$ 4	Due to Title III Social Security and Employment Services Fund for discretionary transfers of NSF fees
	5,287	Due to Unemployment Compensation Special Administration Fund for discretionary transfers of penalties and interest
Total	<u>\$ 5,291</u>	



State of Illinois  
 Department of Employment Security

Individual Nonshared Proprietary Fund  
 Notes to Financial Statements  
 June 30, 2006  
 (Amounts in \$000's)

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7. Interfund Balances and Activities, continued

(b) Transfers to/from Other funds

Interfund transfers in for the year ended June 30, 2006, were as follows:

Fund	Amount	Description/Purpose
Unemployment Compensation Trust Fund	\$ 3	Transfer of excess funds from Employment Security Administrative Fund

Interfund transfers out for the year ended June 30, 2006, were as follows:

Fund	Amount	Description/Purpose
Unemployment Compensation Trust Fund	\$ 17,276	Discretionary transfer of penalties and interest to Unemployment Compensation Special Administration Fund
	16	Discretionary transfer of NSF fees to Title III Social Security and Employment Services Fund
Total	<u>\$ 17,292</u>	

8. Intergovernmental Payables

Intergovernmental payables of \$7,526 represent \$3,611 of interstate combined wage claim benefits payable and a \$3,915 arbitrage payment due to the Internal Revenue Service as a result of the early redemption of revenue bonds.

State of Illinois  
 Department of Employment Security

Individual Nonshared Proprietary Fund  
 Notes to Financial Statements  
 June 30, 2006  
 (Amounts in \$000's)

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9. Bonds Payable

On July 1, 2004, the Unemployment Insurance Fund Building Receipts Revenue Bonds, Series 2004 of \$712 million were issued pursuant to the Master Indenture of Trust, dated as of June 1, 2004, with LaSalle Bank National Association as Trustee. The payment of principal, premiums and interest is secured by a pledge of and lien on the Pledged Revenues, the sole source of which is the Fund Building receipts. These receipts are directed for deposit into the Master Bond Fund. Bond proceeds are not appropriated. The bonds were issued as follows:

Bonds	Interest Rates	Amount
Series 2004A (fixed rate)	5%	\$ 340,000
Series 2004B (auction rate)	1.35% - 2.85%	\$ 372,000

These bonds were issued due to the depletion of the Unemployment Compensation Trust Fund in early March 2003 and the continued borrowing from the Federal Government to pay unemployment benefits. The State, acting by and through the Department, is authorized to issue Series 2004 Bonds pursuant to Public Act 93-0634, as supplemented by Public Act 93-0676 (the Authorizing Legislation) for the purpose of (1) reducing the cost of covering shortfalls in the Illinois UTF account below the cost of relying exclusively on Federal advances, and (2) to ensure that employers in Illinois remain eligible for full credit against the FUTA tax.

The interest on these advances through July 1, 2004 totaling \$19,000 and the balance of the advances from the federal government of \$585,175 was paid on September 27, 2004 and September 30, 2004, respectively, from the proceeds of the bonds issued.

Bond issuance costs and bond premium are amortized over the term of the related debt.

In August 2005 the Department exercised its option to redeem early the remainder (\$43,900 was redeemed in February 2005) of the Series 2004B Bonds (Auction Rate Securities) as follows:

Fiscal Year	Date	Amount
2006	08/09/2005	\$ 93,000
	08/16/2005	93,000
	08/23/2005	93,000
	08/30/2005	49,100
		\$ 328,100

State of Illinois  
Department of Employment Security

Individual Nonshared Proprietary Fund  
Notes to Financial Statements  
June 30, 2006  
(Amounts in \$000's)

9. Bonds Payable, continued

In December 2005, there was a scheduled bond redemption of the Series 2004A (Fixed Rate) and in June 2006, the Department exercised its option to redeem early all the remaining Series 2004A (Fixed Rate) as follows:

Fiscal Year	Date	Amount
2006	12/15/2005	\$ 185,000
	06/15/2006	155,000
		\$ 340,000

The following is a summary of the long-term obligation activities of the Department for the year ended June 30, 2006:

Issue	Balances July 1, 2005	Issuances	Retirements	Balances June 30, 2006	Due Within One Year
\$340,000 Series 2004A (Fixed Rate) Bonds are due in scheduled principal installments of \$75,000,000 to \$185,000,000 beginning December 15, 2005 through December 15, 2007; interest at 5.00%	\$ 340,000	\$ -	\$ 340,000	\$ -	\$ -
\$372,000 Series 2004B (Auction Rate Securities) Bonds mature on December 15, 2013 and redeemed in February 2005 and August 2005	328,100	-	328,100	-	-
Unamortized Bond Premium on Series 2004A (Fixed Rate) Bonds	9,198	-	9,198	-	-
	\$ 677,298	\$ -	\$ 677,298	\$ -	\$ -

State of Illinois  
Department of Employment Security

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June 30, 2006  
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**10. Risk Management**

The Department is exposed to various risks of loss related to torts; theft of, damage to, and destruction of assets; error and omissions; workers compensation and natural disasters. The State retains the risk of loss (i.e., self insured) for these risks. The Department's risk management activities for workers compensation are financed through appropriations to the Illinois Department of Central Management Services and are accounted for in the General Fund of the State. The claims are not considered to be a liability of the Department and, accordingly, have not been reported in the Department's financial statements for the year ended June 30, 2006.

**11. Contingencies**

While the Department is involved in various claims and legal actions arising in the ordinary course of business, it is the opinion of management that the ultimate disposition of these matters will not have a material effect on the individual nonshared proprietary funds financial statements.

**12. New Accounting Pronouncement**

The *Governmental Accounting Standards Board* (GASB) has issued the following statement:

Statement No. 45 - *Accounting and Financial Reporting by Employers for Postemployment Benefits Plans Other Than Pensions*, which establishes standards for the measurement and display of OPEB expense/expenditures and related liabilities (assets), note disclosures, and if applicable, required supplementary information (RSI) in the financial reports of state and local government employers. This statement is effective for the period beginning July 1, 2007.

Management has not yet completed its assessment of the impact of this statement on the 2006 financial statements.

# McGladrey & Pullen

Certified Public Accountants

## 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 William G. Holland  
Auditor General  
State of Illinois

As Special Assistant Auditors for the Auditor General, we have audited the Unemployment Compensation Trust Fund (Individual Nonshared Proprietary Fund) of the State of Illinois, Department of Employment Security (Department), as of and for the year ended June 30, 2006, and have issued our report thereon dated November 22, 2006. 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.

### Internal Control Over Financial Reporting

In planning and performing our audit, we considered the Department's internal control over financial reporting of the Individual Nonshared Proprietary Fund in order to determine our auditing procedures for the purpose of expressing our opinion on the financial statements and not to provide an opinion on the internal control over financial reporting. Our consideration of the internal control over financial reporting would not necessarily disclose all matters in the internal control over financial reporting that might be material weaknesses. A material weakness is a reportable condition in which the design or operation of one or more of the internal control components does not reduce to a relatively low level the risk that misstatements caused by error or fraud in amounts that would be material in relation to the Individual Nonshared Proprietary Fund's financial statements being audited may occur and not be detected within a timely period by employees in the normal course of performing their assigned functions. We noted no matters involving the internal control over financial reporting and its operation that we consider to be material weaknesses.

### Compliance and Other Matters

As part of obtaining reasonable assurance about whether the Department's 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 no instances of noncompliance or other matters that are required to be reported under *Government Auditing Standards*.

This report is intended solely for the information and use of the Auditor General, the General Assembly, the Legislative Audit Commission, the Governor, Department 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.

*McGladrey & Pullen, LLP*

Schaumburg, Illinois  
November 22, 2006

**SUPPLEMENTARY INFORMATION**

State of Illinois  
 Department of Employment Security  
 Nonshared Proprietary Funds  
 Combining Statement of Net Assets  
 June 30, 2006  
 (Amounts in \$000's)

	Unemployment Compensation Trust Fund	Master Bond Fund	Eliminations	Total
<b>Current Assets</b>				
Cash and cash equivalents	\$ -	\$ 10,000	\$ -	\$ 10,000
Investments	1,137,136	-	-	1,137,136
Receivables, net:				
Taxes	505,595	-	-	505,595
Intergovernmental	27,844	-	-	27,844
Other	74,585	820	-	75,405
Due from State funds	3,563	-	-	3,563
Due from component units of the State of Illinois	151	-	-	151
<b>Total current assets</b>	<b>1,748,874</b>	<b>10,820</b>	<b>-</b>	<b>1,759,694</b>
<b>Current Liabilities</b>				
Accounts payable	-	5	-	5
Benefit payments payable	75,840	-	-	75,840
Intergovernmental payables	3,611	3,915	-	7,526
Due to other State funds	5,291	-	-	5,291
<b>Total current liabilities</b>	<b>84,742</b>	<b>3,920</b>	<b>-</b>	<b>88,662</b>
<b>Net Assets</b>				
Restricted for:				
Unemployment compensation benefits	1,664,132	-	-	1,664,132
Unrestricted	-	6,900	-	6,900
<b>Total net assets</b>	<b>\$ 1,664,132</b>	<b>\$ 6,900</b>	<b>\$ -</b>	<b>\$ 1,671,032</b>

State of Illinois  
Department of Employment Security

Nonshared Proprietary Funds  
Combining Statement of Revenues, Expenses, and Changes in Net Assets  
Year Ended June 30, 2006  
(Amounts in \$000's)

	Unemployment Compensation Trust Fund	Master Bond Fund	Eliminations	Total
Operating revenues:				
Contributions - Unemployment taxes	\$ 2,647,627	\$ -	\$ -	\$ 2,647,627
Federal government	31,013	-	-	31,013
Total operating revenues	<u>2,678,640</u>	<u>-</u>	<u>-</u>	<u>2,678,640</u>
Operating expenses				
Benefit payments and refunds	1,719,571	-	-	1,719,571
Operating income	<u>959,069</u>	<u>-</u>	<u>-</u>	<u>959,069</u>
Nonoperating revenues (expenses)				
Interest and investment income	26,533	7,332	-	33,865
Interest and investment expense	-	(6,731)	-	(6,731)
Other expenses	-	(4,960)	-	(4,960)
Total nonoperating revenues (expenses)	<u>26,533</u>	<u>(4,359)</u>	<u>-</u>	<u>22,174</u>
Income (loss) before transfers:	985,602	(4,359)	-	981,243
Transfers in	310,468	349,824	(660,289)	3
Transfers out	(367,116)	(310,465)	660,289	(17,292)
Increase in net assets	928,954	35,000	-	963,954
Net assets, July 1, 2005	<u>735,178</u>	<u>(28,100)</u>	<u>-</u>	<u>707,078</u>
Net assets, June 30, 2006	<u>\$ 1,664,132</u>	<u>\$ 6,900</u>	<u>\$ -</u>	<u>\$ 1,671,032</u>



State of Illinois  
Department of Employment Security

Nonshared Proprietary Funds  
Combining Statement of Cash Flows  
Year Ended June 30, 2006  
(Amounts in \$000's)

	Unemployment Compensation Trust Fund	Master Bond Fund	Eliminations	Total
Cash flows from operating activities				
Contributions - Unemployment taxes received	\$ 2,661,900	\$ -	\$ -	\$ 2,661,900
Federal grants received	31,013	-	-	31,013
Unemployment benefits paid	(1,717,578)	-	-	(1,717,578)
<b>Net cash provided by operating activities</b>	<b>975,335</b>	<b>-</b>	<b>-</b>	<b>975,335</b>
Cash flows from noncapital financing activities				
Transfers in	310,465	795,513	-	1,105,978
Transfer out	(810,951)	(310,465)	-	(1,121,416)
Principal paid on revenue bonds	-	(668,100)	-	(668,100)
Interest paid on revenue bonds	-	(17,173)	-	(17,173)
Other noncapital financing activities	-	(901)	-	(901)
<b>Net cash (used in) noncapital         financing activities</b>	<b>(500,486)</b>	<b>(201,126)</b>	<b>-</b>	<b>(701,612)</b>
Cash flows from investing activities				
Purchase of investment securities	(2,592,127)	-	-	(2,592,127)
Sale of investment securities	2,086,308	-	-	2,086,308
Interest and investment income	26,533	7,332	-	33,865
<b>Net cash provided by (used in)         investing activities</b>	<b>(479,286)</b>	<b>7,332</b>	<b>-</b>	<b>(471,954)</b>
Net (decrease) in cash and cash equivalents	(4,437)	(193,794)	-	(198,231)
Cash and cash equivalents, July 1, 2005	4,437	203,794	-	208,231
Cash and cash equivalents, June 30, 2006	\$ -	\$ 10,000	\$ -	\$ 10,000

State of Illinois  
 Department of Employment Security

Nonshared Proprietary Funds  
 Combining Statement of Cash Flows - Continued  
 Year Ended June 30, 2006  
 (Amounts in \$000's)

	Unemployment Compensation Trust Fund	Master Bond Fund	Eliminations	Total
Reconciliation of operating income to net cash provided by operating activities				
Operating income	\$ 959,069	\$ -	\$ -	\$ 959,069
Adjustments to reconcile operating income to net cash provided by operating activities:				
Provision for uncollectible accounts	(10,730)	-	-	(10,730)
Changes in assets and liabilities				
Receivables	19,056	-	-	19,056
Intergovernmental receivables	1,576	-	-	1,576
Due from other funds	4,522	-	-	4,522
Due from component units	19	-	-	19
Benefit payments payable	3,222	-	-	3,222
Intergovernmental payables	(1,399)	-	-	(1,399)
<b>Net cash provided by operating activities</b>	<b>\$ 975,335</b>	<b>\$ -</b>	<b>\$ -</b>	<b>\$ 975,335</b>

State of Illinois  
 Department of Employment Security

Nonshared Proprietary Funds  
 Interfund Balances and Activities  
 June 30, 2006  
 (Amounts in \$000's)

Interfund Balances and Activities

(a) Balances Due to/from Other Funds

The following balances at June 30, 2006 represent amounts due from other Department and State of Illinois funds.

Fund	Amount	Description/Purpose
Unemployment Compensation Trust Fund	\$ 2,775	Due from General Revenue Fund for reimbursement of unemployment benefits paid to employees of other State agencies
	740	Due from Road Fund for reimbursement of unemployment benefits paid to former employees of the Illinois Department of Transportation
	48	Due from Title III Social Security and Employment Services Fund for the reimbursement of unemployment benefits to former employees of the Department
Total	<u>\$ 3,563</u>	
Fund	Amount	Description/Purpose
Unemployment Compensation Trust Fund	\$ 4	Due to Title III Social Security and Employment Services Fund for discretionary transfers of NSF fees
	5,287	Due to Unemployment Compensation Special Administration Fund for discretionary transfers of penalties and interest
Total	<u>\$ 5,291</u>	

State of Illinois  
Department of Employment Security

Nonshared Proprietary Funds  
Interfund Balances and Activities  
June 30, 2006  
(Amounts in \$000's)

Interfund Balances and Activities, continued

(b) Transfers to/from Other Funds

Interfund transfers in for the year ended June 30, 2006 were as follows:

Fund	Amount	Description/Purpose
Unemployment Compensation Trust Fund	\$ 310,465	Transfer of excess Fund Building Receipts from the Master Bond Fund
	3	Transfer of excess funds from Employment Security Administrative Fund
Total	<u>\$ 310,468</u>	
Master Bond Fund	\$ 349,824	Transfer of excess Fund Building Receipts from the Unemployment Compensation Trust Fund
Total	<u>\$ 349,824</u>	

Interfund transfers out for the year ended June 30, 2006 were as follows:

Fund	Amount	Description/Purpose
Unemployment Compensation Trust Fund	\$ 349,824	Transfer of excess Fund Building Receipts to the Master Bond Fund
	17,276	Discretionary transfer of penalties and interest to Unemployment Compensation Special Administration Fund
	16	Discretionary transfer of NSF fees to Title III Social Security and Employment Services Fund
Total	<u>\$ 367,116</u>	
Master Bond Fund	\$ 310,465	Transfer of excess Fund Building Receipts to Unemployment Compensation Trust Fund
Total	<u>\$ 310,465</u>	