

**STATE OF ILLINOIS
DEPARTMENT OF HEALTHCARE AND FAMILY SERVICES
LOCAL GOVERNMENT HEALTH INSURANCE RESERVE FUND**

**FINANCIAL AUDIT
For the Year Ended June 30, 2008**

STATE OF ILLINOIS
DEPARTMENT OF HEALTHCARE AND FAMILY SERVICES
LOCAL GOVERNMENT HEALTH INSURANCE RESERVE FUND
FINANCIAL AUDIT
For the Year Ended June 30, 2008

AGENCY OFFICIALS

Director	Barry S. Maram
Assistant Director	Sharron Matthews
General Counsel	Nancy Shalowitz (7/1/07-12/28/07)
General Counsel	Kyong Lee (Acting) (12/31/07 – Current)
Inspector General	John C. Allen
State Purchasing Officer	Thomas Meirink (7/01/07 – 6/25/08)
State Purchasing Officer	Tom Sestak (Acting) (6/26/08 – Current)
Division of Finance, Administrator	Michael Moss
Office of Fiscal Management, Chief	Jack Dodds

Department of Healthcare and Family Services offices are located at:

201 South Grand Avenue East
Springfield, IL 62763

2200 Churchill Road
Springfield, IL 62702

STATE OF ILLINOIS
DEPARTMENT OF HEALTHCARE AND FAMILY SERVICES
LOCAL GOVERNMENT HEALTH INSURANCE RESERVE FUND
FINANCIAL AUDIT
For the Year Ended June 30, 2008

FINANCIAL STATEMENT REPORT

SUMMARY

The audit of the accompanying financial statements of the Illinois Department of Healthcare and Family Services' Local Government Health Insurance Reserve Fund was performed by the Office of the Auditor General.

Based on their audit, the auditors expressed an unqualified opinion on the Local Government Health Insurance Reserve Fund's financial statements.

SUMMARY OF FINDINGS

The auditors identified matters involving the Department's internal control over financial reporting that they considered to be significant deficiencies. The significant deficiencies are described in the accompanying Schedule of Findings on pages 20-22 of this report as finding 08-1, third party internal control reviews not obtained.

EXIT CONFERENCE

The financial audit finding and recommendation appearing in this report was discussed with Department personnel at an exit conference on May 22, 2009.

The response to the recommendation was provided by Peggy Edwards, Audit Liaison for the Department, on May 29, 2009.

SPRINGFIELD OFFICE:
ILES PARK PLAZA
740 EAST ASH • 62703-3154
PHONE: 217/782-6046
FAX: 217/785-8222 • TTY: 888/261-2887



CHICAGO OFFICE:
MICHAEL A. BILANDIC BLDG. • SUITE S-900
160 NORTH LASALLE • 60601-3103
PHONE: 312/814-4000
FAX: 312/814-4006

OFFICE OF THE AUDITOR GENERAL
WILLIAM G. HOLLAND

INDEPENDENT AUDITORS' REPORT

Honorable William G. Holland
Auditor General
State of Illinois

We have audited the accompanying financial statements of the Local Government Health Insurance Reserve Fund of the State of Illinois, Department of Healthcare and Family Services, as of and for the year ended June 30, 2008, as listed in the table of contents. These financial statements are the responsibility of the State of Illinois, Department of Healthcare and Family Services' 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.

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of the Local Government Health Insurance Reserve Fund of the State of Illinois, Department of Healthcare and Family Services, as of June 30, 2008, 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.

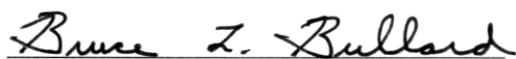
In accordance with *Government Auditing Standards*, we have also issued a report dated June 26, 2009 on our consideration of the State of Illinois, Department of Healthcare and Family Services' internal control over financial reporting of the Local Government Health Insurance Reserve Fund and on our tests of the State of Illinois, Department of Healthcare and Family Services' 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.

INTERNET ADDRESS: AUDITOR@MAIL.STATE.IL.US

RECYCLED PAPER • SOYBEAN INKS

The Schedule of Claims for the Ten Years Ended June 30, 2008 on page 16 is not a required part of the financial statements of the Local Government Health Insurance Reserve Fund but is supplementary information required by accounting principles generally accepted in the United States of America. We have applied certain limited procedures which consisted principally of inquiries of management regarding the methods of measurement and presentation of the required supplementary information. However, we did not audit the information and express no opinion on it.

The State of Illinois, Department of Healthcare and Family Services has not presented a management's discussion and analysis for the Local Government Health Insurance Reserve Fund that accounting principles generally accepted in the United States of America has determined is necessary to supplement, although not required to be part of, the financial statements.



Bruce L. Bullard, CPA

Director of Financial and Compliance Audits

June 26, 2009

STATE OF ILLINOIS
DEPARTMENT OF HEALTHCARE AND FAMILY SERVICES
LOCAL GOVERNMENT HEALTH INSURANCE RESERVE FUND
STATEMENT OF NET ASSETS
June 30, 2008

(Expressed in Thousands)

ASSETS

Cash equity with State Treasurer	\$ 9,023
Cash and cash equivalents	2,252
Due from other government - federal	34
Due from other government - local	99
Other receivables, net	271
Total current assets	11,679
 Capital assets being depreciated, net	 6
Total assets	11,685

LIABILITIES

Accounts payable and accrued liabilities	4,262
Due to other government - federal	2
Due to other Department funds	4
Due to other State funds	117
Total current liabilities	4,385
 Noncurrent portion of long-term obligations	 71
Total liabilities	4,456

NET ASSETS

Invested in capital assets, net of related debt	6
Unrestricted	7,223
Total net assets	\$ 7,229

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

STATE OF ILLINOIS
DEPARTMENT OF HEALTHCARE AND FAMILY SERVICES
LOCAL GOVERNMENT HEALTH INSURANCE RESERVE FUND
**STATEMENT OF REVENUES, EXPENSES
AND CHANGES IN FUND NET ASSETS**
For the Year Ended June 30, 2008

(Expressed in Thousands)

OPERATING REVENUES	
Charges for sales and services	\$ 60,189
Total operating revenues	60,189
 OPERATING EXPENSES	
Benefit payments and refunds	60,313
Depreciation	3
General and administrative	898
Total operating expenses	61,214
Operating income (loss)	(1,025)
 NONOPERATING REVENUES (EXPENSES)	
Interest and investment income	735
Other revenues	145
Income (loss) before contributions and transfers	(145)
Transfers-out	-
Change in net assets	(145)
Net assets, July 1, 2007	7,374
NET ASSETS, JUNE 30, 2008	\$ 7,229

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

STATE OF ILLINOIS
DEPARTMENT OF HEALTHCARE AND FAMILY SERVICES
LOCAL GOVERNMENT HEALTH INSURANCE RESERVE FUND
STATEMENT OF CASH FLOWS
For the Year Ended June 30, 2008

(Expressed in Thousands)

CASH FLOWS FROM OPERATING ACTIVITIES:	
Cash received from sales and services	\$ 60,132
Cash payments to suppliers for goods and services	(61,512)
Cash payments to employees for services	(648)
Cash receipts from other operating activities	1,016
Net cash provided (used) by operating activities	<u>(1,012)</u>
CASH FLOWS FROM NONCAPITAL FINANCING ACTIVITIES:	
Operating grants received	<u>160</u>
Net cash provided (used) by noncapital financing activities	<u>160</u>
CASH FLOWS FROM CAPITAL AND RELATED FINANCING ACTIVITIES:	
Acquisition and construction of capital assets	<u>-</u>
Net cash (used) by capital and related financing activities	<u>-</u>
CASH FLOWS FROM INVESTING ACTIVITIES:	
Interest and dividends on investments	<u>752</u>
Net cash provided (used) by investing activities	<u>752</u>
Net increase (decrease) in cash and cash equivalents	(100)
Cash and cash equivalents, July 1, 2007	11,375
CASH AND CASH EQUIVALENTS, JUNE 30, 2008	<u><u>\$ 11,275</u></u>
Reconciliation of cash and cash equivalents to the statement of net assets:	
Total cash and cash equivalents per the statement of net assets	\$ 2,252
Add: cash equity with State Treasurer	9,023
CASH AND CASH EQUIVALENTS, JUNE 30, 2008	<u><u>\$ 11,275</u></u>

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

STATE OF ILLINOIS
DEPARTMENT OF HEALTHCARE AND FAMILY SERVICES
LOCAL GOVERNMENT HEALTH INSURANCE RESERVE FUND
STATEMENT OF CASH FLOWS
For the Year Ended June 30, 2008

(Expressed in Thousands)

**Reconciliation of operating income (loss) to net cash
provided (used) by operating activities:**

OPERATING INCOME (LOSS)	<u>\$ (1,025)</u>
Adjustments to reconcile operating income (loss) to net cash provided (used) by operating activities:	
Depreciation expense	3
Changes in assets and liabilities:	
(Increase) decrease in accounts receivable	53
(Increase) decrease in intergovernmental receivables	(11)
Increase (decrease) in accounts payable and accrued liabilities	(175)
Increase (decrease) in intergovernmental payables	2
Increase (decrease) in due to other funds	102
Increase (decrease) in other liabilities	39
Total adjustments	<u>13</u>
NET CASH PROVIDED (USED) BY OPERATING ACTIVITIES	<u><u>\$ (1,012)</u></u>

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

STATE OF ILLINOIS
DEPARTMENT OF HEALTHCARE AND FAMILY SERVICES
LOCAL GOVERNMENT HEALTH INSURANCE RESERVE FUND
NOTES TO THE FINANCIAL STATEMENTS
June 30, 2008

(1) Organization

The Local Government Health Insurance Reserve Fund (LGHIRF) was established to provide health and dental insurance to participating local governmental entities. The fund is part of the primary government of the State of Illinois. The Department of Healthcare and Family Services (Department) is responsible for the financial reporting of the fund.

As of June 30, 2008, there were 488 local governmental entities participating with approximately 5,694 employees, 3,821 dependents and 312 retirees covered. Each participating local governmental unit is required to enter into a written agreement with the Department of Central Management Services (DCMS). The agreement sets forth the responsibilities of both parties. The Department works in conjunction with DCMS to administer the Local Government Health Plan.

The responsibilities required of DCMS are:

- Setting and adjusting premium rates
- Billing and collecting monthly premiums from local governmental units
- Enrollment and termination of members and dependents after notification by the local governmental unit
- Establishment of a Local Government Health Plan Advisory Board, consisting of seven advisors from the participating local governmental units

The responsibilities required of the Department of Healthcare and Family Services are:

- Establishment of the Local Government Health Insurance Reserve Fund
- Processing and paying authorized claims

The responsibilities required of the local governmental units are:

- Enrollment of all employees and dependents that meet eligibility guidelines and who elect to participate
- Collection and transmission of monthly member and dependent premiums
- Designation of a Health Plan Representative
- Participate in the program for a minimum of two years

(2) Summary of Significant Accounting Policies

(a) Basis of Presentation

The LGHIRF prepares its financial statements in accordance with Government Accounting Standards Board (GASB) Statement Nos. 10, 29, 30 and 34.

STATE OF ILLINOIS
DEPARTMENT OF HEALTHCARE AND FAMILY SERVICES
LOCAL GOVERNMENT HEALTH INSURANCE RESERVE FUND
NOTES TO THE FINANCIAL STATEMENTS
June 30, 2008

GASB 10 and 30 provide accounting and reporting standards that apply to public entity risk pools, and require public entity risk pools to account for their activities using proprietary fund accounting. Proprietary activities are accounted for using the economic resources measurement focus and the accrual basis of accounting.

GASB 29 allows proprietary entities to apply all Financial Accounting Standards Board statements and interpretations, excluding those limited to not for profit organizations, issued after November 30, 1989, except for those that conflict with or contradict GASB pronouncements.

Proprietary fund operating revenues, such as charges for services, 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. Non-operating revenues, such as subsidies and investment earnings, result from non-exchange transactions or ancillary activities.

(b) Cash and Cash Equivalents

Cash equivalents are defined as short-term, highly liquid investments readily convertible to cash with maturities of less than 90 days at the time of purchase. Cash and cash equivalents include cash on hand and cash in banks for locally held funds.

(c) Investments

Investments are reported at fair value.

(d) Capital Assets

Capital assets, which includes property, plant, and equipment, are reported at cost or estimated historical cost based on appraisals. Contributed assets are reported at estimated fair value at the time received. Capital assets are depreciated using the straight-line method.

Capitalization thresholds and the estimated useful lives are as follows:

Capital Asset Category	Capitalization Threshold	Estimated Useful Life (in Years)
Equipment	\$5,000	3-10 years

STATE OF ILLINOIS
DEPARTMENT OF HEALTHCARE AND FAMILY SERVICES
LOCAL GOVERNMENT HEALTH INSURANCE RESERVE FUND
NOTES TO THE FINANCIAL STATEMENTS
June 30, 2008

(e) Compensated Absences

The liability for compensated absences reported in the proprietary fund statement of net assets consists of unpaid, accumulated vacation and sick leave balances for Department employees. The liability has been calculated using the vesting method, in which leave amounts for both employees who currently are eligible to receive termination payments and other employees who are expected to become eligible in the future to receive such payments upon termination are included. The liability has been calculated based on the employees' current salary level and includes salary related costs (e.g., Social Security and Medicare tax).

Legislation that became effective January 1, 1998 capped the paid sick leave for all State Employees' Retirement System members at December 31, 1997. Employees continue to accrue twelve sick days per year, but will not receive monetary compensation for any additional time earned after December 31, 1997. Sick days earned between 1984 and December 31, 1997 (with a 50% cash value) would only be used after all days with no cash value are depleted. Any sick days earned and unused after December 31, 1997 will be converted to service time for purposes of calculating employee pension benefits.

(f) Use of Estimates

The preparation of financial statements in conformity with Generally Accepted Accounting Principles (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.

(g) Health Benefits Claims Processing

The State Employees Group Insurance Act of 1971 (5 ILCS 375) establishes the Department's responsibility for administering the State's health benefit programs. The Department contracts with third-party administrators to process health, dental and prescription claims submitted by healthcare service providers relating to the applicable self-insured portions of the health benefit programs accounted for in the Local Government Health Insurance Reserve Fund. It is the Department's policy to recognize claims expense and accrue any unpaid liability relating to claims incurred but not reported (IBNR) based on actuarial projections and reports of processed claims provided by the third-party administrators.

STATE OF ILLINOIS
DEPARTMENT OF HEALTHCARE AND FAMILY SERVICES
LOCAL GOVERNMENT HEALTH INSURANCE RESERVE FUND
NOTES TO THE FINANCIAL STATEMENTS
June 30, 2008

(3) Deposits and Investments

(a) Deposits

The State Treasurer is the custodian of the State’s cash and cash equivalents for funds maintained in the State Treasury. 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 the 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. Detail on the nature of these deposits and investments is available within the State of Illinois’ Comprehensive Annual Financial Report.

Cash on deposit with the State Treasurer totaled \$9,023 thousand at June 30, 2008.

(b) Investments

As of June 30, 2008, the Department had the following investments outside of the State Treasury:

	Fair Value <u>(Thousands)</u>	Book Value <u>(Thousands)</u>	Weighted Average Maturity <u>(Years)</u>
Illinois Public Treasurers’ Investment			
Pool	<u>\$ 2,252</u>	<u>\$ 2,252</u>	0.068
Total fixed income investments	<u>\$ 2,252</u>	<u>\$ 2,252</u>	

Interest Rate Risk: The Department does not have a formal investment policy that limits investment maturities as a means of managing its exposure to fair value losses arising from increasing interest rates.

Credit Risk: The Department does not have a formal investment policy that limits investment choices. The Illinois Public Treasurers’ Investment Pool was rated AAAM by Standard & Poor’s.

STATE OF ILLINOIS
DEPARTMENT OF HEALTHCARE AND FAMILY SERVICES
LOCAL GOVERNMENT HEALTH INSURANCE RESERVE FUND
NOTES TO THE FINANCIAL STATEMENTS
June 30, 2008

(4) Capital Assets

Capital asset activity (amounts expressed in thousands) for the year ended June 30, 2008 is as follows:

	Balance July 1, 2007	Additions	Deletions	Net Transfers	Balance June 30, 2008
Capital assets being depreciated:					
Equipment	\$ 9	\$ -	\$ -	\$ -	\$ 9
Less accumulated depreciation:					
Equipment	-	3	-	-	3
Total capital assets being depreciated, net	<u>\$ 9</u>	<u>\$ (3)</u>	<u>\$ -</u>	<u>\$ -</u>	<u>\$ 6</u>

(5) Long-Term Obligations

Changes in long-term obligations (amounts expressed in thousands) for the year ended June 30, 2008 were as follows:

	Balance July 1, 2007	Additions	Deletions	Balance June 30, 2008	Amounts Due Within One Year
Compensated Absences	\$ 32	\$ 45	\$ (6)	\$ 71	\$ -
Total	<u>\$ 32</u>	<u>\$ 45</u>	<u>\$ (6)</u>	<u>\$ 71</u>	<u>\$ -</u>

STATE OF ILLINOIS
DEPARTMENT OF HEALTHCARE AND FAMILY SERVICES
LOCAL GOVERNMENT HEALTH INSURANCE RESERVE FUND
NOTES TO THE FINANCIAL STATEMENTS
June 30, 2008

(6) Risk Pool Disclosure

The LGHIRF had previously contracted with third party reinsurers for reinsurance coverage. However, no such coverage was in place for the year ended June 30, 2008.

The basis used in calculating the estimated liability for future claims is based on claims reported but not paid during the fiscal year plus an estimate of claims incurred but not reported (IBNR). The estimate for claims incurred but not reported was calculated using a factor based on historical experience stated as a percentage of claims reported vs. total claims incurred during the policy cycle. The estimated ultimate cost of settling the claims includes the effect of inflation and other societal and economic factors. For the year ended June 30, 2008, all claims are paid on a two-year claim cycle.

Based on the above method, the liability for future claims (amounts expressed in thousands) at June 30, 2008 is as follows:

Claims incurred and reported but not paid as of June 30	\$1,149
Estimated liability for claims incurred but not reported	3,065
Total estimated liability for future claims	\$4,214

A reconciliation of total benefit claim payments and refunds including claims adjustment expense is as follows (amounts expressed in thousands):

Payments made for benefit claims	\$60,501
Less: liability for unpaid claims, beginning of year	4,402
Subtotal	56,099
Add: liability for unpaid claims, end of year	4,214
Total benefit claim payments and refunds	\$60,313

STATE OF ILLINOIS
DEPARTMENT OF HEALTHCARE AND FAMILY SERVICES
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NOTES TO THE FINANCIAL STATEMENTS
June 30, 2008

The following reconciliation represents changes in aggregate liabilities (amounts expressed in thousands) for the Fund during the past two years:

	Healthcare Claims	
	2008	2007
Unpaid claims and claim adjustment expense at beginning of year	\$4,402	\$5,504
Incurred claim and adjustment expenses:		
Provision for insured claims of the current year	61,044	61,423
Decrease in provisions for claims of prior year	(731)	(1,776)
Total incurred claims and claim adjustments	\$60,313	\$59,647
Payments:		
Claims and claim adjustment expense attributable to claims of the current year	\$56,830	\$57,021
Claims and claim adjustment expense attributable to claims of prior year	3,671	3,728
Total Payment	\$60,501	\$60,749
Total unpaid claims and claim adjustments expense at end of year	\$4,214	\$4,402

(7) Contingencies

The Department is a party to numerous legal proceedings, many of which normally occur in the course of operations. These proceedings are not, in the opinion of the Department's legal counsel, likely to have a material adverse impact on the Department's financial position. In the event a material action is settled against the Department, such amounts would be paid from future appropriations or by another State agency. Accordingly, no amounts have been provided in the accompanying financial statements related to outstanding litigation.

STATE OF ILLINOIS
DEPARTMENT OF HEALTHCARE AND FAMILY SERVICES
LOCAL GOVERNMENT HEALTH INSURANCE RESERVE FUND
SCHEDULE OF CLAIMS FOR ACTIVE EMPLOYEES

For the Ten Years Ended June 30, 2008

DEVELOPMENT INFORMATION

The table below illustrates how the Fund's earned required contribution and investment income compared to related costs of loss and other expenses assumed by the Fund as of the following fiscal year ends (expressed in thousands).

The following information for the ten fiscal years ended June 30, 2008 is being gathered prospectively, as data becomes available because the revenues and expenses were first allocated between earned and ceded for the fiscal year ended June 30, 1999.

	2008	2007	2006	2005	2004	2003	2002	2001	2000	1999
Net earned required contribution and investment revenue:										
Earned	\$ 60,924	\$ 64,261	\$ 67,074	\$ 67,876	\$ 72,400	\$ 81,854	\$ 88,640	\$ 87,366	\$ 71,645	\$ 57,656
Ceded	-	-	-	-	-	-	-	(1,234)	(1,210)	(596)
Net earned revenue	<u>60,924</u>	<u>64,261</u>	<u>67,074</u>	<u>67,876</u>	<u>72,400</u>	<u>81,854</u>	<u>88,640</u>	<u>86,132</u>	<u>70,435</u>	<u>57,060</u>
Unallocated expenses	901	1,869	835	2,799	2,796	785	827	751	1,390	489
Estimated incurred claims and expenses, end of policy year:										
Incurred	60,313	59,647	63,919	67,559	67,837	71,465	79,534	86,543	80,892	59,034
Ceded	-	-	-	-	-	-	-	(80)	924	(1,256)
Net incurred claims	<u>60,313</u>	<u>59,647</u>	<u>63,919</u>	<u>67,559</u>	<u>67,837</u>	<u>71,465</u>	<u>79,534</u>	<u>86,463</u>	<u>81,816</u>	<u>57,778</u>
Paid (cumulative) as of:										
End of policy year	56,830	57,021	63,274	67,053	64,416	58,355	82,262	76,091	63,807	51,981
One year later		60,692	67,002	70,891	67,833	63,399	99,967	87,785	74,517	60,016
Two years later			67,002	70,891	67,833	63,399	99,967	87,785	74,517	60,016
Three years later				70,891	67,833	63,399	99,967	87,785	74,517	60,016
Four years later					67,833	63,399	99,967	87,785	74,517	60,016
Five years later						63,399	99,967	87,785	74,517	60,016
Six years later							99,967	87,785	74,517	60,016
Seven years later								87,785	74,517	60,016
Eight years later									74,517	60,016
Nine years later										60,016
Reestimated ceded losses and expenses	-	-	-	-	-	-	-	1,980	1,522	1,256

STATE OF ILLINOIS
DEPARTMENT OF HEALTHCARE AND FAMILY SERVICES
LOCAL GOVERNMENT HEALTH INSURANCE RESERVE FUND
SCHEDULE OF CLAIMS FOR ACTIVE EMPLOYEES

For the Ten Years Ended June 30, 2008

	2008	2007	2006	2005	2004	2003	2002	2001	2000	1999
Reestimated incurred claims and expenses:										
End of policy year	61,044	61,423	68,778	75,003	74,749	69,914	97,965	97,779	83,618	58,376
One year later		60,692	67,002	70,891	67,833	63,399	99,967	87,785	74,517	60,016
Two years later			67,002	70,891	67,833	63,399	99,967	87,785	74,517	60,016
Three years later				70,891	67,833	63,399	99,967	87,785	74,517	60,016
Four years later					67,833	63,399	99,967	87,785	74,517	60,016
Five years later						63,399	99,967	87,785	74,517	60,016
Six years later							99,967	87,785	74,517	60,016
Seven years later								87,785	74,517	60,016
Eight years later									74,517	60,016
Nine years later										60,016
Increase (decrease) in estimated incurred claims and expenses from end of policy year	\$ -	\$ (731)	\$ (1,776)	\$ (4,112)	\$ (6,916)	\$ (6,515)	\$ 2,002	\$ (9,994)	\$ (9,101)	\$ 1,640

SPRINGFIELD OFFICE:
ILES PARK PLAZA
740 EAST ASH • 62703-3154
PHONE: 217/782-6046
FAX: 217/785-8222 • TTY: 888/261-2887



CHICAGO OFFICE:
MICHAEL A. BILANDIC BLDG. • SUITE 5-900
160 NORTH LASALLE • 60601-3103
PHONE: 312/814-4000
FAX: 312/814-4006

OFFICE OF THE AUDITOR GENERAL
WILLIAM G. HOLLAND

INDEPENDENT ACCOUNTANTS' 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

We have audited the Local Government Health Insurance Reserve Fund of the State of Illinois, Department of Healthcare and Family Services, as of and for the year ended June 30, 2008, and have issued our report thereon dated June 26, 2009. 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 State of Illinois, Department of Healthcare and Family Services' internal control over financial reporting of the Local Government Health Insurance Reserve Fund as a basis for designing our auditing procedures for the purpose of expressing our opinion on the financial statements, but not for the purpose of expressing an opinion on the effectiveness of the State of Illinois, Department of Healthcare and Family Services' internal control over financial reporting. Accordingly, we do not express an opinion on the effectiveness of the State of Illinois, Department of Healthcare and Family Services' internal control over financial reporting.

Our consideration of internal control over financial reporting was for the limited purpose described in the preceding paragraph and would not necessarily identify all deficiencies in the internal control over financial reporting that might be significant deficiencies or material weaknesses. However, as discussed below, we identified certain deficiencies in internal control over financial reporting that we consider to be significant deficiencies.

A control deficiency 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 misstatements on a timely basis. A significant deficiency is a control deficiency, or combination of control deficiencies, that adversely affects the entity's ability to initiate, authorize, record, process, or report financial data reliably in accordance with generally accepted accounting principles such that there is more than a remote likelihood that a misstatement of the entity's financial statements that is more than inconsequential will not be prevented or detected by the entity's internal control. We consider the deficiencies in the accompanying schedule of findings to be significant deficiencies in internal control over financial reporting as item 08-1.

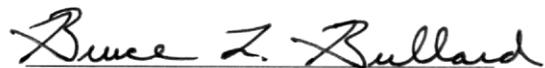
A material weakness is a significant deficiency, or combination of significant deficiencies, that results in more than a remote likelihood that a material misstatement of the financial statements will not be prevented or detected by the entity's internal control.

Our consideration of internal control over financial reporting was for the limited purpose described in the first paragraph of this section and would not necessarily identify all deficiencies in the internal control over financial reporting that might be significant deficiencies, and would not necessarily disclose all significant or material weaknesses. However, we believe that none of the significant deficiencies described is a material weakness.

Compliance and Other Matters

As part of obtaining reasonable assurance about whether the State of Illinois, Department of Healthcare and Family Services' Local Government Health Insurance Reserve Fund 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*.

The State of Illinois, Department of Healthcare and Family Services' response to the finding identified in our audit is described in the accompanying schedule of findings. We did not audit the State of Illinois, Department of Healthcare and Family Services' response and, accordingly, we express no opinion on it.



Bruce L. Bullard, CPA

Director of Financial and Compliance Audits

June 26, 2009

STATE OF ILLINOIS
DEPARTMENT OF HEALTHCARE AND FAMILY SERVICES
LOCAL GOVERNMENT HEALTH INSURANCE RESERVE FUND
SCHEDULE OF FINDINGS
For the Year Ended June 30, 2008

08-1. **FINDING** (Third party internal control reviews not obtained)

The Department of Healthcare and Family Services (Department) did not obtain an independent internal control review of its third parties involved with the processing of health insurance claims for the Local Government Health Plan. Without a review, the Department did not have assurance that information system controls to prevent errors or irregularities were established.

The Department contracts with five different third-party health insurance service providers to process health insurance claims. Each of the health insurance service provider uses their own computer system to process these health insurance claims. During our review of third party health insurance service providers, we noted that the Department did not obtain an independent internal control review for two of the service providers during fiscal year 2008.

Of the health insurance payments made to the five third-party health insurance service providers totaling \$28,573,571 in fiscal year 2008, \$7,978,387 (28%) of the health insurance payments were processed under a third-party health insurance service provider for which the Department did not obtain an independent internal control review.

Statement on Auditing Standards (AU 324.02) states that a service auditor's report on a service organization's description of its controls that may be relevant to a user organization's internal control as it relates to an audit of financial statements, on whether such controls were suitably designed to achieve specified control objectives, on whether they had been placed in operation as of a specific date, and on whether the controls that were tested were operating with sufficient effectiveness to provide reasonable, but not absolute, assurance that the related control objectives were achieved during the period specified. Statement on Auditing Standards (AU 324.06) also states when a user organization uses a service organization, transactions that affect the user organization's financial statements are subjected to controls that are, at least in part, physically and operationally separate from the user organization.

The Fiscal Control and Internal Auditing Act (30 ILCS 10/3001) requires all State agencies to establish and maintain a system of internal fiscal and administrative controls, which shall provide assurance that revenues, expenditures, and transfers of assets, resources, or funds applicable to operations are properly recorded and accounted for to permit the preparation of accounts and reliable financial reports and to maintain accountability over the State's resources.

Good internal controls require that third party service providers arrange to have a periodic independent review of internal controls placed in operation and issue a report on the results of this review commonly known as a SAS 70 report. The SAS 70 report should be obtained from the service organizations that process critical data for the Department.

STATE OF ILLINOIS
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For the Year Ended June 30, 2008

The Department stated that they negotiate long term contracts with the parties involved in processing insurance claims for the health care plans. Typical healthcare contracts have five year initial periods and up to five one-year renewal periods. The two contracts cited were initially negotiated with a five-year contract in 2001, for fiscal year 2002 implementation, without a SAS 70 requirement. The two contracts are currently in one-year renewal periods without a SAS 70 requirement. The Department previously submitted the relevant portions of the Sarbanes Oxley audit pertaining to internal controls as they relate to the audited financial statements for one of the two contracts. In addition, a 2008 Annual Report with SEC form 10-K and a Financial Statement audit were previously submitted for the remaining contract. The Annual Report with SEC form 10-K identified above includes the "Report of Independent Registered Public Accounting Firm". The vendor of the original contract was acquired October 1, 2007. Prior to this the vendor was a privately held corporation.

Due to the significance of the reliance placed by the Department on the procedures performed by the third party, it is critical that the Department obtains independent internal control reviews. In addition, it is essential to obtain and review an independent review of the third party service provider's information systems environment. An independent review provides a method of evaluating the systems in place at the service provider and helps the Department develop internal control processes that would complement those at the service provider. Based on the review, the Department would have additional assurance that the internal controls are appropriate to ensure the information received from the service provider is accurate and reliable. (Finding Code No. 08-1)

RECOMMENDATION

We recommend the Department require that each third-party health insurance service provider engage independent auditors to perform an annual independent internal control review on the controls placed in operation and the tests of their operating effectiveness.

DEPARTMENT RESPONSE

The Department respectfully disagrees with this finding. The majority of these contracts were originally executed prior to industry acceptance of SAS 70.

The Fiscal Year 2010 contracts and renewals for the two vendors not submitting SAS 70 audits have already been negotiated and have been signed by the vendors. In order to implement this requirement for those, the Department would have to renegotiate their contracts. Renegotiating those contracts at this date would jeopardize contracts beginning July 1, 2009. Negotiating an additional audit into these renewals would also increase the cost of the contract.

The Department will include a SAS 70 requirement to all future contracts bid with third parties involved with the processing of health insurance claims.

STATE OF ILLINOIS
DEPARTMENT OF HEALTHCARE AND FAMILY SERVICES
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SCHEDULE OF FINDINGS
For the Year Ended June 30, 2008

AUDITOR'S COMMENT

The auditors requested all third party internal control reviews from the Department and, for the two contracts noted above, the Department indicated that they relied on "equivalent" reviews for one of the contracts and they did not have a third party internal control review or equivalent review for the other contract.

With regard to one of the contracts, the Department did provide the auditors with what they called a Sox Report. The documentation that the Department provided was an excel spreadsheet that documented computer controls. This spreadsheet was not accompanied by any type of cover letter or auditor's report. After the auditors questioned the Sox Report, the Department contacted the vendor and the Department was informed that the Sox Report is actually part of the vendor's SAS 70 Report.

For the other contract, the Department indicated that they provided the auditors with a 2008 Annual Report with SEC Form 10-K. The Department did not have this Annual Report until the auditors asked for the SAS 70 Reports. The Department could not provide any "equivalent" reviews prior to the 2008 Annual Report.

The Department cannot state to the auditors that they are relying on these "equivalent" reports if they do not obtain them unless requested by the auditors. There is clearly no internal controls to obtain and review these reports.