

**STATE OF ILLINOIS
DEPARTMENT OF HEALTHCARE AND FAMILY SERVICES
TEACHER HEALTH INSURANCE SECURITY FUND**

**FINANCIAL AUDIT
For the Year Ended June 30, 2012**

STATE OF ILLINOIS
DEPARTMENT OF HEALTHCARE AND FAMILY SERVICES
TEACHER HEALTH INSURANCE SECURITY FUND
FINANCIAL AUDIT
For the Year Ended June 30, 2012

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STATE OF ILLINOIS
DEPARTMENT OF HEALTHCARE AND FAMILY SERVICES
TEACHER HEALTH INSURANCE SECURITY FUND
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AGENCY OFFICIALS

Director	Julie Hamos
Assistant Director	Sharron Matthews
General Counsel	Jeanette Badrov
Inspector General	John C. Allen (07/01/11 – 10/31/11) Bradley Hart (11/01/11 – Current)
Division of Finance, Administrator	Vacant (07/01/11 – 08/31/11) Frank Kopel (09/01/11 – 12/31/12) Vacant (1/1/13 - 2/28/13) Michael Casey (3/1/13 - Current)
Office of Fiscal Management, Chief	Jack Dodds

Department of Healthcare and Family Services offices are located at:

201 South Grand Avenue East
Springfield, IL 62763

2200 Churchill Road
Springfield, IL 62702

STATE OF ILLINOIS
DEPARTMENT OF HEALTHCARE AND FAMILY SERVICES
TEACHER HEALTH INSURANCE SECURITY FUND
FINANCIAL AUDIT
For the Year Ended June 30, 2012

FINANCIAL STATEMENT REPORT

SUMMARY

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

Based on their audit, the auditors expressed an unqualified opinion on the Teacher Health Insurance Security Fund's 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 pages 21-22 of this report as finding 12-1 (Lack of written rate-setting methodology).

EXIT CONFERENCE

The Department waived an exit conference in correspondence dated March 18, 2013.

The response to the recommendation was provided by Julie Hamos, Director, in a letter dated March 29, 2013.

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OFFICE OF THE AUDITOR GENERAL
WILLIAM G. HOLLAND

INDEPENDENT AUDITORS' REPORT

Honorable William G. Holland
Auditor General
State of Illinois

We have audited the accompanying financial statements of the Teacher Health Insurance Security Fund of the State of Illinois, Department of Healthcare and Family Services, as of and for the year ended June 30, 2012, as listed in the table of contents. These financial statements are the responsibility of the State of Illinois, Department of Healthcare and Family Services' management. Our responsibility is to express an opinion on these financial statements based on our audit.

We conducted our audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes consideration of internal control over financial reporting as a basis for designing audit procedures that are appropriate for the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the State of Illinois, Department of Healthcare and Family Services' internal control over financial reporting. Accordingly, we express no such opinion. An audit also includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, 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 A, the financial statements present only the Teacher Health Insurance Security Fund and do not purport to, and do not, present fairly the financial position of the State of Illinois, Department of Healthcare and Family Services as of June 30, 2012, and its changes in financial position for the year then ended in conformity with accounting principles generally accepted in the United States of America.

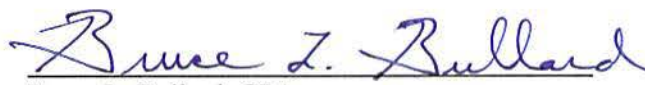
In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of the Teacher Health Insurance Security Fund of the State of Illinois, Department of Healthcare and Family Services, as of June 30, 2012, and the changes in financial position

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 March 29, 2013 on our consideration of the State of Illinois, Department of Healthcare and Family Services' internal control over financial reporting of the Teacher Health Insurance Security Fund and on our tests of the State of Illinois, Department of Healthcare and Family Services' compliance with certain provisions of laws, regulations, contracts and grant agreements and other matters. The purpose of that report is to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing, and not to provide an opinion on the internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* and should be considered in assessing the results of our audit.

Accounting principles generally accepted in the United States of America require that the Schedule of Funding Progress for the year ended June 30, 2012 and the Schedule of Contributions from Employers and Other Contributing Entities for the year ended June 30, 2012 on pages 17 and 18 be presented to supplement the fund financial statements. Such information, although not a part of the financial statements of the Teacher Health Insurance Security Fund is required by the Governmental Accounting Standards Board who considers it to be an essential part of financial reporting for placing the fund financial statements in an appropriate operational, economic, or historical context. We have applied certain limited procedures to the required supplementary information in accordance with auditing standards generally accepted in the United States of America, which consisted of inquiries of management about the methods of preparing the information and comparing the information for consistency with management's responses to our inquiries, the fund financial statements, and other knowledge we obtained during our audit of the fund financial statements. We do not express an opinion or provide any assurance on the information because the limited procedures do not provide us with sufficient evidence to express an opinion or provide any assurance.

Management has omitted management's discussion and analysis for the Teacher Health Insurance Security Fund that accounting principles generally accepted in the United States of America require to be presented to supplement the fund financial statements. Such missing information, although not a part of the fund financial statements, is required by the Governmental Accounting Standards Board who considers it to be an essential part of the financial reporting for placing the fund financial statements in an appropriate operational, economic, or historical context. Our opinion on the fund financial statements is not affected by this missing information.


Bruce L. Bullard, CPA
Director of Financial and Compliance Audits

March 29, 2013

STATE OF ILLINOIS
DEPARTMENT OF HEALTHCARE AND FAMILY SERVICES
TEACHER HEALTH INSURANCE SECURITY FUND
STATEMENT OF PLAN NET ASSETS
June 30, 2012

(amounts expressed in thousands)

Assets	
Cash and short-term investments	\$ 52,029
Securities lending collateral of State Treasurer	11,325
Receivables	
Employer	3,485
Employee	4,646
Federal government	5,862
Interest	8
Other receivables	9,131
Total receivables	<u>23,132</u>
Due from other funds	56,331
Total assets	<u><u>142,817</u></u>
 Liabilities	
Accounts payable and other	162,464
Intergovernmental payables	2
Due to other funds	135
Obligations under security lending of State Treasurer	11,325
Compensated absences, current	5
Total current liabilities	<u>173,931</u>
Long-term compensated absences	82
Total liabilities	<u><u>174,013</u></u>
 Net assets held in trust for other postemployment benefits	 <u><u>\$ (31,196)</u></u>

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

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STATEMENT OF CHANGES IN PLAN NET ASSETS
For the Year Ended June 30, 2012

(amounts expressed in thousands)

Additions

Contributions	
Employer	\$ 71,376
State	87,622
Plan member:	
Actives	95,271
Retirees	165,651
Federal government Medicare Part D	24,911
Consolidated Omnibus Budget Reconciliation Act	119
Total contributions	<u>444,950</u>
Interest income	127
Total additions	<u><u>445,077</u></u>

Deductions

Benefit payments and refunds	480,452
General and administrative expense	2,946
Total deductions	<u><u>483,398</u></u>

Net additions (deductions) (38,321)

Net assets held in trust for other postemployment benefits

Beginning of year	7,125
End of year	<u><u>\$ (31,196)</u></u>

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

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The Teacher Health Insurance Security Fund (also known as The Teacher Retirement Insurance Program, “TRIP”) is a non-appropriated trust fund held outside the State Treasury, with the State Treasurer as custodian. Revenues deposited into the Trust are for the sole purpose of providing the health benefits to retirees, as established under the plan, and associated administrative costs. TRIP is a cost-sharing multiple-employer defined benefit post-employment healthcare plan that covers retired employees of participating school districts throughout the State of Illinois, excluding the Chicago Public School System. TRIP health coverage includes provisions for medical, prescription, and behavioral health benefits, but does not provide vision, dental, or life insurance benefits. Annuitants may participate in the State administered Preferred Provider Organization plan or choose from several managed care options. The State Employees Group Insurance Act of 1971 (5 ILCS 375/6.5) establishes the eligibility and benefit provisions for the plan. The Illinois Departments of Healthcare and Family Services (HFS) and Central Management Services (CMS) administer the plan with the cooperation of the Teachers’ Retirement System (TRS).

In order to be eligible, retirees of public schools must have been certified educators or administrators during their time of employment. Eligibility to participate in the plan is currently limited to former full-time employees, or if not a full-time employee, an individual that is in a permanent and continuous basis in a position in which services are expected to be rendered for at least one school term, and their dependents.

A. Summary of Significant Accounting Principles

Financial Reporting Entity: As defined by Generally Accepted Accounting Principles (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 a financial benefit to or impose a financial burden on the primary government; or
- 2) Fiscal dependence on the primary government.

Based upon the required criteria, the Teacher Health Insurance Security Fund has no component units and is not a component unit of any other entity. However, because the Teacher Health Insurance Security Fund is not legally separate from the State of Illinois, the financial statements of the Teacher Health Insurance Security Fund are included in the financial statements of the State of Illinois as a pension (and other employee benefit) trust fund. The State of Illinois’ Comprehensive Annual Financial Report may be obtained by writing to the State Comptroller’s Office, Division of Financial Reporting, 325 West Adams Street, Springfield, Illinois, 62704-1871.

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Basis of Presentation: The financial statements present only the Teacher Health Insurance Security Fund administered by the State of Illinois, Department of Healthcare and Family Services. They are intended to present the financial position and the changes in financial position of only the Teacher Health Insurance Security Fund. They do not purport to, and do not, present fairly the financial position of the State of Illinois or the Department of Healthcare and Family Services as of June 30, 2012, and the changes in financial position for the year ended in conformity with accounting principles generally accepted in the United States of America.

Basis of Accounting: TRIP's financial statements are prepared using the accrual basis of accounting. Plan member contributions are recognized in the period in which the contributions are due. Employer contributions to the plan are recognized when due and the employer has made a formal commitment to provide the contributions. Benefits and refunds are recognized when due and payable in accordance with the terms of the plan.

Cash and Cash Equivalents: Cash and cash equivalents include cash on hand and cash in banks for locally held funds. Cash equivalents are defined as short-term, highly liquid investments readily convertible to cash.

Investments/Deposits: The investments are in the State Treasury Investment Pool (Illinois Funds). Investments are reported at fair value.

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

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

Use of Estimates: The preparation of financial statements in conformity with Generally Accepted Accounting Principles (GAAP) requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and to disclose contingent assets and liabilities at the date of the financial statements and the reported

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amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.

B. Contribution Information

Membership of the plan consisted of the following at June 30, 2012:

Retirees and beneficiaries receiving benefits	72,324
Waived retirees who may elect healthcare coverage in the future	18,300
Terminated plan members entitled to but not yet receiving benefits thru TRIP	8,884
Terminated plan members entitled to but not yet receiving benefits thru other TRS plans	5,532
Active plan members	<u>162,259</u>
Total	<u>267,299</u>
Number of participating employers	1,002

The State Employees Group Insurance Act of 1971 (5 ILCS 375/6.6) requires that all active contributors of the Teachers' Retirement System (TRS), who are not employees of a department, make contributions to the plan at a rate of .88% of salary and for every employer of a teacher to contribute an amount equal to .66% of each teacher's salary. HFS determines, by rule, the percentage required, which each year shall not exceed 105% of the percentage of salary actually required to be paid in the previous fiscal year.

The State Employees Group Insurance Act of 1971 (5 ILCS 375/6.5) requires that the HFS Director determine the rates and premiums of annuitants and dependent beneficiaries and establish the cost-sharing parameters, as well as funding. Member premiums are set by this statute, which provides for a subsidy of either 50% or 75%, depending upon member benefit choices. Dependents are eligible for coverage, at a rate of 100% of the cost of coverage.

For the year ended June 30, 2012, member annuitants (including their dependent beneficiaries) contributed \$165.6 million, or approximately 39.45% of total premiums, through their required contributions. Member required contributions ranged from \$72.77 to \$189.46, per month per retiree, and from \$324.86 to \$568.39, per month per retiree and spouse (assuming Medicare eligibility). For non-Medicare eligible members, required contributions ranged from \$59.29 to \$653.03, per month per retiree, and from \$296.49 to \$1,959.07, per month per retiree plus dependents. The State Employees Group Insurance Act of 1971 (5 ILCS 375/6.6) requires active teachers contribute .88% of salaries; they contributed \$95.3 million, or approximately 22.69% of total premiums. The State Employees

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Group Insurance Act of 1971 (5 ILCS 375/6.6) also requires participating school districts contribute .66% of salaries; they contributed \$71.4 million, or approximately 16.99% of total premiums. In addition, the State Employees Group Insurance Act of 1971 (5 ILCS 375/6.6) requires the State contribute .88% of salaries; they contributed \$87.6 million, or approximately 20.87% of total premiums. The fund received \$24.9 million in Medicare Part D subsidy payments from the federal government.

C. Deposits and Investments

Deposits

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

Cash on deposit with the State Treasurer totaled \$38,724 thousand at June 30, 2012.

Investments

Section 2 of the Public Funds Investment Act limits the State’s investments outside the State Treasury to securities of the U.S. government or its agencies, short-term obligations of domestic corporations exceeding \$500 million in assets that are rated in the three highest categories by at least two nationally recognized statistical ratings organizations not to exceed ten percent of the domestic corporations outstanding obligations, money market mutual funds invested in the U.S. government and/or its agencies, and repurchase agreements securities of the U.S. government or its agencies or money market mutual funds invested in the U.S. government or its agencies. Investments of public funds in a Public Treasurers’ Investment Pool created under Section 17 of the State Treasurer Act are also permitted.

As of June 30, 2012, the Department had the following investments in the State Treasury Investment Pool (Illinois Funds):

	Fair Value (Thousands)	Weighted Average Maturity (Years)
State Treasury Investment Pool (Illinois Funds)	<u>\$13,305</u>	0.069%
Total fixed income investments	<u><u>\$13,305</u></u>	

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

Credit Risk: The Department does not have a formal investment policy that limits investment choices. The State Treasury Investment Pool (Illinois Funds) were rated AAAM by Standard & Poor's.

D. Status and Funding Progress – OPEB Plans

The funded status of the plan as of the most recent actuarial valuation date available as of June 30, 2012 is as follows (amounts expressed in thousands):

Actuarial Date	Actuarial Value of Assets (a)	Actuarial Accrued Liability (AAL)-- Projected Unit (b)	Unfunded AAL (UAAL) (b-a)	Funded Ratio (a/b)	Covered Payroll (c)	UAAL as a Percentage of Covered Payroll ([b-a]/c)
6/30/11	\$7,125	\$18,860,375	\$18,853,250	0.04%	\$8,791,038	214.46%

Actuarial valuations of an ongoing plan involve estimates of the value of reported amounts and assumptions about the probability of occurrence of events far into the future. Examples include assumptions about future employment, mortality, and the healthcare cost trend. Actuarially determined amounts are subject to continual revision as actual results are compared with past expectations and new estimates are made about the future. The Schedule of Funding Progress, presented as required supplementary information following the notes to the financial statements, presents multi-year trend information about whether the actuarial values of plan assets are increasing or decreasing over time, relative to the actuarial accrued liabilities for benefits.

The accompanying Schedule of Contributions from Employers and Other Contributing Entities presents trend information about the amounts contributed to the plan by employers in comparison to the Annual Required Contribution (ARC), an amount that is actuarially determined in accordance with the parameters of GASB Statement 43. The ARC represents a level of funding that, if paid on an ongoing basis, is projected to cover normal cost for each year and amortize any unfunded actuarial liabilities (or funding excess) over a period not to exceed thirty years.

Projections of benefits for financial reporting purposes are based on the substantive plan (the plan as understood by the employer and plan members) and include the types of benefits

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provided at the time of each valuation and the historical pattern of sharing of benefit costs between the employer and plan members to that point. The actuarial methods and assumptions used include techniques that are designed to reduce the effects of short-term volatility in actuarial accrued liabilities and the actuarial value of assets, consistent with the long-term perspective of the calculations. Additional information as of the latest actuarial valuation follows:

Valuation date	6/30/11
Actuarial Cost Method	Projected Unit Credit
Amortization Method	Level Percentage of Pay
Remaining Amortization Period	30 Years
Asset Valuation Method	Market Value
Actuarial Assumptions:	
Inflation Rate	3.0%
Amortization Period	Open
Investment Rate of Return*	4.5 %
Healthcare Cost Trend Rate	9% grading down .5% per year over 6 years to 6% and in the 7 th year grading down .4% to 5.6% Initial 5% Ultimate

* Determined as a blended rate of the expected long-term investment returns on plan assets based upon the funded level of the plan as of the valuation date.

E. Long-Term Obligations

Changes in long-term obligations (amounts expressed in thousands) for the year ended June 30, 2012, were as follows:

	Balance July 1, 2011	Additions	Deletions	Balance June 30, 2012	Amounts Due Within One Year
Compensated Absences	\$97	\$65	\$75	\$87	\$5
Total	\$97	\$65	\$75	\$87	\$5

F. Pension Plan

The vested full-time employees paid from the Teacher Health Insurance Security Fund may 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

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Systems. The financial position and results of operations of the SERS for fiscal year 2012 are included in the State of Illinois' Comprehensive Annual Financial Report (CAFR) for the year ended June 30, 2012. 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 based upon an actuarially determined percentage of their payrolls. For fiscal year 2012, the employer contribution rate was 34.190%. Effective for pay periods beginning after December 31, 1991, the State opted to pay the employee portion of retirement for most State agencies (including the Department) with employees covered by the State Employees' and Teachers' Retirement Systems. However, effective with the fiscal year 2004 budget, the State opted to stop paying the portion or a part of the portion of retirement for many State agencies (including the Department) for certain classes of employees covered by the State Employees' and Teachers' Retirement Systems. The pickup, when applicable, is subject to sufficient annual appropriations and those employees covered may vary across employee groups and State agencies.

G. Post-employment Benefits

The State provides health, dental, vision, and life insurance benefits for retirees and their dependents in a program administered by the Department of Healthcare and Family Services along with the Department of Central Management Services. Substantially all State employees become eligible for post-employment benefits if they eventually become annuitants of one of the State sponsored pension plans. Health, dental, and vision benefits include basic benefits for annuitants and dependents under the State's self-insurance plan and insurance contracts currently in force. Annuitants may be required to contribute towards health, dental, and vision benefits with the amount based on factors such as date of retirement, years of credited service with the State, whether the annuitant is covered by Medicare, and whether the annuitant has chosen a managed health care plan. Annuitants who retired prior to January 1, 1998, and who are vested in the State Employees Retirement System do not contribute towards health, dental, and vision benefits. For annuitants who retired on or after January 1, 1998, the annuitant's contribution amount is reduced five percent for each year of credited service with the State allowing those annuitants with twenty or more years of credited service to not have to contribute towards health, dental, and vision benefits. Annuitants also receive life insurance coverage equal to the annual salary of the last day of employment until age 60, at which time the benefit becomes \$5,000.

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The total cost of the State's portion of health, dental, vision, and life insurance benefits of all members, including post-employment health, dental, vision, and life insurance benefits, is recognized as an expense by the State in the Illinois Comprehensive Annual Financial Report. The State finances the costs on a pay-as-you-go basis. The total costs incurred for health, dental, vision, and life insurance benefits are not separated by department or component unit for annuitants and their dependents nor active employees and their dependents.

A summary of post-employment 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 financial statements of the Department of Healthcare and Family Services. A copy of the financial statements of the Department of Healthcare and Family Services may be obtained by writing to the Department of Healthcare and Family Services, 201 South Grand Ave., Springfield, Illinois, 62763-3838.

H. Fund Deficit

For the fiscal year ending June 30, 2012, total benefits and expenses were \$483.4 million which were partially financed by \$87.6 million in State contributions, \$71.4 million in employer contributions, \$24.9 million in the federal government Medicare Part D subsidy, \$95.3 million in active member contributions, and \$165.7 million in retired member contributions, resulting in a net shortfall of approximately \$38.3 million or approximately 7.93% of total benefits and expenses.

Because contributions made by the State, employers, employees, and retired members are defined as a fixed percentage of payroll, the funding policy does not provide a provision for adverse experience. The following factor contributed to the fund deficit: the current financing policy does not provide a specific provision for claims incurred during the fiscal year that are expected to be paid in the following fiscal year.

I. Commitments and Contingencies

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

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J. Securities Lending Transactions

The State Treasurer lends securities to broker-dealers and other entities for collateral that will be returned for the same securities in the future. The State Treasurer has, through a Securities Lending Agreement, authorized Deutsche Bank Group to lend the State Treasurer's securities to broker-dealers and banks pursuant to a form of loan agreement.

During fiscal years 2012 and 2011, Deutsche Bank Group lent U.S. Treasury and U.S. agency securities and received as collateral U.S. dollar denominated cash. Borrowers were required to deliver collateral for each loan equal to at least 100% of the aggregated market value of the loaned securities. Loans are marked to market daily. If the market value of collateral falls below 100%, the borrower must provide additional collateral to raise the market value to 100%.

The State Treasurer did not impose any restrictions during fiscal years 2012 and 2011 on the amount of the loans available or the eligible securities. In the event of borrower default, Deutsche Bank Group provides the State Treasurer with counterparty default indemnification. In addition, Deutsche Bank Group is obligated to indemnify the State Treasurer if the Deutsche Bank Group loses any securities, collateral or investments of the State Treasurer in Deutsche Bank Group's custody. Moreover, there were no losses during fiscal years 2012 and 2011 resulting from a default of the borrowers or Deutsche Bank Group.

During fiscal years 2012 and 2011, the State Treasurer and the borrowers maintained the right to terminate all securities lending transactions on demand. The cash collateral received on each loan was invested in repurchase agreements with approved counterparties collateralized with securities approved by the Deutsche Bank Group and marked to market daily at no less than 102%. Because the loans are terminable at will, their duration did not generally match the duration of the investments made with the cash collateral. The State Treasurer had no credit risk as a result of its securities lending program as the collateral held exceeded the fair value of the securities lent. The securities lending collateral invested in repurchase agreements and the fair value of securities on loan for the State Treasurer as of June 30, 2012 were \$4,556,511,251 and \$4,551,829,732, respectively. The securities lending collateral invested in repurchase agreements and the fair value of securities on loan for the State Treasurer as of June 30, 2011 were \$3,456,373,500 and \$3,446,138,880, respectively.

In accordance with GASB Statement No. 28, paragraph 9, the Office of the State Treasurer has allocated the assets and obligations at June 30, 2012 arising from securities lending agreements to the various funds of the State. The total allocated to the Teacher Health Insurance Security Fund at June 30, 2012 was \$11,325 thousand.

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June 30, 2012

K. Transfer of Administration of Funds to Other State Agency

Per the Governor's Executive Order 12-01, the Department's respective powers, duties, rights and responsibilities related to the Teacher Health Insurance Security program are transferred to the Department of Central Management Services as of July 1, 2012.

STATE OF ILLINOIS
DEPARTMENT OF HEALTHCARE AND FAMILY SERVICES
TEACHER HEALTH INSURANCE SECURITY FUND
REQUIRED SUPPLEMENTARY INFORMATION
SCHEDULE OF FUNDING PROGRESS
(amounts expressed in thousands)
(Unaudited)

Actuarial Valuation Date	Actuarial Value of Assets (a)	Actuarial Accrued Liability (AAL)-- Projected Unit (b)	Unfunded AAL (UAAL) (b-a)	Funded Ratio (a/b)	Covered Payroll (c)	UAAL as a Percentage of Covered Payroll ([(b-a)/c]
6/30/2007	\$ 65,790	\$ 14,284,678	\$ 14,218,888	0.46%	\$ 7,785,458	182.63%
6/30/2009	\$ 54,603	\$ 14,931,396	\$ 14,876,793	0.37%	\$ 8,428,359	176.51%
6/30/2011	\$ 7,125	\$ 18,860,375	\$ 18,853,250	0.04%	\$ 8,791,038	214.46%

STATE OF ILLINOIS
DEPARTMENT OF HEALTHCARE AND FAMILY SERVICES
TEACHER HEALTH INSURANCE SECURITY FUND
REQUIRED SUPPLEMENTARY INFORMATION
SCHEDULE OF CONTRIBUTIONS FROM EMPLOYERS
AND OTHER CONTRIBUTING ENTITIES
(amounts expressed in thousands)
(Unaudited)

Year Ended June 30	Annual Required Contribution	State Contributions	State Percentage Contributed	Employer's Contributions	Employer's Percentage Contributed	Medicare Part D Contributions	Medicare Part D Percentage Contributed
2008	\$ 1,059,415	\$ 68,596	6.47%	\$ 63,458	5.99%	\$ 19,930	1.88%
2009	\$ 1,145,505	\$ 75,474	6.59%	\$ 66,312	5.79%	\$ 22,285	1.95%
2010	\$ 1,197,052	\$ 79,007	6.60%	\$ 67,706	5.66%	\$ 23,897	2.00%
2011	\$ 1,540,322	\$ 85,953	5.58%	\$ 70,570	4.58%	\$ 23,422	1.52%
2012	\$ 1,609,637	\$ 87,622	5.44%	\$ 71,376	4.43%	\$ 24,911	1.55%

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OFFICE OF THE AUDITOR GENERAL
WILLIAM G. HOLLAND

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

We have audited the Teacher Health Insurance Security Fund of the State of Illinois, Department of Healthcare and Family Services, as of and for the year ended June 30, 2012, and have issued our report thereon dated March 29, 2013. 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

Management of the State of Illinois, Department of Healthcare and Family Services is responsible for establishing and maintaining effective internal control over financial reporting. In planning and performing our audit, we considered the State of Illinois, Department of Healthcare and Family Services' internal control over financial reporting of the Teacher Health Insurance Security Fund as a basis for designing our auditing procedures for the purpose of expressing our opinion on the financial statements, but not for the purpose of expressing an opinion on the effectiveness of the State of Illinois, Department of Healthcare and Family Services' internal control over financial reporting. Accordingly, we do not express an opinion on the effectiveness of the State of Illinois, Department of Healthcare and Family Services' internal control over financial reporting.

A *deficiency in internal control* exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent, or detect and correct misstatements on a timely basis. A *material weakness* is a deficiency, or a combination of deficiencies, in internal control such that there is a reasonable possibility that a material misstatement of the entity's financial statements will not be prevented, or detected and corrected on a timely basis.

Our consideration of internal control over financial reporting was for the limited purpose described in the first paragraph of this section and was not designed to identify all deficiencies in the internal control over financial reporting that might be deficiencies, 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. However, we identified certain deficiencies in internal control over financial reporting, described in the accompanying schedule of findings as item 12-1 that we consider to be a significant deficiency in internal control over financial reporting. A *significant deficiency* is a deficiency, or a combination of deficiencies, in internal control that is less severe than a material weakness, yet important enough to merit attention by those charged with governance.

Compliance and Other Matters

As part of obtaining reasonable assurance about whether the State of Illinois, Department of Healthcare and Family Services' Teacher Health Insurance Security 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 noted certain matters which we have reported to management of the State of Illinois, Department of Healthcare and Family Services in a separate letter dated March 29, 2013.

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



Bruce L. Bullard, CPA
Director of Financial and Compliance Audits

March 29, 2013

STATE OF ILLINOIS
DEPARTMENT OF HEALTHCARE AND FAMILY SERVICES
TEACHER HEALTH INSURANCE SECURITY FUND
SCHEDULE OF FINDINGS
For the Year Ended June 30, 2012

12-1. **FINDING** (Lack of written rate-setting methodology)

The Illinois Department of Healthcare and Family Services (Department) did not have a documented written rate-setting methodology to calculate the insurance rates that are used to determine the premium rates charged to participants for the Teachers' Retirement Insurance Program (TRIP).

We noted that only one individual was involved in calculating the insurance rates and there was no written rate-setting methodology of how this individual calculates the TRIP insurance rates. This individual left the agency near the end of the fiscal year and the Department did not have any other employees aware of how the previous individual calculated the rates. Additionally, there was no formal process for a documented review of the insurance rate calculation.

Further, auditors noted that the Department provided the Teachers' Retirement System of the State of Illinois by April 15th with historical and projected data on enrollment, utilization, and costs of TRIP information which is used to determine the amount of health care premiums charged to participants in TRIP; however, there was no rate-setting methodology provided explaining where the information was obtained from and how the information was used to determine the premium rates.

The State Employees Group Insurance Act of 1971 (5 ILCS 375/6.5(e)) requires the Director of the Department of Central Management Services to determine the insurance rates and premiums for Teachers' Retirement System benefit recipients and dependent beneficiaries, and present to the Teachers' Retirement System of the State of Illinois, by April 15th of each calendar year, the rate-setting methodology (including but not limited to utilization levels and costs) used to determine the amount of the health care premiums.

Executive Order 2005-3, *Executive Order to Reorganize Agencies by the Transfer of Certain Healthcare Procurement and Administrative Functions Primarily of the Department of Central Management Services to the Department of Healthcare and Family Services* issued by the Governor on April 1, 2005 transferred the respective powers, duties, rights and responsibilities related to State Healthcare Purchasing from various departments, including CMS, to the Department of Healthcare and Family Services. The Executive Order states the statutory powers, duties, rights and responsibilities of the various agencies, including CMS, derive from various statutes including 5 ILCS 375 *et seq.* The functions associated with State Healthcare Purchasing intended to be transferred included rate development.

Executive Order 2012-1, *Executive Order to Reorganize Agencies by the Transfer of Certain Functions of the Department of Healthcare and Family Services to the Department of Central Management Services, the Department of Corrections, the*

STATE OF ILLINOIS
DEPARTMENT OF HEALTHCARE AND FAMILY SERVICES
TEACHER HEALTH INSURANCE SECURITY FUND
SCHEDULE OF FINDINGS
For the Year Ended June 30, 2012

Department of Juvenile Justice, the Department of Human Services, and the Department of Veterans' Affairs issued by the Governor on March 1, 2012 transferred the respective powers, duties, rights and responsibilities related to State Healthcare Purchasing from the Department of Healthcare and Family Services back to various departments, including CMS. The departments had until September 30, 2012 to complete the transfer of functions.

Good internal controls would require that no one individual should control a key aspect of a transaction or event. The Statewide Accounting Management Systems Manual (Procedure 2.50.10) requires duties and responsibilities be assigned systematically to a number of individuals to ensure that effective checks and balances are in place and routinely practiced.

A formal written rate-setting methodology would provide clear procedures and specific documentation requirements for ensuring that insurance rates are being calculated consistently and the correct premium rates are being charged for TRIP.

Department management stated that the rate setting calculations are performed via formulas retained in electronic spreadsheets and staff resources were not available to convert the electronic methodology into written procedures. Executive Order 2012-01 transferred the Office of Healthcare Purchasing from HFS back to CMS effective July 1, 2012.

Without a formal written rate-setting methodology, the Department cannot ensure that the insurance rates are being calculated consistently and correct premium rates being charged for TRIP are in accordance with State statutory requirements. In addition, over reliance on one individual for the calculation of TRIP insurance rates without a proper written rate-setting methodology subjects the State to potential disruption in the event that there are changes to that individual's employment status. (Finding Code No. 12-1, 11-2, 10-1)

RECOMMENDATION

We recommend the Department develop a formal written rate-setting methodology as required by the State Employees Group Insurance Act and submit it to the Teachers' Retirement System.

DEPARTMENT RESPONSE

Executive Order 2012-01 transferred the Office of Healthcare Purchasing from HFS back to CMS effective July 1, 2012. The functions associated with State Healthcare Purchasing and the development of a formal written rate-setting methodology are now the responsibility of CMS.

STATE OF ILLINOIS
DEPARTMENT OF HEALTHCARE AND FAMILY SERVICES
TEACHER HEALTH INSURANCE SECURITY FUND
PRIOR FINDINGS NOT REPEATED
For the Year Ended June 30, 2012

A. **FINDING** (Financial statement preparation)

In the prior year, the Illinois Department of Healthcare and Family Services (Department) did not complete the Teacher Health Insurance Security Fund's financial statements in a timely manner. The Department did not provide a complete set of financial statements until January 17, 2012, six and a half months after the fiscal year end.

In the current year, the Department improved the process of financial reporting and completed the Teacher Health Insurance Security Fund's financial statements in a timely manner. (Finding Code No. 11-1)