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, 2013

WILLIAM G. HOLLAND

AUDITOR GENERAL

STATE OF ILLINOIS
COMPREHENSIVE ANNUAL FINANCIAL REPORT
FINANCIAL AUDIT
For the Year Ended June 30, 2013

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The annual financial statements of the State of Illinois for the year ended June 30, 2013 were issued under a separate cover.

STATE OF ILLINOIS
COMPREHENSIVE ANNUAL FINANCIAL REPORT
FINANCIAL AUDIT
For the Year Ended June 30, 2013

STATE OFFICIALS

Governor	Patrick Quinn
Comptroller	Judy Baar Topinka
Speaker of the House	Michael J. Madigan
President of the Senate	John J. Cullerton
House Republican Leader	Jim Durkin
Senate Republican Leader	Christine Radogno

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	0

SCHEDULE OF FINDINGS

Item No.	Page	Description	Finding Type
		FINDINGS (*GOVERNMENT AUDITING STANDARDS*)	
2013-001	7	Inadequate Financial Reporting Process	Material Weakness
2013-002	12	Financial Reporting Weaknesses	Material Weakness
2013-003	16	Late Payment of Statutorily Mandated Transfers	Noncompliance
2013-004	18	Debt Covenant Violation	Noncompliance
2013-005	20	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 March 3, 2014.

Ms. Katie Madonia, Director of Financial Reporting, Office of the State Comptroller on February 27, 2014.

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OFFICE OF THE AUDITOR GENERAL
WILLIAM G. HOLLAND

INDEPENDENT AUDITOR'S REPORT ON INTERNAL CONTROL OVER FINANCIAL REPORTING AND ON COMPLIANCE AND OTHER MATTERS BASED ON AN AUDIT OF FINANCIAL STATEMENTS PERFORMED IN ACCORDANCE WITH *GOVERNMENT AUDITING STANDARDS*

Honorable 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, in accordance with the auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards* issued by the Comptroller General of the United States, the financial statements of the 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, 2013, and the related notes to the financial statements, which collectively comprise the State of Illinois' basic financial statements as listed in the Table of Contents for Section II of the Illinois Comprehensive Annual Financial Report, and have issued our report thereon dated February 28, 2014.

Our report is modified to include a reference to other auditors who audited the financial statements of certain university related organizations and included an emphasis-of-matter paragraph which stated that as discussed in Note 2 to the financial statements, the financial statements have been restated as of July 1, 2012 for a prior year error, reclassification of governmental fund balances and the implementation of GASB Statement 61, *The Financial Reporting Entity: Omnibus-an amendment of GASB Statements No. 14 and No. 34.* Our report also included an emphasis-of-matter paragraph which stated the deficit for net position of governmental activities in Fiscal Year 2013 continued to increase by $1,248,647,000 from $46,585,459,000 at June 30, 2012 to $47,834,106,000 at June 30, 2013. 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.

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.

Internal Control Over Financial Reporting

In planning and performing our audit of the financial statements, we considered the State of Illinois' internal control over financial reporting (internal control) to determine the audit procedures that are appropriate in the circumstances 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. Accordingly, we do not express an opinion on the effectiveness of the State of Illinois' internal control.

Our consideration of internal control was for the limited purpose described in the preceding paragraph and was not designed to identify all deficiencies in internal control that might be material weaknesses or significant deficiencies and therefore, material weaknesses or significant deficiencies may exist that were not identified. However, as described in the accompanying schedule of findings, we identified certain deficiencies in internal control 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 2013-001, 2013-002 and 2013-005 to be material weaknesses.

Compliance and Other Matters

As part of obtaining reasonable assurance about whether the State of Illinois' financial statements are free from material misstatement, we performed tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements, noncompliance with which could have a direct and material effect on the determination of financial statement amounts. However, providing an opinion on compliance with those provisions was not an objective of our audit, and accordingly, we do not express such an opinion. The results of our tests disclosed 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 2013-003 and 2013-004.

The Office of the Governor's and Office of the State Comptroller's Response to Findings

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. The Office of the Governor's and the Office of the State Comptroller's responses were not subjected to the auditing procedures applied in the audit of the financial statements and, accordingly, we express no opinion on the responses.

Purpose of this Report

The purpose of this report is solely to describe the scope of our testing of internal control and compliance and the results of that testing, and not to provide an opinion on the effectiveness of the State of Illinois' internal control or on compliance. This report is an integral part of an audit performed in accordance with *Government Auditing Standards* in considering the State of Illinois' internal control and compliance. Accordingly, this communication is not suitable for any other purpose.

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, IL
February 28, 2014

2013-001. **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 2013-002 for additional detail. The lack of timely financial reporting limits effective oversight of State finances, may adversely affect the State's bond rating, and may jeopardize 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 towards major State agencies under the organizational structure of the Office of the Governor and towards the Office of the State Comptroller.

The Office of the State Comptroller has made significant changes to the system used to compile financial information; 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. During an Illinois Office of the Auditor General's management audit (released February 2011) of the State's financial reporting system it was reported that 88 of 90 primary units of government had 263 different financial reporting systems that are used by primary government agencies. Furthermore, it was reported that only 16 percent of these financial reporting systems are compliant with Generally Accepted Accounting Principles (GAAP), which drastically increases the amount of time spent by agencies during the year-end GAAP conversion process. In addition, 53 percent of the financial reporting systems are not interrelated which, consequently, requires manual intervention to convert data, increasing the likelihood of errors and is time consuming.

The financial reporting to the Office of the State Comptroller requires State agencies to prepare a series of financial reporting forms (SCO forms) designed by the Office of the State Comptroller which are utilized to prepare the CAFR. For the most part, these SCO forms are completed for each of the State's 839 primary government/fiduciary funds and 21 component units. The forms are completed by accounting personnel within each State agency who have varying levels of knowledge, experience, and understanding of 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, these agency personnel may lack the qualifications, time, support, and training necessary to 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 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 twelve audits of the CAFR. Additionally, beginning balances related to the primary government have been restated for 10 of the last 12 years.

Even though problems still exist in regard to the State's ability to provide accurate and timely external financial reporting, we do acknowledge that the number of deficiencies reported by the auditors in relation to the CAFR and SEFA has decreased and the timeliness has improved. We also acknowledge that there have been two Public Acts that have positively affected the financial reporting process. Public Act 97-408, which became 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. We noted that only one agency under the Governor was delinquent in their financial reporting to the Office of the State Comptroller. Public Act 97-1055, which became 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." The Board first met on September 25, 2013 and has had an additional four meetings.

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 Governor's management stated that the weaknesses are due to (1) lack of a Statewide accounting and grants management system and (2) lack of personnel adequately trained in governmental accounting and federal grants management. The lack of a Statewide accounting system is due in part to the State's current inability to obtain the capital funding required to acquire and implement such a system. Without adequate financial and grants management systems, agency staff are required to perform highly manual calculations of balance sheet and SEFA amounts in a short time frame which results in increased errors. The lack of adequate financial and grants management personnel is due in part to a failure to update the qualifications in the respective job titles to ensure that applicants have the minimum required education and skill sets to be properly trained.

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. 2013-001, 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 State 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. The Governor has appointed 3 members, all of whom have been confirmed by the Senate. The Comptroller has done the same. The Board has met several times and is already conducting its statutory functions. Currently the Board is working with internal auditors to devise a standard method of conducting audit-like reviews of agency financial reporting processes with the aim of correcting deficiencies in cooperation with agency management and developing management practices and recommendations to prevent such problems 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 and it is 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.

Governor Quinn also signed into law SB 2381, now codified as Public Act #98-0589 and cited as the Grant Information Collection Act. This law requires that the State Chief Information Officer (CIO) coordinate with State agencies to develop appropriate systems to accurately report data containing financial information, including a module specific to the management and administration of grant funds. Additionally, each grantor agency that is authorized to award grant funds must coordinate with the State CIO to provide for the publication of data sets containing information regarding awards of grant funds that the grantor agency has made during the previous fiscal year. Such data sets must be published at least quarterly and include, at a minimum, the grantor agency name; the name and postal zip code of the grantee; the amount of each grant award; a short description of the purpose of the award; the date of each award; and the duration of each award. This grant information will be published to the State's Open Data website, data.illinois.gov, to a Grants Explorer the development of which is expected to be complete in March, 2014.

A Request for Proposals for an enterprise resources planning project management office consultant was issued in October 2013 and a contract award pursuant to this solicitation is expected to be made in March 2014. This consultant will develop the necessary Statewide requirements for one or more RFPs for software and implementation services to address the State's need. In particular, activities incident to issuing one or more such RFPs include reviewing archived documentation; assessing, documenting and assembling technical system requirements; drafting the RFP(s); supporting the procurement process; assisting with the proposal review, evaluation and selection processes; and project planning. Additionally, the contract will allow the State the option to engage this consultant to provide services concurrent with ERP system integration including, *inter alia*, quality assurance; independent verification and validation; and business process optimization.

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 Comptroller:

The Office accepts the recommendation. The 2013 CAFR opinion was signed on February 28, 2014, which is approximately 3 months earlier than the 2012 CAFR. Even with this improvement, the State still faced several road blocks in the timely completion of the CAFR. The General Assembly enacted P.A. 97-0691, which extended lapse period from August 31 to December 31 for fiscal year 2013 and future fiscal years for medical assistance payments of the Department of Healthcare and Family Services. As a result of the extension, the preparation and completion of critical financial schedules was delayed, and will continue to be delayed in future fiscal years. Further, the CAFR completion was delayed because of financial reporting issues identified during individual State agency financial audits. The CAFR cannot be finalized until these issues are resolved at the individual State agency reporting level.

The Office will continue to assist the Governor's Office in their efforts to increase the quality of GAAP packages by providing enhanced training and technical assistance to State agencies. In addition, the Office will work with the Governor's Office in their efforts to develop a Statewide financial accounting system. Furthermore, the Office will continue to work with the newly created Financial Reporting Standards Board in their mission to improve the timeliness, quality and processing of financial reporting for the State.

2013-002. **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 2013-001 the State has a decentralized financial reporting process. Primarily in response to this decentralized process, we perform audits at 24 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 a combination of deficiencies, in internal control that is less severe than a material weakness, yet important enough to merit attention by those charged with governance.

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

Agency	Material Weaknesses	Significant Deficiencies	Combined Total
Department of Central Management Services	1	1	2
Department of Employment Security	1	0	1
Department of Human Services	2	2	4
Department of the Lottery	2	0	2
Department of Healthcare and Family Services	0	3	3
Department of Revenue	2	4	6
Department of Transportation	3	3	6
Illinois Gaming Board	2	0	2
Illinois State Board of Education	1	0	1
State Employees' Retirement System	0	1	1
Illinois Student Assistance Commission	0	1	1
Total	14	15	29

Details of each material weakness and significant deficiency are reported in each of the agency's financial audit for the year ended June 30, 2013 (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 are 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 amounts due from local governments	$11,499	Department of Transportation

Misstatements Identified During the Audit Process

The following chart indicates adjustments identified during our audits.

Opinion Unit	Amount (in thousands)*	Responsible Agency
Governmental Activities	$13,484	Department of Central Management Services
Governmental Activities	$202,021	Department of Human Services
Governmental Activities	$21,236	Department of Revenue
Governmental Activities	$199,201	Department of Transportation
Governmental Activities	$16,963	Illinois State Board of Education
Business-type Activities	$17,532	Department of the Lottery
General Fund	$183,237	Department of Human Services
Road Fund	$11,499	Department of Transportation
Aggregate Remaining Fund Information	$13,484	Department of Central Management Services
Aggregate Remaining Fund Information	$17,532	Department of the Lottery
Aggregate Remaining Fund Information	$21,236	Department of Revenue
Aggregate Remaining Fund Information	$38,441	Illinois State Board of Education

* *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 Governor's management stated that the weaknesses are due to (1) lack of a Statewide accounting and grants management system and (2) lack of personnel adequately trained in governmental accounting and federal grants management. The lack of a Statewide accounting system is due in part to the State's current inability to obtain the capital funding required to acquire and implement such a system. Without adequate financial and grants management systems, agency staff are required to perform highly manual calculations of balance sheet and SEFA amounts in a short time frame which results in increased errors. The lack of adequate financial and grants management personnel is due in part to a failure to update the qualifications in the respective job titles to ensure that applicants have the minimum required education and skill sets to be properly trained.

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. 2013-002, 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 2013-001 also address finding 2013-002. The Governor's Office has focused on solving this problem by implementing a centralized financial accounting system as described in the response to finding 2013-001. As the State develops an enterprise-wide financial accounting system it will 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 by providing enhanced training and technical assistance to State agencies. In addition, the Office will continue to work with the newly created Financial Reporting Standards Board in their mission to improve the timeliness, quality and processing of financial reporting for the State.

2013-003. **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, 2013, 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 2013, we noted 380 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 delays of making such transfers in Fiscal Year 2013 compared to Fiscal Years 2012 and Fiscal Year 2011:

	Fiscal Year 2013	Fiscal Year 2012	Fiscal Year 2011
• Number of late transfers	380 transfers	398 transfers	327 transfers
• Range of days transfers were late	33 to 416 days	34 to 529 days	31 to 454 days
• Total volume of late transfers, in dollars	$2.82 billion	$2.45 billion	$2.21 billion
• Late transfers outstanding as of and paid after June 30	$616 million	$1.11 billion	$889 million

Comptroller management stated, as they did during the prior examinations, 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 Comptroller stated that approximately 139 of the FY13 transfers totaling $1.06 billion contained 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. 2013-003, 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 a 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.

2013-004. **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, 2010, 2011, and 2012 financial statements, the Illinois Designated Account Purchase Program (IDAPP) was in violation of one or more debt covenants related to the agency's revolving credit (loan) agreement. In addition, the facility matured on July 27, 2010 and has not been repaid. Per the agreement, the minimum required coverage condition ratio is 104%, while the ratio as of June 30, 2013 was 101.04%. Also per the agreement, the default ratio is set at a maximum of 6.25%, but at June 30, 2013 this ratio was 7.17%.

As a result of the debt covenant violation and the maturity of the facility, 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 the maturity of the loan and has not communicated to IDAPP any intent to exercise the remedies available to it under the terms of the loan agreement. The balance of the line of credit with the bank was $240,606,827 at June 30, 2013.

According to Commission management, the coverage condition and default issues are due to the poor performance of the portfolio. The portfolio continues to experience a high level of delinquent accounts. The line of credit has not been refinanced because of the conditions in the private loan credit market.

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. 2013-004, 12-4, 11-4, 10-6, 09-3)

RECOMMENDATION

We recommend IDAPP continue to monitor the 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 reviews the loan covenants on a monthly basis and 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.

2013-005. **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 $4.061 billion, on hand at June 30, 2013 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 $2.648 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 2013-001 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 $318 million in interest payments during Fiscal Year 2013.

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. 2013-005, 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.

As noted in earlier responses, procurement and implementation of a Statewide ERP system will facilitate the State's ability to better track and analyze the State's financial transaction such that agencies will be able to make informed, timely expenditure decisions. Of course, many other factors contribute to payment delays, such as revenue fluctuations, timing of tax payments, severe weather events requiring greater expenditures than normally expected.

The steps taken and planned to implement SB3794 will improve the State's ability to secure appropriate staff to undertake the work needed for appropriate control over financial reporting, as well as enabling more rigorous audits of the GAAP process to identify and remediate structural flaws in existing agency processes. The work of the Financial Reporting Standards Board will lead to improved training of agency staff.

The Governor continues to work with the General Assembly to establish an annual spending plan and identify resources to be used to address the structural backlog.

The following steps have been taken to address the historical backlog of tax refunds:

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 FY13 and continued in the budget development for FY14 and FY15. As a result, the entire income tax refund backlog has been paid. According to the Comptroller the fund cash surplus on June 4, 2013 was $317.137 million. The actual FY13 funds that were transferred in FY14 were $396.946 million. The estimate for FY14 to be transferred in FY15 is $100 million, which demonstrates a lowered reliance on GRF funds to pay tax refunds.