STATE OF ILLINOIS
OFFICE OF THE
AUDITOR GENERAL
William G. Holland, Auditor General

SUMMARY REPORT DIGEST

STATE OF ILLINOIS

Statewide Financial Statement Audit
For the Year Ended: June 30, 2011

Release Date: June 21, 2012

Summary of Findings:

Total this audit:	**5**
Total last audit:	**8**
Repeated from last audit:	**5**

INTRODUCTION

The Illinois Office of the State Comptroller prepares the State of Illinois Comprehensive Annual Financial Report (CAFR). The CAFR is the State's official annual report which provides the readers with the financial position of the State as of June 30, 2011, and results of operations during the fiscal year.

The financial section of the CAFR includes the Independent Auditors' Report on the basic financial statements, the management discussion and analysis, the basic financial statements, required supplementary information, and individual fund statements and schedules.

AUDITORS' OPINION

The June 30, 2011 financial statements of the State of Illinois are fairly presented in all material respects.

The financial statements reflect a continuing financial deficit. At June 30, 2011:

- The net assets of governmental activities continued to deteriorate and the deficit increased by $6.3 billion from FY10 to FY11. Overall, net assets of governmental activities are reported as a deficit of $43.8 billion. (Exhibit 1)

- The General Revenue Fund deficit decreased by $738 million from FY10 to FY11. The June 30, 2011 deficit was $8.1 billion. (Exhibit 2)

Over time, increases and decreases in net assets measure whether the State's financial position is improving or deteriorating. A comparison of Illinois' financial position to other states is contained in Exhibit 3.

REPORT ON INTERNAL CONTROL OVER FINANCIAL REPORTING AND ON COMPLIANCE

In accordance with *Government Auditing Standards*, a report on our consideration of the State of Illinois' internal control over financial reporting and our tests of its compliance is also issued as part of our financial statement audit. This report is a separate document and is summarized in this document. Our report noted that the State's decentralized internal control system is not adequate. We also reported significant financial reporting deficiencies at several State agencies.

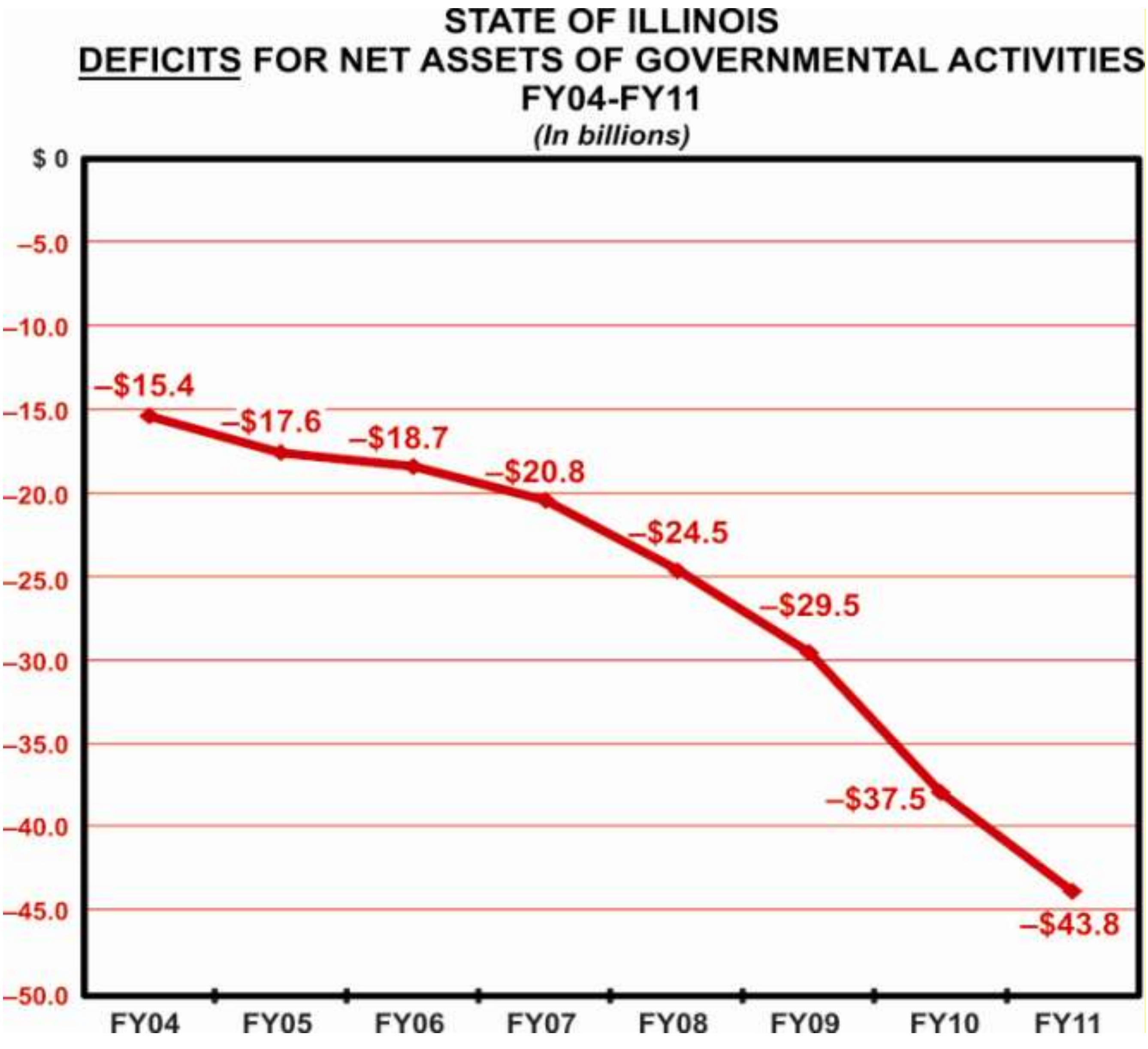
STATE OFFICIALS

Governor	Patrick Quinn
Comptroller (January 10, 2011 to Present)	Judy Baar Topinka
Comptroller (through January 9, 2011)	Daniel W. Hynes
Speaker of the House	Michael J. Madigan
President of the Senate	John J. Cullerton

FINANCIAL ANALYSIS OF THE STATE

The net assets of the State's governmental activities declined $6.283 billion. The following condensed financial information was derived from the government-wide Statement of Net Assets and reflects the State's governmental activities financial position as of June 30 for fiscal years 2004 through 2011.

EXHIBIT 1



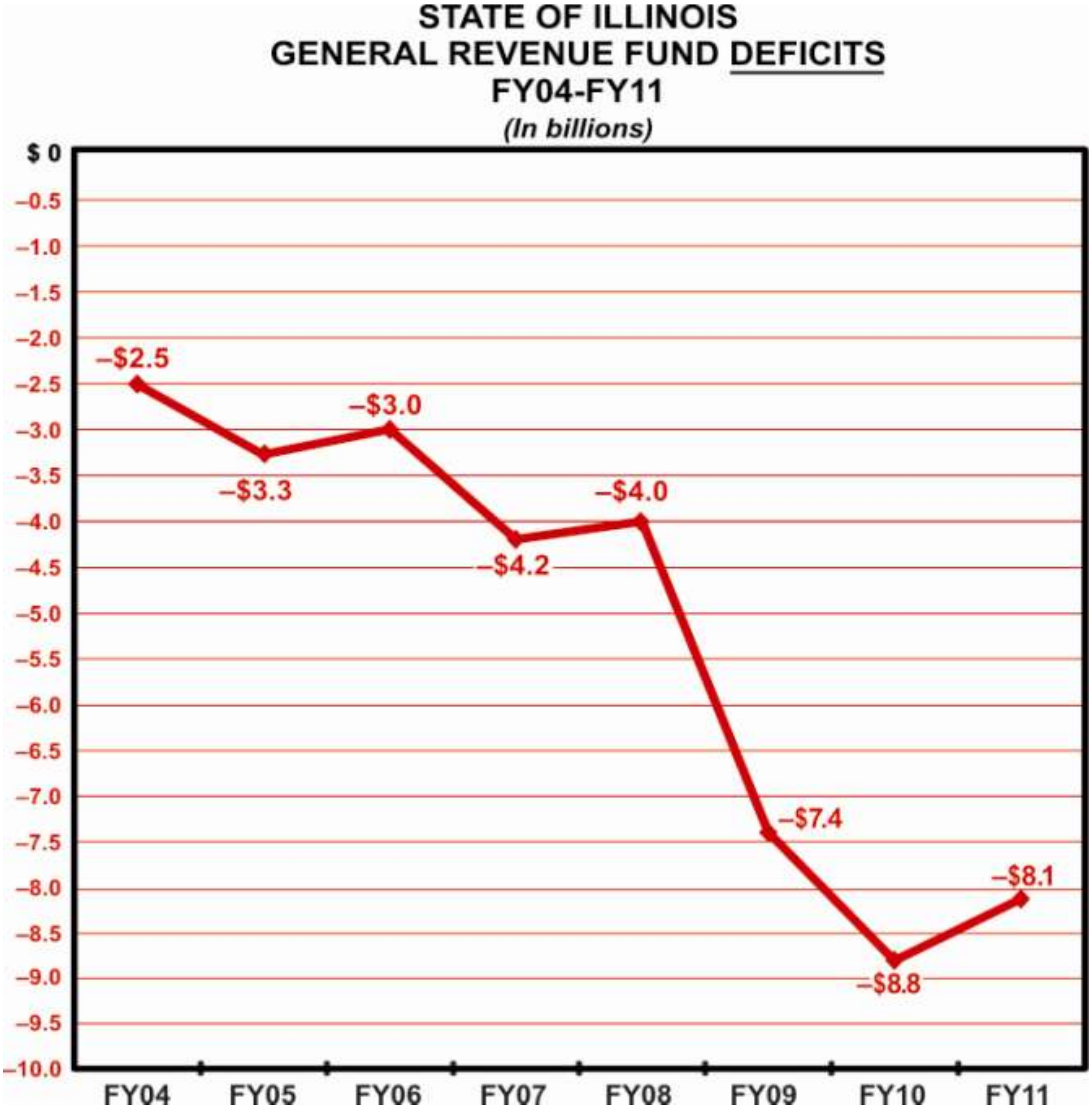
Source: Illinois' Comprehensive Annual Financial Report (2011)
Numbers reflect restatements.

The deficits reflected in Exhibit 1 are presented on an accrual basis and represent the excess of total liabilities over total assets at a given point in time. These deficits represent the deferral of current and prior year costs to future periods.

GENERAL REVENUE FUND

Many programs are accounted for in the General Fund. The GAAP basis financial position of the General Revenue Fund deficit decreased at June 30, 2011 from June 30, 2010. The fund balance deficit in the State's General Revenue Fund decreased by $738 million on a GAAP basis (from a deficit of $8.818 billion, as restated, to a deficit of $8.080 billion). Exhibit 2 reflects the General Revenue Fund deficit for fiscal years 2004 through 2011.

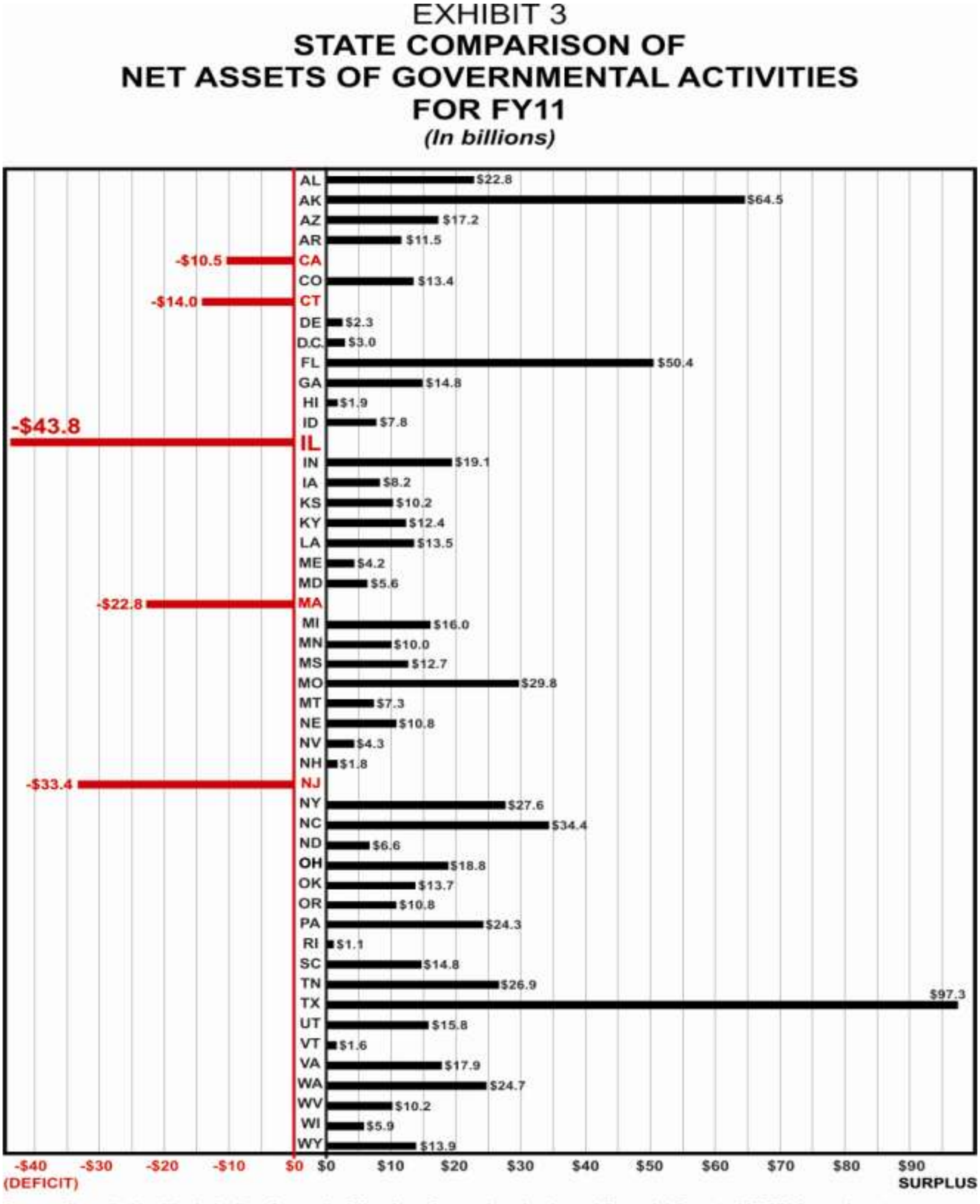
EXHIBIT 2



Source: Illinois' Comprehensive Annual Financial Report (2011)
Numbers reflect restatements.

STATE COMPARISON

Exhibit 3 provides an analysis of Illinois' Net Assets at June 30, 2011 compared to other States.



Source: Compiled by Illinois Auditor General's Office from Comprehensive Annual Financial Reports (CAFR) for each state, excluding New Mexico and South Dakota, which were not available at June 1, 2012.

FINDINGS, CONCLUSIONS, AND RECOMMENDATIONS

INADEQUATE FINANCIAL REPORTING PROCESS

Process does not allow timely financial reporting

Financial statements not completed until the end of May for five consecutive fiscal years due to reporting issues at State agencies

The State of Illinois' current financial reporting process does not allow the State to prepare a complete and accurate Comprehensive Annual Financial Report (CAFR) or the Schedule of Expenditures of Federal Awards (SEFA) in a timely manner. Reporting issues at various individual agencies caused delays in finalizing the financial statements, which did not occur until at least the end of May of the subsequent year for the past five fiscal years. The lack of timely financial reporting limits effective oversight of State finances, adversely affects the State's bond rating, and jeopardizes federal funding.

Financial reporting problems continue even after numerous findings issued

Accurate and timely financial reporting problems continue to exist even though the auditors have: 1) continuously reported numerous findings on the internal controls (material weaknesses and significant deficiencies), 2) commented on the inadequacy of the financial reporting process of the State, and 3) regularly proposed adjustments to financial statements year after year. These findings have been directed primarily toward the Office of the Comptroller (IOC) and major State agencies under the organizational structure of the Office of the Governor.

Financial reporting problems not resolved

Financial reporting process dependent on post audits

The Office of the State Comptroller has made changes to the system used to compile financial information; however, the State has not solved all problems to effectively remediate these financial reporting weaknesses. The process is overly dependent on the post audit program being a part of the internal control for financial reporting even though the Illinois Office of the Auditor General has repeatedly informed State agency officials that the post audit function **is not and should not** be an internal control mechanism for any operational activity related to financial reporting. (Finding 1, pages 7-10)

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

Governor's Office agreed with the finding and is working to address the challenges

The Governor's Office response stated the Governor's Office, the Governor's Office of Management and Budget and the Office of the Comptroller are working to address these challenges and have developed a timeline for short term, mid-term and long range plans. The response provided further details these plans The Governor's Office further stated that they will continue working with the agencies to provide as much complete information as possible given the State's current capacities.

IOC will assist the Governor's Office in their efforts to increase the quality of the GAAP packages

The Comptroller's Office response stated the IOC will continue to assist the Governor's Office in their efforts to increase the quality of the GAAP packages and provide training and technical assistance to State Agencies. In addition, legislation passed by the General Assembly, and if approved by the Governor, would create the Financial Accounting Standards Board whose mission would be to improve the timeliness, quality, and processing of financial reporting for the State.

FINANCIAL REPORTING WEAKNESSES

13 of 23 agencies with 44 internal control findings over financial reporting

The State of Illinois did not have adequate controls to assess the risk that information reported by individual agencies of the primary government would not be fairly stated and compliant with generally accepted accounting principles. The Office of the Auditor General performs audits at 23 agencies of the primary government, including five pension systems and the State Board of Investments. During these audits, we noted at 13 agencies there were a total of 16 material weaknesses and 28 significant deficiencies related to the internal controls over the financial reporting process.

Internal control deficiencies extend financial reporting timelines

Material weaknesses and significant deficiencies further extend financial reporting timelines since additional measurements and reporting is required. Completion or substantial completion of these audits is necessary in order for the Auditor General to issue an opinion on the State's basic financial statements.

In addition to the deficiencies noted above, restatements and material errors were noted during our audits, which are as follows:

Beginning balances restated

- The beginning balances in the financial statements of the primary government were restated due to the correction of one error. The restatement totaled $325.778 million due to the Department of Healthcare and Family Services understating the Department's drug rebate receivables.

Material misstatements identified

- Material misstatements were identified by the auditors at six agencies. The misstatements ranged from $1.6 million to $349 million. (Finding 2, pages 11-14)

We recommended the State implement additional internal control procedures in order to assess the risk of material misstatements to the financial statements and to identify such misstatements during the financial statement preparation process. The internal control procedures should include a formal evaluation of prior problems and implementation of procedures to reduce the risk of these problems reoccurring.

Governor's Office agreed, noting the need for an entity-wide financial accounting sytem

The Governor's Office response stated that with agencies all using many financial systems it is difficult to set Statewide internal controls. Rather than spend time monitoring a multitude of financial systems and the internal controls needed, the Governor's Office has focused on solving this problem with a centralized financial accounting system. The Governor's Office further stated that if the State had an entity-wide financial accounting system, internal controls would be built into the system to lessen the risk that statements are not fairly presented. These internal controls would detect any deficiencies that could result in a material weakness or a significant deficiency.

IOC will assist the Governor's Office in their efforts to increase the quality of the GAAP packages

The Comptroller's Office response stated the IOC will continue to assist the Governor's Office in their efforts to increase the quality of the GAAP packages by providing training and technical advice to State agencies. In addition, legislation passed by the General Assembly, and if approved by the Governor, would create the Financial Accounting Standards Board whose mission would be to improve the timeliness, quality, and processing of financial reporting for the State.

FINANCES INCREASE RISKS

Insufficient controls over the State's finances

Increased risk that liabilities will not be recorded properly

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

$4.740 billion of approved payments on hand at June 30, 2011

The State had transactions, totaling $4.740 billion, on hand at June 30, 2011 that had been approved for payment by the State, but remained unpaid at year end due to the State's cash flow difficulties. Of this amount, approximately $3 billion was owed to external parties, the remaining balance was related to intra-governmental transactions.

$1.5 billion owed to taxpayers and businesses

During our audit of the Illinois Department of Revenue (IDOR), the auditors reported that there was a deficit balance totaling $1.5 billion in the Income Tax Refund Fund, a sub account of the General Revenue Fund, because the State did not allocate sufficient income tax revenues into the Income Tax Refund Fund.

Large deficits in the Income Tax Refund Fund indicate that the State is essentially borrowing from taxpayers

State borrowing from taxpayers

(individuals and businesses) since overpayments of taxes are not revenue to the State when accounted for in accordance with generally accepted accounting principles (GAAP). Delays in paying tax refunds generates additional adjustments to convert cash basis amounts to GAAP basis. These necessary adjustments, due to lack of cash payment, increases the risk that liabilities will not be recognized in the proper period. (Finding 5, pages 19-21)

The Governor should work with the General Assembly to improve the State's control over State finances

We recommended the Governor work with the General Assembly to improve the State's control over State finances in a manner that eliminates significant payment delays including refunds due to taxpayers.

Governor's Office disagrees that balances owed are the result of insufficient controls over its current finances

The Governor's Office response stated that the Office recognizes that significant balances are owed at year-end; however disagrees that this is the result of insufficient controls over its current finances. The Office attributed the unpaid bills as a result of decades of fiscal mismanagement as well as the economic downturn and diminished revenues.

Governor's Office stated the Medicaid reform will have a 2013 impact of reducing unpaid Medicaid payments

The Governor's Office further stated that the Office successfully undertook Medicaid reform in the 2012 legislative session and this reform will have a 2013 impact of reducing the part of the unpaid accounts payable that belongs to Medicaid payments. In addition the Fiscal Year 2013 budget that passed the legislature has funds set aside to begin paying down the liability. These unpaid bills create a risk that liabilities are unrecorded is the result of finding 11-1. If the State had a consolidated accounting system with a general ledger, these liabilities could be properly recorded.

Governor's Office agreed that the refund rate is insufficient to pay tax refund

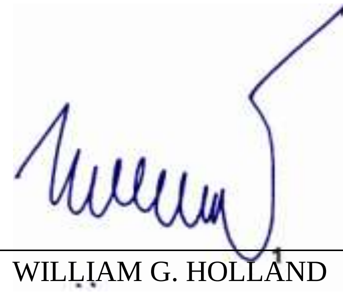
The Governor's Office and GOMB agreed that the refund rate set by the General Assembly is insufficient to pay tax refunds. The 2013 refund rate that is set for FY 2013 is closer to what is estimated to be needed to pay refunds in fiscal 2013.

Auditors comment that held payments of $4.740 billion at the end of Fiscal Year 2011 created additional risks for liability recognition

In an auditors' comment we noted that the amount of held payments of $4.740 billion at the end of Fiscal Year 2011 created an additional risk that material liabilities would not be recorded in the proper period. The held payments had legal authorization for payment and were unpaid due to a lack of resources. Attributing the cause of this additional weakness to a lack of control over State finances is reasonable since the State essentially follows a cash basis budget process. As noted in the finding, we do agree that economic conditions are relevant to the cause of the condition.

OTHER FINDINGS

The remaining findings included two noncompliance issues. We will review the State's progress towards the implementation of our recommendations in our next audit.



WILLIAM G. HOLLAND
Auditor General

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