

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, 2007

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, 2007

Table of Contents

	<u>Page(s)</u>
Agency Officials	1-2
<u>Individual Nonshared Governmental Funds:</u>	
Financial Statement Report Summary	3
Independent Auditor's Report	4-5
Individual Nonshared Governmental Fund Financial Statements:	
Balance Sheets	6
Statements of Revenues, Expenditures and Changes in Fund Balances	7
Notes to Financial Statements	8-18
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 <i>Government Auditing Standards</i>	19-20
<u>Individual Nonshared Proprietary Fund:</u>	
Financial Statement Report Summary	21
Independent Auditor's Report	22-23
Individual Nonshared Proprietary Fund Financial Statements:	
Statement of Net Assets	24
Statement of Revenues, Expenses and Changes in Net Assets	25
Statement of Cash Flows	26-27
Notes to Financial Statements	28-38

State of Illinois
Department of Employment Security

Financial Audits
For the Year Ended June 30, 2007

Table of Contents (Cont.)

	<u>Page(s)</u>
<u>Individual Nonshared Proprietary Fund – Continued</u>	
Supplementary Information	
Combining Fund Financial Statements	
Combining Statement of Net Assets	39
Combining Statement of Revenues, Expenses and Changes in Net Assets	40
Combining Statement of Cash Flows	41-42
Interfund Balances and Activities	43-44
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 <i>Government Auditing Standards</i>	45-46
Schedule of Findings	47-48

State of Illinois
Department of Employment Security

Agency Officials
June 30, 2007

Director	Ms. Brenda A. Russell
Previous to March 5, 2007	Mr. James P. Sledge
March 5, 2007 to present	
Deputy Director, Administration	Ms. Elizabeth Nicholson
Deputy Director, Operations	Mr. Keith Chambers
Previous to March 2, 2007	Ms. LaToya Price-Childs
April 2, 2007 to present	
Chief Financial Officer	Mr. Jon Gingrich
Chief Information Services Officer	Mr. Thomas Revane
Manager, Revenue Division	Ms. Lois Cuevas
Manager, Field Operations	Ms. Virginia Long
General Counsel	Mr. Joseph P. Mueller
Manager, Accounting Services Division	Mr. L. Briant Coombs
Manager, Workforce and Career Information (Economic Information and Analysis)	
Previous to August 1, 2007	Mr. Henry L. Jackson
August 1, 2007 to present	Mr. Mitch Daniels (acting)
Manager, General Services Division	Mr. John Rogers
Manager, Human Resources Division	Mr. Ken Santiago
Manager, Unemployment Insurance Division	Ms. Carolyn Vanek
Manager, Employment Services Division	Mr. Bennett Krause

State of Illinois
Department of Employment Security

Agency Officials
June 30, 2007

Manager, 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, 2007

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, 2007

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, 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, 2007, 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, 2007, 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, 2007, 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 January 31, 2008 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
January 31, 2008

State of Illinois
 Department of Employment Security

Individual Nonshared Governmental Funds
 Balance Sheets
 June 30, 2007
 (Amounts in \$000's)

	Title III Social Security and Employment Services Fund	Unemployment Compensation Special Administration Fund	Special Programs Fund
Assets			
Cash and cash equivalents	\$ 21,297	\$ 10,522	\$ -
Intergovernmental receivables	11,043	-	1,502
Other receivables	48	89	-
Due from other State funds	17	4,177	-
Inventories	1,355	-	-
Total assets	<u>\$ 33,760</u>	<u>\$ 14,788</u>	<u>\$ 1,502</u>
Liabilities and Fund Balances			
Liabilities:			
Accounts payable and accrued liabilities	\$ 4,977	\$ 219	\$ 1,493
Intergovernmental payables	289	-	7
Due to other State funds	8,005	-	2
Deferred revenues	242	-	-
Total liabilities	<u>13,513</u>	<u>219</u>	<u>1,502</u>
Fund Balances:			
Reserved for inventories	1,355	-	-
Reserved for encumbrances	6	-	-
Unreserved - undesignated	18,886	14,569	-
Total fund balances	<u>20,247</u>	<u>14,569</u>	<u>-</u>
Total liabilities and fund balances	<u>\$ 33,760</u>	<u>\$ 14,788</u>	<u>\$ 1,502</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, 2007
 (Amounts in \$000's)

	Title III Social Security and Employment Services Fund	Unemployment Compensation Special Administration Fund	Special Programs Fund
Revenues			
Federal government	\$ 164,582	\$ -	\$ 24,659
Other revenues	2,173	-	48
Licenses and fees	25	-	-
Interest and investment income	956	829	-
Total revenues	<u>167,736</u>	<u>829</u>	<u>24,707</u>
Expenditures			
Employment and economic development	182,381	2,258	24,707
Capital outlays	693	-	-
Total expenditures	<u>183,074</u>	<u>2,258</u>	<u>24,707</u>
Deficiency of revenues over (under) expenditures	<u>(15,338)</u>	<u>(1,429)</u>	<u>-</u>
Other financing sources (uses)			
Transfers in	10,013	16,675	7,712
Transfers out	(712)	(11,483)	-
Total other financing sources (uses)	<u>9,301</u>	<u>5,192</u>	<u>7,712</u>
Net changes in fund balances	(6,037)	3,763	7,712
Fund balances, July 1, 2006	<u>26,284</u>	<u>10,806</u>	<u>(7,712)</u>
Fund balances, June 30, 2007	<u>\$ 20,247</u>	<u>\$ 14,569</u>	<u>\$ -</u>

See Notes to Financial Statements.

State of Illinois
Department of Employment Security

Individual Nonshared Governmental Funds
Notes to Financial Statements
June 30, 2007
(Amounts in 000's)

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) **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, 2007
(Amounts in 000's)

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, and Special Programs 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, 2007, 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, 2007
(Amounts in 000's)

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, 2007
(Amounts in 000's)

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, 2007.

(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, 2007
(Amounts in 000's)

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, 2007, were as follows:

Fund	Deposits in Custody of State Treasurer	Cash On Hand
Title III Social Security and Employment Services	\$ 21,292	\$ 5
Unemployment Compensation Special Administration	10,522	-
	<u>\$ 31,814</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, 2007
 (Amounts in 000's)

4. Interfund Balances and Activities

(a) Balances Due to/from Other Funds

The following balances at June 30, 2007 represent amounts due from other Department and State of Illinois funds.

Fund	Amount	Description/Purpose
Title III Social Security and Employment Services	\$ 3	Due from Unemployment Compensation Trust Fund representing discretionary transfers of NSF fees
	9	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>\$ 17</u>	
Unemployment Compensation Special Administration	\$ 4,177	Due from Unemployment Compensation Trust Fund representing discretionary transfers of penalties and interest
	Total	<u>\$ 4,177</u>

State of Illinois
 Department of Employment Security

Individual Nonshared Governmental Funds
 Notes to Financial Statements
 June 30, 2007
 (Amounts in 000's)

4. Interfund Balances and Activities, continued

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

The following balances at June 30, 2007 represent amounts due to other Department and State of Illinois funds.

Fund	Amount	Description/Purpose
Title III Social Security and Employment Services	\$ 38	Due to Unemployment Compensation Trust Fund for reimbursement of unemployment benefits paid to former employees of the Department
	7,967	Due to other State funds for payment of services
Total	<u>\$ 8,005</u>	
Special Programs Fund	\$ 2	Due to Department of Revenue for remittance of claimant's State withholding taxes
Total	<u>\$ 2</u>	

State of Illinois
Department of Employment Security

Individual Nonshared Governmental Funds
Notes to Financial Statements
June 30, 2007
(Amounts in 000's)

4. Interfund Balances and Activities, continued

(b) Transfers to/from Other Funds

Interfund transfers in for the year ended June 30, 2007, 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
	13	Discretionary transfer of NSF fees from Unemployment Compensation Trust Fund
Total	<u>\$ 10,013</u>	
Unemployment Compensation Special Administration	\$ 16,675	Discretionary transfer of penalties and interest from Unemployment Compensation Trust Fund
Total	<u>\$ 16,675</u>	
Special Programs Fund	\$ 7,000	TRA settlement funding from Master Bond Fund
	712	TRA settlement funding from Title III Social Security and Employment Services Fund
	<u>\$ 7,712</u>	

Interfund transfers out for the year ended June 30, 2007, were as follows:

Title III Social Security and Employment Services	\$ 712	To fund TRA settlement under the Special Programs Fund
	<u>\$ 712</u>	

State of Illinois
Department of Employment Security

Individual Nonshared Governmental Funds
Notes to Financial Statements
June 30, 2007
(Amounts in 000's)

4. Interfund Balances and Activities, continued

(b) Transfers to/from Other Funds, continued

Fund	Amount	Description/Purpose
Unemployment Compensation Special Administration	\$ 10,000	Discretionary transfer of penalties and interest to Title III Social Security and Employment Services Fund
	1,483	Mandatory transfer to Unemployment Compensation Trust Fund
Total	<u>\$ 11,483</u>	

5. Liability to the Federal Government and Deficit Fund Balance

On July 10, 2006, the Department and the USDOL- 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 Department paid the first installment of \$712 into the fund on July 24, 2006 and a final installment of \$7,000 on January 23, 2007. Payment of this settlement is shown in the Statement of Revenue, Expenditures, and Changes in Fund Balances-Other financing sources as Transfers in under the Special Programs fund, see Note 4b for details of fund transfers. This settlement amount was used to pay TRA benefits and was fully expended in May 2007.

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 2007 are included in the State of Illinois' Comprehensive Annual Financial Report (CAFR) for the year ended June 30, 2007. 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 2007, the employer contribution rate was 11.53%.

State of Illinois
Department of Employment Security

Individual Nonshared Governmental Funds
Notes to Financial Statements
June 30, 2007
(Amounts in 000's)

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.

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, 2007. 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. There has been no reduction in insurance coverage from coverage in the prior year. Settlement amounts have not exceeded coverage for the current or prior two fiscal years. 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, 2007.

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, 2007, there were no material questioned costs 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 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, 2007
(Amounts in 000's)

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 Services Fund, Unemployment Compensation Special Administration 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, 2007, and have issued our report thereon dated January 31, 2008. 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 as a basis for designing our auditing procedures for the purpose of expressing our opinions on the financial statements, but not for the purpose of expressing an opinion on the effectiveness of the Department's internal control over financial reporting. Accordingly, we do not express an opinion on the effectiveness of the Department's internal control over financial reporting.

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.

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 internal control that might be significant deficiencies or material weaknesses. We did not identify any deficiencies in internal control over financial reporting that we consider to be material weaknesses, as defined above.

Compliance and Other Matters

As part of obtaining reasonable assurance about whether the Department's Individual Nonshared Governmental 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*.

We are currently conducting a State compliance examination of the Department as required by the Illinois State Auditing Act. The results of that examination will be reported to management under separate cover.

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
January 31, 2008

STATE OF ILLINOIS
DEPARTMENT OF EMPLOYMENT SECURITY

Individual Nonshared Proprietary Fund

Financial Audit

For the Year Ended June 30, 2007

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, 2007

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.

SUMMARY OF FINDINGS

The auditors identified a matter involving the Department's internal control over financial reporting that they considered to be a significant deficiency. The significant deficiency is described in the accompanying Schedule of Findings on page 47 of this report, as finding 07-1, *Failure to Review Computerized Information Systems of Third Party Bank Trustee*. The auditors also consider finding 07-1 to be a material weakness.

EXIT CONFERENCE

The finding and recommendation appearing in this report was discussed with Department personnel at an exit conference on January 22, 2008. Attending were:

	Illinois Department of Employment Security
Chief of Finance	Jon Gingrich (via telephone)
Manager, Accounting Services Division	L. Briant Coombs
Audit Liaison	Kathy Harlan
	McGladrey & Pullen, LLP
Partner	Joseph J. Evans
Supervisor	Heather Morandi
	Office of the Auditor General
Audit Manager	Jon Fox (via telephone)

The response to the recommendation was provided by Jon Gingrich, Chief Financial Officer in a letter dated January 25, 2008.

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, 2007, 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, 2007, 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, 2007, 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 January 31, 2008 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
January 31, 2008

State of Illinois
Department of Employment Security

Individual Nonshared Proprietary Fund

Statement of Net Assets

June 30, 2007

(Amounts in \$000's)

	Unemployment Compensation Trust Fund
Current Assets	
Cash and cash equivalents	\$ 2,778
Investments	1,765,139
Receivables, net:	
Taxes	476,759
Intergovernmental	28,974
Other	90,872
Due from State funds	3,910
Due from component units of the State of Illinois	155
	<hr/>
Total current assets	2,368,587
	<hr/>
Current Liabilities	
Benefit payments payable	81,946
Intergovernmental payables	4,717
Due to other State funds	4,180
	<hr/>
Total current liabilities	90,843
	<hr/>
Net Assets	
Restricted for:	
Unemployment compensation benefits	2,277,744
Unrestricted	-
	<hr/>
Total net assets	\$ 2,277,744
	<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, 2007
 (Amounts in \$000's)

	Unemployment Compensation Trust Fund
Operating revenues:	
Contributions - Unemployment taxes	\$ 2,334,077
Federal government	25,730
Total operating revenues	<u>2,359,807</u>
Operating expenses	
Benefit payments and refunds	<u>1,795,169</u>
Operating income	<u>564,638</u>
Nonoperating revenues (expenses)	
Interest and investment income	<u>64,279</u>
Total nonoperating revenues (expenses)	<u>64,279</u>
Income before transfers:	628,917
Transfers in	1,483
Transfers out	<u>(23,688)</u>
Increase in net assets	606,712
Net assets, July 1, 2006	<u>1,671,032</u>
Net assets, June 30, 2007	<u><u>\$ 2,277,744</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, 2007
 (Amounts in \$000's)

	Unemployment Compensation Trust Fund
Cash flows from operating activities	
Contributions - Unemployment taxes received	\$ 2,361,939
Federal grants received	25,730
Unemployment benefits paid	(1,804,741)
Net cash provided by operating activities	<u>582,928</u>
Cash flows from noncapital financing activities	
Transfers in	1,606
Transfers out	(24,922)
Other noncapital financing activities	(3,920)
Net cash (used in) noncapital financing activities	<u>(27,236)</u>
Cash flows from investing activities	
Purchase of investment securities	(2,492,593)
Sale of investment securities	1,864,590
Interest and investment income	65,089
Net cash (used in) investing activities	<u>(562,914)</u>
Net decrease in cash and cash equivalents	(7,222)
Cash and cash equivalents, July 1, 2006	<u>10,000</u>
Cash and cash equivalents, June 30, 2007	<u>\$ 2,778</u>

See Notes to Financial Statements.

State of Illinois
Department of Employment Security

Individual Nonshared Proprietary Fund
Statement of Cash Flows - Continued
Year Ended June 30, 2007
(Amounts in \$000's)

	Unemployment Compensation Trust Fund
Reconciliation of operating income to net cash provided by operating activities	
Operating income	\$ 564,638
Adjustments to reconcile operating income to net cash provided by operating activities:	
Provision for uncollectible accounts	(8,121)
Changes in assets and liabilities	
Receivables	20,680
Intergovernmental receivables	(1,130)
Due from other funds	(347)
Due from component units	(4)
Benefit payments payable	6,106
Intergovernmental payables	1,106
Net cash provided by operating activities	\$ 582,928

See Notes to Financial Statements.

1. Description of Funds

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. The Master Bond Fund was closed on February 1, 2007 and excess receipts were transferred to the UI Trust Fund once all bonds were redeemed.

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, 2007, 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

2. Summary of Significant Accounting Policies, continued

(b) Basis of Presentation, continued

Unemployment Insurance 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 federal funding for federally mandated benefit programs. 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.

State of Illinois
Department of Employment Security

Individual Nonshared Proprietary Fund
Notes to Financial Statements
June 30, 2007
(Amounts in \$000's)

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.

(g) Net Assets

Net assets consist of the following:

Restricted net assets, totaling \$2,277,744 as of June 30, 2007, 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.

3. Deposits and Investments

Cash and investments as of June 30, 2007 have a carrying amount in the accompanying financial statements as follows:

Cash and cash equivalents	\$	2,778
Investments		1,765,139
	\$	<u>1,767,917</u>

State of Illinois
Department of Employment Security

Individual Nonshared Proprietary Fund
Notes to Financial Statements
June 30, 2007
(Amounts in \$000's)

3. Deposits and Investments, continued

At June 30, 2007, cash on deposit for the Unemployment Compensation Trust Fund (UTF) for locally held funds has a carrying amount of \$440 and the bank balance was \$440. Of the bank balance, \$100 was insured through the Federal Depository Insurance Corporation (FDIC). The remaining \$340 was collateralized with securities pledged to the Federal Reserve Bank of New York in the name of the Department. Deposits in Illinois Funds and in the custody of the State Treasurer for the UTF totaled \$25,630 and had a carrying amount of \$2,338 at June 30, 2007.

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 \$1,765,139 at June 30, 2007. These deposits are pooled and invested with other States' funds and have not been categorized 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, 2007
 (Amounts in \$000's)

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, 2007 the Weighted Average Maturity of the Department's investments were:

Investment Type	Fair Value	Investment Maturities	
		<u>Weighted Average (in Years)</u>	
		Less Than 1	1-5
Deposits in custody of the U.S. Treasury	\$ 1,765,139	\$ -	\$ 1,765,139

State of Illinois
Department of Employment Security

Individual Nonshared Proprietary Fund
Notes to Financial Statements
June 30, 2007
(Amounts in \$000's)

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, 2007 for the Department's investments:

Investment Type	Total	Rating as of Year End
		Not Rated
Special Issue U.S. Treasury Bonds	\$ 1,765,139	\$ 1,765,139

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, 2007, \$340 of the Department's deposits with financial institutions in excess of federal depository limits was collateralized by pledged U.S. Treasury Bonds in the name of the Department at the Federal Reserve Bank of New York and \$5,019 is invested in shares of Fidelity Institutional Money Market Treasury Fund which are collateralized by U.S. Treasury Obligations of the underlying securities. All such shares are held in the Illinois National Bank as agent for the Illinois Department of Employment Security.

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, 2007
(Amounts in \$000's)

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 which, per statute, is typically on a 4 year collection cycle. Balances as of June 30, 2007, are as follows:

Taxes receivable:

Unemployment taxes	\$ 554,748
Interest and penalties receivable on taxes	<u>36,981</u>
Total taxes receivable	591,729
Less: allowance for uncollectible taxes	<u>(114,970)</u>
Taxes receivable	<u><u>\$ 476,759</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 \$28,974 as of June 30, 2007.

6. Other Receivables

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 which, per statute, is typically based on a 4-year collection cycle.

Balances as of June 30, 2007 are as follows:

Other receivables	\$ 342,319
Less: allowance for uncollectible accounts	<u>(251,447)</u>
Other receivables	<u><u>\$ 90,872</u></u>

State of Illinois
Department of Employment Security

Individual Nonshared Proprietary Fund
Notes to Financial Statements
June 30, 2007
(Amounts in \$000's)

7. Interfund Balances and Activities

(a) Balances Due to/from Other Funds

The following balances at June 30, 2007 represent amounts due from other Department and State of Illinois funds.

Fund	Amount	Description/Purpose
Unemployment Compensation Trust Fund	\$ 3,072	Due from General Revenue Fund for reimbursement of unemployment benefits paid to employees of other State agencies
	800	Due from Road Fund for reimbursement of unemployment benefits paid to former employees of the Illinois Department of Transportation
	38	Due from Title III Social Security and Employment Services Fund for the reimbursement of unemployment benefits to former employees of the Department
Total	<u>\$ 3,910</u>	

Due from component units of the State of Illinois of which \$155 represents reimbursement of unemployment benefits paid to employees of State universities.

The following balances at June 30, 2007 represent amounts due to other Department and State of Illinois funds.

Fund	Amount	Description/Purpose
Unemployment Compensation Trust Fund	\$ 3	Due to Title III Social Security and Employment Services Fund for discretionary transfers of NSF fees
	4,177	Due to Unemployment Compensation Special Administration Fund for discretionary transfers of penalties and interest
Total	<u>\$ 4,180</u>	

State of Illinois
 Department of Employment Security

Individual Nonshared Proprietary Fund
 Notes to Financial Statements
 June 30, 2007
 (Amounts in \$000's)

7. Interfund Balances and Activities, continued

(b) Transfers to/from Other funds

Interfund transfers in for the year ended June 30, 2007, were as follows:

Fund	Amount	Description/Purpose
Unemployment Compensation Trust Fund	\$ 1,483	Mandatory transfer from Unemployment Compensation Special Administration Fund

Interfund transfers out for the year ended June 30, 2007, were as follows:

Fund	Amount	Description/Purpose
Unemployment Compensation Trust Fund	\$ 16,675	Discretionary transfers of penalties and interest to Unemployment Compensation Special Administration Fund
	13	Discretionary transfer of NSF fees to Title III Social Security and Employment Services Fund
	7,000	TRA settlement transfer to Special Programs Fund
Total	<u>\$ 23,688</u>	

8. Intergovernmental Payables

Intergovernmental payables of \$4,717 represent interstate combined wage claim benefits payable.

State of Illinois
Department of Employment Security

Individual Nonshared Proprietary Fund
Notes to Financial Statements
June 30, 2007
(Amounts in \$000's)

9. 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. There has been no reduction in insurance coverage from coverage in the prior year. Settlement amounts have not exceeded coverage for the current or prior two fiscal years. 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, 2007.

10. 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.

11. 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 2007 financial statements.

SUPPLEMENTARY INFORMATION

State of Illinois
 Department of Employment Security
 Nonshared Proprietary Funds
 Combining Statement of Net Assets
 June 30, 2007
 (Amounts in \$000's)

	Unemployment Compensation Trust Fund	Master Bond Fund	Eliminations	Total
Current Assets				
Cash and cash equivalents	\$ 2,778	\$ -	\$ -	\$ 2,778
Investments	1,765,139	-	-	1,765,139
Receivables, net:				
Taxes	476,759	-	-	476,759
Intergovernmental	28,974	-	-	28,974
Other	90,872	-	-	90,872
Due from State funds	3,910	-	-	3,910
Due from component units of the State of Illinois	155	-	-	155
	<u>2,368,587</u>	<u>-</u>	<u>-</u>	<u>2,368,587</u>
Current Liabilities				
Benefit payments payable	81,946	-	-	81,946
Intergovernmental payables	4,717	-	-	4,717
Due to other State funds	4,180	-	-	4,180
	<u>90,843</u>	<u>-</u>	<u>-</u>	<u>90,843</u>
Net Assets				
Restricted for:				
Unemployment compensation benefits	2,277,744	-	-	2,277,744
Unrestricted	-	-	-	-
	<u>\$ 2,277,744</u>	<u>\$ -</u>	<u>\$ -</u>	<u>\$ 2,277,744</u>

State of Illinois
 Department of Employment Security

Nonshared Proprietary Funds
 Combining Statement of Revenues, Expenses, and Changes in Net Assets
 Year Ended June 30, 2007
 (Amounts in \$000's)

	Unemployment Compensation Trust Fund	Master Bond Fund	Eliminations	Total
Operating revenues:				
Contributions - Unemployment taxes	\$ 2,334,077	\$ -	\$ -	\$ 2,334,077
Federal government	25,730	-	-	25,730
Total operating revenues	<u>2,359,807</u>	<u>-</u>	<u>-</u>	<u>2,359,807</u>
Operating expenses				
Benefit payments and refunds	<u>1,795,169</u>	<u>-</u>	<u>-</u>	<u>1,795,169</u>
Operating income	<u>564,638</u>	<u>-</u>	<u>-</u>	<u>564,638</u>
Nonoperating revenues (expenses)				
Interest and investment income	<u>64,056</u>	<u>223</u>	<u>-</u>	<u>64,279</u>
Total nonoperating revenues (expenses)	<u>64,056</u>	<u>223</u>	<u>-</u>	<u>64,279</u>
Income before transfers:	628,694	223	-	628,917
Transfers in	1,606	-	(123)	1,483
Transfers out	<u>(16,688)</u>	<u>(7,123)</u>	<u>123</u>	<u>(23,688)</u>
Increase (decrease) in net assets	613,612	(6,900)	-	606,712
Net assets, July 1, 2006	<u>1,664,132</u>	<u>6,900</u>	<u>-</u>	<u>1,671,032</u>
Net assets, June 30, 2007	<u>\$ 2,277,744</u>	<u>\$ -</u>	<u>\$ -</u>	<u>\$ 2,277,744</u>

State of Illinois
Department of Employment Security

Nonshared Proprietary Funds
Combining Statement of Cash Flows
Year Ended June 30, 2007
(Amounts in \$000's)

	Unemployment Compensation Trust Fund	Master Bond Fund	Eliminations	Total
Cash flows from operating activities				
Contributions - Unemployment taxes received	\$ 2,361,939	\$ -	\$ -	\$ 2,361,939
Federal grants received	25,730	-	-	25,730
Unemployment benefits paid	(1,804,741)	-	-	(1,804,741)
Net cash provided by operating activities	582,928	-	-	582,928
Cash flows from noncapital financing activities				
Transfers in	1,606	-	-	1,606
Transfer out	(17,799)	(7,123)	-	(24,922)
Other noncapital financing activities	-	(3,920)	-	(3,920)
Net cash (used in) noncapital financing activities	(16,193)	(11,043)	-	(27,236)
Cash flows from investing activities				
Purchase of investment securities	(2,492,593)	-	-	(2,492,593)
Sale of investment securities	1,864,590	-	-	1,864,590
Interest and investment income	64,046	1,043	-	65,089
Net cash provided by (used in) investing activities	(563,957)	1,043	-	(562,914)
Net increase (decrease) in cash and cash equivalents	2,778	(10,000)	-	(7,222)
Cash and cash equivalents, July 1, 2006	-	10,000	-	10,000
Cash and cash equivalents, June 30, 2007	\$ 2,778	\$ -	\$ -	\$ 2,778

State of Illinois
 Department of Employment Security

Nonshared Proprietary Funds
 Combining Statement of Cash Flows - Continued
 Year Ended June 30, 2007
 (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	\$ 564,638	\$ -	\$ -	\$ 564,638
Adjustments to reconcile operating income to net cash provided by operating activities:				
Provision for uncollectible accounts	(8,121)	-	-	(8,121)
Changes in assets and liabilities				
Receivables	20,680	-	-	20,680
Intergovernmental receivables	(1,130)	-	-	(1,130)
Due from other funds	(347)	-	-	(347)
Due from component units	(4)	-	-	(4)
Benefit payments payable	6,106	-	-	6,106
Intergovernmental payables	1,106	-	-	1,106
Net cash provided by operating activities	\$ 582,928	\$ -	\$ -	\$ 582,928

State of Illinois
 Department of Employment Security

Nonshared Proprietary Funds
 Interfund Balances and Activities
 June 30, 2007
 (Amounts in \$000's)

Interfund Balances and Activities

(a) Balances Due to/from Other Funds

The following balances at June 30, 2007 represent amounts due from other Department and State of Illinois funds.

Fund	Amount	Description/Purpose
Unemployment Compensation Trust Fund	\$ 3,072	Due from General Revenue Fund for reimbursement of unemployment benefits paid to employees of other State agencies
	800	Due from Road Fund for reimbursement of unemployment benefits paid to former employees of the Illinois Department of Transportation
	38	Due from Title III Social Security and Employment Services Fund for the reimbursement of unemployment benefits to former employees of the Department
Total	<u>\$ 3,910</u>	

The following balances at June 30, 2007 represent amounts due to other Department and State of Illinois funds.

Fund	Amount	Description/Purpose
Unemployment Compensation Trust Fund	\$ 3	Due to Title III Social Security and Employment Services Fund for discretionary transfers of NSF fees
	4,177	Due to Unemployment Compensation Special Administration Fund for discretionary transfers of penalties and interest
Total	<u>\$ 4,180</u>	

State of Illinois
Department of Employment Security

Nonshared Proprietary Funds
Interfund Balances and Activities
June 30, 2007
(Amounts in \$000's)

Interfund Balances and Activities, continued

(b) Transfers to/from Other Funds

Interfund transfers in for the year ended June 30, 2007 were as follows:

Fund	Amount	Description/Purpose
Unemployment Compensation Trust Fund	\$ 1,483	Mandatory transfer from Unemployment Compensation Administration Fund
	123	Transfer of excess funds and to close the Master Bond Fund
Total	<u>\$ 1,606</u>	

Interfund transfers out for the year ended June 30, 2007 were as follows:

Fund	Amount	Description/Purpose
Unemployment Compensation Trust Fund	\$ 16,675	Discretionary transfer of penalties and interest to Unemployment Compensation Special Administration Fund
	13	Discretionary transfer of NSF fees to Title III Social Security and Employment Services Fund
Total	<u>\$ 16,688</u>	
Master Bond Fund	\$ 7,000	To fund TRA settlement under the Special Programs Fund
	123	Transfer excess funds to the Unemployment Trust Fund and to close the Master Bond Fund
Total	<u>\$ 7,123</u>	

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, 2007, and have issued our report thereon dated January 31, 2008. 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 in order to determine our auditing procedures for the purpose of expressing our opinions on the financial statements and not for the purpose of expressing an opinion on the effectiveness of the Department's internal control over financial reporting. Accordingly, we do not express an opinion on the effectiveness of the State of Illinois, Department of Employment Security's internal control over financial reporting.

Our consideration of the internal control over financial reporting was for the limited purpose described in the preceding paragraph and 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 deficiency described in finding 07-1 in the accompanying schedule of findings to be a significant deficiency in internal control over financial reporting.

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 the 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 that might be significant deficiencies and, accordingly, would not necessarily disclose all significant deficiencies that are also considered to be material weaknesses. However, we consider the significant deficiency described above, item 07-1, to be a material weakness.

Compliance and Other Matters

As part of obtaining reasonable assurance about whether the Department's Individual Nonshared Proprietary 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*.

We are currently conducting a State compliance examination of the Department as required by the Illinois State Auditing Act. The results of that examination will be reported to management under separate cover.

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

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
January 31, 2008

State of Illinois
Department of Employment Security

Schedule of Findings
For the Year Ended June 30, 2007

Current Findings – *Government Auditing Standards*

07-1 Failure to Review Computerized Information Systems of Third Party Bank Trustee

The Department did not obtain an independent internal control review of its bank trustee involved with the processing of cash receipts and other data for the Department. Without a review, the Department did not have assurance that information system controls to prevent errors or irregularities were established.

The Department contracts for computer services with an outside commercial bank to process cash receipts and other data submitted by employers. Substantially all of the Department's Insurance tax receipts are processed by the bank. For approximately 35% of the Department's Unemployment Insurance tax receipts totaling \$800 million, the Department relies primarily on the controls within the Bank to ensure the receipts and other data are processed accurately. The contracting for computer services with an outside bank may pose internal control and security risks similar to those encountered in an agency's internal computer environment. An independent review would provide the Department assurances regarding the security, integrity, and recovery capability of computer systems of the third party processor. Additionally, the review would specify procedures necessary for the Department to ensure controls are working effectively.

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 periodically from the bank trustee that processes critical data for the Department.

According to the Department, as a result of the prior compliance finding, it included a SAS 70 review in the fiscal year 2007 contract requirements for the bank trustee; however, the review was not completed by the bank's auditors in a timely manner.

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 better assurance that the internal controls are adequate to ensure the information received from the service provider is accurate and reliable. (Finding Code No. 07-1, 05-7)

Recommendation

We recommend the Department periodically obtain and review a SAS 70 review from the third party bank trustee processing cash receipts and other data for the Department.

State of Illinois
Department of Employment Security

Schedule of Findings
For the Year Ended June 30, 2007

Current Findings – *Government Auditing Standards*

07-1 Failure to Review Computerized Information Systems of Third Party Bank Trustee (Continued)

Department Response

We accept the recommendation. Significant progress has already been made by the bank and their external auditors since the initial compliance audit finding. The testing for the Type I SAS 70 review was completed in December 2007 and the corresponding final report will be issued in February 2008. A more comprehensive Type II SAS 70 review will also be completed with the Type II report anticipated to be issued by August 2008.

While we agree that there is no better substitute for a SAS 70 review, we also strongly feel that there are other compensating controls and mitigating factors in place that minimize the risks associated with any errors or irregularities coming from the bank. The on-site presence of IDES staff at the bank, the exception process which redirects incomplete packets directly to IDES for handling, existing bank security measures and the significant stake that employers have in accurate reporting and processing all contribute to the reduction of risk. We look forward to the completion of the Type I and Type II SAS 70 reviews with the expectation that they will indeed confirm that there are not any major control weaknesses at this bank.