

State of Illinois
Department of Employment Security

Individual Nonshared Governmental Funds
Individual Nonshared Proprietary Fund
Financial Audits
For the Year Ended June 30, 2008
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, 2008

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**State of Illinois
Department of Employment Security**

**Agency Officials
June 30, 2008**

Director	Mr. James P. Sledge
Previous to August 25, 2008	Ms. Maureen T. O'Donnell
August 25, 2008 to present	
Deputy Director, Administration	Ms. Elizabeth Nicholson
Previous to August 26, 2008	Ms. Theresa Larkin
September 22, 2008 to present	
Deputy Director, Operations	Ms. LaToya Price-Childs
Chief Financial Officer	Mr. Jon Gingrich
Chief Information Services Officer	Mr. Thomas Revane
Manager, Revenue Division	Ms. Lois Cuevas
Manager, Workforce Development	Ms. Virginia Long
General Counsel	Mr. Joseph P. Mueller
Manager, Accounting Services Division	Mr. L. Briant Coombs
Manager, Economic Information & Analysis Division	
Acting, prior to June 1, 2008	Mr. Mitch Daniels
June 1, 2008 to present	Dr. Evelina Tainer Loescher
Manager, General Services Division	Mr. John Rogers
Manager, Human Resources	Mr. Ken Santiago
Manager, Unemployment Insurance Division	Ms. Carolyn Vanek
Manager, Employment Services Division	Mr. Bennett Krause
Manager, Strategic Planning	
Previous to August 6, 2008	Ms. Georgina Heard-LaBonne
August 6, 2008 to present	Ms. Kisha Hart
Equal Opportunity Officer	Mr. Carlos Charneco

The Department's Administrative offices are located at:

33 South State Street
Chicago, IL 60603-2802

850 East Madison Street
Springfield, IL 62702-5603

**STATE OF ILLINOIS
DEPARTMENT OF EMPLOYMENT SECURITY**

Individual Nonshared Governmental Funds

Financial Statements

For the Year Ended June 30, 2008

**Performed as Special Assistant Auditors
for the Auditor General, State of Illinois**

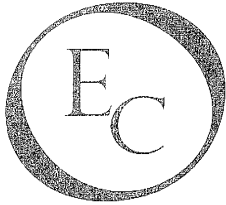
**State of Illinois
Department of Employment Security**

**Financial Statements
For the Year Ended June 30, 2008**

FINANCIAL STATEMENT REPORT SUMMARY

The audit of the accompanying individual nonshared governmental fund financial statements of the State of Illinois, Department of Employment Security (Department) was performed by E. C. Ortiz & Co., LLP.

Based on their audits, the auditors expressed unqualified opinions on the Department's individual nonshared governmental fund financial statements.



E.C. ORTIZ & CO., LLP
CERTIFIED PUBLIC ACCOUNTANTS

INDEPENDENT AUDITORS' 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, 2008, 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 Department as of June 30, 2008, 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, 2008, 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 30, 2009 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 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.

E. C. Ortiz + Co., LLP

Chicago, Illinois
March 30, 2009

State of Illinois
Department of Employment Security

Individual Nonshared Governmental Funds
Balance Sheets
June 30, 2008
(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	\$ 12,665	\$ 12,569	\$ -
Intergovernmental receivables	16,443	-	1,430
Other receivables	22	21	-
Due from other State funds	90	4,318	-
Inventories	1,015	-	-
Total assets	\$ 30,235	\$ 16,908	\$ 1,430
Liabilities and Fund Balances			
Liabilities:			
Accounts payable and accrued liabilities	\$ 6,317	\$ 272	\$ 1,430
Intergovernmental payables	300	-	-
Due to other State funds	5,962	-	-
Total liabilities	12,579	272	1,430
Fund Balances:			
Reserved for inventories	1,015	-	-
Reserved for encumbrances	2	-	-
Unreserved - undesignated	16,639	16,636	-
Total fund balances	17,656	16,636	-
Total liabilities and fund balances	\$ 30,235	\$ 16,908	\$ 1,430

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, 2008
 (Amounts in \$000's)

	Title III Social Security and Employment Services Fund	Unemployment Compensation Special Administration Fund	Special Programs Fund
Revenues			
Federal government	\$ 177,692	\$ -	\$ 40,061
Other revenues	1,913	-	
Licenses and fees	12	-	-
Interest and investment income	575	451	-
Total revenues	<u>180,192</u>	<u>451</u>	<u>40,061</u>
Expenditures			
Employment and economic development	192,740	2,235	40,061
Capital outlays	58	-	-
Total expenditures	<u>192,798</u>	<u>2,235</u>	<u>40,061</u>
Deficiency of revenues over (under) expenditures	<u>(12,606)</u>	<u>(1,784)</u>	<u>-</u>
Other financing sources (uses)			
Transfers in	10,015	15,400	-
Transfers out	-	(11,549)	-
Total other financing sources (uses)	<u>10,015</u>	<u>3,851</u>	<u>-</u>
Net changes in fund balances	(2,591)	2,067	-
Fund balances, July 1, 2007	<u>20,247</u>	<u>14,569</u>	<u>-</u>
Fund balances, June 30, 2008	<u>\$ 17,656</u>	<u>\$ 16,636</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, 2008
(Amounts in \$000's)

1. **Description of Funds**

The State of Illinois, Department of Employment Security (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.
- (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 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, 2008
(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 either 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 Program Funds administered by the Department and do not purport to, and do not, present fairly the financial position of the Department as of June 30, 2008, 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 balance have been presented for each individual nonshared governmental fund administered by the Department.

Each of the nonshared governmental funds is a special revenue fund. 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.

State of Illinois
Department of Employment Security

Individual Nonshared Governmental Funds
Notes to Financial Statements
June 30, 2008
(Amounts in \$000's)

2. Summary of Significant Accounting Policies, continued

(b) Basis of Presentation, continued

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.

(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.

State of Illinois
Department of Employment Security

Individual Nonshared Governmental Funds
Notes to Financial Statements
June 30, 2008
(Amounts in \$000's)

2. Summary of Significant Accounting Policies, continued

(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, 2008.

(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.

(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.

State of Illinois
Department of Employment Security

Individual Nonshared Governmental Funds
Notes to Financial Statements
June 30, 2008
(Amounts in \$000's)

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.

Deposits in the custody of the State Treasurer (or in transit) and cash on hand at June 30, 2008, were as follows:

Fund	Deposits in Custody of State Treasurer	Cash On Hand
Title III Social Security and Employment Services	\$ 12,660	\$ 5
Unemployment Compensation Special Administration	12,569	-
	\$ 25,229	\$ 5

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, 2008
 (Amounts in \$000's)

4. Interfund Balances and Activities

(a) Balances Due to/from Other Funds

The following balances at June 30, 2008 represent amounts due from other Department and State of Illinois funds.

Fund	Amount	Description/Purpose
Title III Social Security and Employment Services	\$ 7	Due from Unemployment Compensation Trust Fund representing discretionary transfers of NSF fees
	6	Due from IL 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
	72	Due from Department of Commerce and Economic Opportunities.
Total	<u>\$ 90</u>	
Unemployment Compensation Special Administration	\$ 4,318	Due from Unemployment Compensation Trust Fund representing transfers of penalties and interest
Total	<u>\$ 4,318</u>	

State of Illinois
 Department of Employment Security

Individual Nonshared Governmental Funds
 Notes to Financial Statements
 June 30, 2008
 (Amounts in \$000's)

4. Interfund Balances and Activities, continued

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

The following balances at June 30, 2008 represent amounts due to other Department and State of Illinois funds.

Fund	Amount	Description/Purpose
Title III Social Security and Employment Services	\$ 21	Due to Unemployment Compensation Trust Fund for reimbursement of unemployment benefits paid to former employees of the Department
	5,941	Due to other State funds for payment of services
Total	<u>\$ 5,962</u>	

(b) Transfers to/from Other Funds

Interfund transfers in for the year ended June 30, 2008, 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.
	15	Discretionary transfer of NSF fees from Unemployment Compensation Trust Fund.
Total	<u>\$ 10,015</u>	
Unemployment Compensation Special Administration	\$ 15,400	Discretionary transfer of penalties and interest from Unemployment Compensation Trust Fund
Total	<u>\$ 15,400</u>	

State of Illinois
 Department of Employment Security

Individual Nonshared Governmental Funds
 Notes to Financial Statements
 June 30, 2008
 (Amounts in \$000's)

4. Interfund Balances and Activities, continued

(b) Transfers to/from Other Funds, continued

Interfund transfers out for the year ended June 30, 2008, were as follows:

Fund	Amount	Description/Purpose
Unemployment Compensation Special Administration	\$ 10,000	Discretionary transfer of funds to Title III Social Security and Employment Services Fund
	1,549	Mandatory transfer to reimburse Unemployment Trust fund for TRA Settlement Funding.
Total	<u>\$ 11,549</u>	

5. 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 2008 are included in the State of Illinois' Comprehensive Annual Financial Report (CAFR) for the year ended June 30, 2008. 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 2008, the employer contribution rate was 16.561%.

State of Illinois
Department of Employment Security

Individual Nonshared Governmental Funds
Notes to Financial Statements
June 30, 2008
(Amounts in \$000's)

6. 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 Employee's 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.

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 expenditure 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.

7. 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, 2008.

**State of Illinois
Department of Employment Security**

**Individual Nonshared Governmental Funds
Notes to Financial Statements
June 30, 2008
(Amounts in \$000's)**

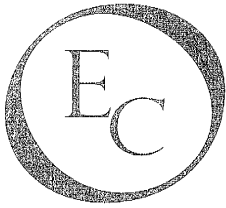
8. Commitments and Contingencies

(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, 2008, 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 position or results of operations of the Department.



E.C. ORTIZ & CO., LLP
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 financial statements of 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, 2008, and have issued our report thereon dated March 30, 2009. We conducted our audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States.

Internal Control Over Financial Reporting

In planning and performing our audit, we considered the Department's internal control over financial reporting of the Nonshared Governmental Funds 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*.

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.

E. C. Outley & Co., LLP

Chicago, Illinois
March 30, 2009

**STATE OF ILLINOIS
DEPARTMENT OF EMPLOYMENT SECURITY**

Individual Nonshared Proprietary Fund

Financial Statements

For the Year Ended June 30, 2008

**Performed as Special Assistant Auditors
For the Auditor General, State of Illinois**

**State of Illinois
Department of Employment Security**

**Financial Statement
For the Year Ended June 30, 2008**

FINANCIAL STATEMENT REPORT SUMMARY

The audit of the accompanying individual nonshared proprietary fund financial statements of the State of Illinois, Department of Employment Security (Department) was performed by E. C. Ortiz & Co., 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 matters involving the Department's internal control over financial reporting that they considered to be significant deficiencies. The significant deficiencies are described in the accompanying Schedule of Findings on pages 36-39 of this report, as finding 08-1 (*Inaccurate Balance of Allowance for Uncollectible Accounts*) and 08-2 (*Inadequate Controls Over Computer Security*). The auditors also consider finding 08-1 to be a material weakness.

EXIT CONFERENCE

The findings and recommendations appearing in this report were discussed with Department personnel at an exit conference on January 8, 2009. Attending were:

Illinois Department of Employment Security

Jon Gingrich, Chief Financial Officer
Linda DeMore, Manager Accounting and Reporting
Briant Coombs, Manager Accounting Services Division
Tom Revane, Chief Information Officer
Kathy Harlan, Audit Liaison

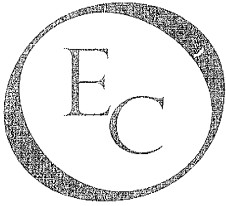
E. C. Ortiz & Co., LLP

Edilberto Ortiz, Partner
Jennifer Santos, Partner
Annabelle Abueg, I/S Manager

Office of the Auditor General

Jon Fox, Audit Manager

The responses to the recommendations were provided by Kathy Harlan, Audit Liaison in a letter dated January 21, 2009.



E.C. ORTIZ & CO., LLP
CERTIFIED PUBLIC ACCOUNTANTS

INDEPENDENT AUDITORS' 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 of the State of Illinois, Department of Employment Security (Department), as of and for the year ended June 30, 2008, as listed in the table of contents. These financial statements are the responsibility of the 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 Department as of June 30, 2008, 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 Department, as of June 30, 2008, and the changes in financial position and cash flows thereof for the year then ended in conformity with accounting principles generally accepted in the United States of America.

In accordance with *Government Auditing Standards*, we have also issued a report dated March 30, 2009 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.

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.

E. C. Ortiz & Co., LLP

Chicago, Illinois
March 30, 2009

State of Illinois
Department of Employment Security

Individual Nonshared Proprietary Fund

Statement of Net Assets

June 30, 2008

(Amounts in \$000's)

	Unemployment Compensation Trust Fund
Current Assets	
Cash and cash equivalents	\$ 449
Deposits held by federal government	1,906,219
Receivables, net:	
Taxes	432,901
Intergovernmental	30,886
Other	123,446
Due from State funds	4,645
Due from component units of the State of Illinois	173
	<hr/>
Total current assets	2,498,719
Current Liabilities	
Benefit payments payable	96,813
Intergovernmental payables	6,423
Due to other State funds	4,325
	<hr/>
Total current liabilities	107,561
Net Assets	
Restricted for:	
Unemployment compensation benefits	2,391,158
Unrestricted	-
	<hr/>
Total net assets	<u>\$ 2,391,158</u>

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, 2008
(Amounts in \$000's)

	Unemployment Compensation Trust Fund
Operating revenues	
Contributions - Unemployment taxes	\$ 1,971,147
Federal government	26,992
Total operating revenues	<u>1,998,139</u>
Operating expenses	
Benefit payments and refunds	<u>1,991,147</u>
Operating income	<u>6,992</u>
Nonoperating revenues (expenses)	
Interest and investment income	88,650
Total nonoperating revenues (expenses)	<u>88,650</u>
Income before transfers	95,642
Transfers in	1,549
Transfers out	<u>(15,415)</u>
Increase in net assets	81,776
Net assets, July 1, 2007	2,277,744
Prior period adjustment	<u>31,638</u>
Net assets, June 30, 2008	<u><u>\$ 2,391,158</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, 2008
 (Amounts in \$000's)

	Unemployment Compensation Trust Fund
Cash flows from operating activities	
Contributions - Unemployment taxes received	\$ 2,045,930
Federal grants received	26,992
Unemployment benefits paid	(2,009,206)
Net cash provided by operating activities	<u>63,716</u>
Cash flows from noncapital financing activities	
Transfers in	1,549
Transfers out	(15,270)
Net cash (used in) noncapital financing activities	<u>(13,721)</u>
Cash flows from investing activities	
Interest and investment income	88,756
Net cash provided by investing activities	<u>88,756</u>
Net increase in cash and cash equivalents	138,751
Cash and cash equivalents, July 1, 2007	<u>1,767,917</u>
Cash and cash equivalents, June 30, 2008	<u>\$ 1,906,668</u>
 <i>Reconciliation of cash and cash equivalents to the Statement of Net Assets</i>	
Total cash and cash equivalents per Statement of Net Assets	\$ 449
Add: Deposits held by federal government	1,906,219
Cash and cash equivalents, June 30, 2008	<u>\$ 1,906,668</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, 2008
 (Amounts in \$000's)

	Unemployment Compensation Trust Fund
	<u> </u>
Reconciliation of operating income to net cash provided by operating activities	
Operating income	\$ 6,992
Adjustments to reconcile operating income to net cash provided by operating activities:	
Provision for uncollectible accounts	(23,058)
Changes in assets and liabilities	
Receivables	65,874
Intergovernmental receivables	(1,912)
Due from other funds	(735)
Due from component units	(18)
Benefit payments payable	14,867
Intergovernmental payables	<u>1,706</u>
Net cash provided by operating activities	<u><u>\$ 63,716</u></u>

See Notes to Financial Statements.

**State of Illinois
Department of Employment Security**

**Individual Nonshared Proprietary Fund
Notes to Financial Statements
June 30, 2008
(Amounts in \$000's)**

1. Description of Funds

The State of Illinois, Department of Employment Security (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.

2. Summary of Significant Accounting Policies

The financial statements of the individual nonshared proprietary fund has 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.

Based upon the required criteria, the individual nonshared proprietary fund does not have component units, nor is 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 Department and do not purport to, and do not, present fairly the financial position of the Department as of June 30, 2008, 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.

State of Illinois
Department of Employment Security

Individual Nonshared Proprietary Fund
Notes to Financial Statements
June 30, 2008
(Amounts in \$000's)

2. Summary of Significant Accounting Policies, continued

(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 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.

State of Illinois
Department of Employment Security

Individual Nonshared Proprietary Fund
Notes to Financial Statements
June 30, 2008
(Amounts in \$000's)

2. Summary of Significant Accounting Policies, continued

(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 followed in the individual nonshared proprietary funds 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 funds, 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) 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.

State of Illinois
Department of Employment Security

Individual Nonshared Proprietary Fund
Notes to Financial Statements
June 30, 2008
(Amounts in \$000's)

2. Summary of Significant Accounting Policies, continued

(f) Net Assets

Net assets consist of the following:

Restricted net assets, totaling \$2,391,158 as of June 30, 2008, 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.

(g) 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

Cash and cash equivalents as of June 30, 2008 have a carrying amount in the accompanying financial statements of \$449.

At June 30, 2008, cash on deposit for the Unemployment Compensation Trust Fund (UTF) for locally held funds has a carrying amount of \$856 and the bank balance was \$856. Of the bank balance, \$100 was insured through the Federal Depository Insurance Corporation (FDIC). The remaining \$756 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 \$18,507 and have a carrying amount of \$(407) at June 30, 2008.

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 categorized 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.

State of Illinois
Department of Employment Security

Individual Nonshared Proprietary Fund
Notes to Financial Statements
June 30, 2008
(Amounts in \$000's)

Deposits held by federal government totaled \$1,906,219 at June 30, 2008. 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.

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, 2008, are as follows:

Taxes receivable:

Unemployment taxes	\$ 495,478
Interest and penalties receivable on taxes	44,067
	<hr/>
Total taxes receivable	539,545
Less: allowance for uncollectible taxes	(106,644)
	<hr/>
Taxes receivable, net	<u>\$ 432,901</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 \$30,886 as of June 30, 2008.

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 on a 4 year collection cycle.

Balances as of June 30, 2008 are as follows:

Other receivables	\$ 328,523
Less: allowance for uncollectible accounts	(205,077)
	<hr/>
Other receivables, net	<u>\$ 123,446</u>

State of Illinois
 Department of Employment Security

Individual Nonshared Proprietary Fund
 Notes to Financial Statements
 June 30, 2008
 (Amounts in \$000's)

7. Interfund Balances and Activities

(a) Balances Due to/from Other Funds

The following balances at June 30, 2008 represent amounts due from other Department and State of Illinois funds.

Fund	Amount	Description/Purpose
Unemployment Compensation Trust Fund	\$ 4,278	Due from General Revenue Fund for reimbursement of unemployment benefits paid to employees of other State agencies
	346	Due from Road Fund for reimbursement of unemployment benefits paid to former employees of the Illinois Department of Transportation
	21	Due from Title III Social Security and Employment Service Fund for the reimbursement of unemployment benefits to former employees of the Department
Total	<u>\$ 4,645</u>	

Due from component units of the State of Illinois of which \$173 represents reimbursement of unemployment benefits paid to employees of State universities.

State of Illinois
 Department of Employment Security

Individual Nonshared Proprietary Fund
 Notes to Financial Statements
 June 30, 2008
 (Amounts in \$000's)

7. Interfund Balances and Activities, continued

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

The following balances at June 30, 2008 represent amounts due to other Department and State of Illinois funds.

Fund	Amount	Description/Purpose
Unemployment Compensation Trust Fund	\$ 7	Due to Title III Social Security and Employment Services Fund for discretionary transfers of NSF fees
	4,318	Due to Unemployment Compensation Special Administration Fund for discretionary transfers of penalties and interests
Total	<u>\$ 4,325</u>	

(b) Transfers to/from Other funds

Interfund transfers in for the year ended June 30, 2008, were as follows:

Fund	Amount	Description/Purpose
Unemployment Compensation Trust Fund	<u>\$ 1,549</u>	Transfer from Unemployment Compensation Special Administration Fund for reimbursement of TRA settlement.

State of Illinois
 Department of Employment Security

Individual Nonshared Proprietary Fund
 Notes to Financial Statements
 June 30, 2008
 (Amounts in \$000's)

7. Interfund Balances and Activities, continued

(b) Transfers to/from Other funds, continued

Interfund transfers out for the year ended June 30, 2008, were as follows:

Fund	Amount	Description/Purpose
Unemployment Compensation Trust Fund	\$ 15,400	Discretionary transfers of penalties and interests to Unemployment Compensation Special Administration Fund
	15	Discretionary transfers of NSF fees to Title III Social Security and Employment Services Fund
Total	<u>\$ 15,415</u>	

8. Intergovernmental Payables

Intergovernmental payables of \$6,423 represent interstate combined wage claim benefits payable.

9. Contingencies

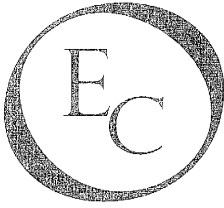
While the Department is involved in various claims and legal actions arising in the ordinary course of business, it is the opinion of management that the ultimate disposition of these matters will not have a material effect on the individual nonshared proprietary funds financial statements.

10. Prior Period Adjustment

For fiscal year 2008, the Department recorded a prior period adjustment increasing net assets by \$31,638 as of June 30, 2007 to reflect a correction of an error in the financial statements of fiscal year 2007. The methodology utilized by the Department to calculate its allowance of uncollectible taxes and, penalties and interest on taxes (P&I) receivable did not correlate with its known history of collecting these types of receivables but instead was based on the unrelated percentage of the year-end balance over the total of prior year's balance and current year's additions to receivables.

Based on a recalculation considering the historical collection percentage of new and delinquent receivables and forecasts of changes in the annual unemployment rate for the U.S. economy, it was determined that the allowance for taxes receivable should be \$83,332 as of June 30, 2007, resulting in an overstatement of the allowance for taxes receivable and an understatement of restricted net assets of \$31,638 as of June 30, 2007.

The cash and cash equivalents, July 1, 2007 balance in the cash flow statement was reclassified to conform to the fiscal year 2008 presentation.



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 financial statements of Unemployment Compensation Trust Fund of the State of Illinois, Department of Employment Security (Department), as of and for the year ended June 30, 2008, and have issued our report thereon dated March 30, 2009. We conducted our audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States.

Internal Control Over Financial Reporting

In planning and performing our audit, we considered the Department's internal control over financial reporting of the Unemployment Compensation Trust 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 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.

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 deficiencies described in the accompanying schedule of findings to be significant deficiencies in internal control over financial reporting (08-1 and 08-2).

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, of the significant deficiencies described above, we consider finding 08-1 to be a material weakness.

Compliance and Other Matters

As part of obtaining reasonable assurance about whether the Department's Unemployment Compensation Trust 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 also noted a certain matter which we have reported to Department management in a separate letter dated March 30, 2009.

The Department's responses to the findings identified in our audit are described in the accompanying schedule of findings. We did not audit the Department's responses and, accordingly, we express no opinion on them.

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.

E. C. Kutiz & Co., LLP

Chicago, Illinois
March 30, 2009

State of Illinois
Department of Employment Security

Schedule of Findings
For the Year Ended June 30, 2008

Current Findings – Government Auditing Standards

08-1 Inaccurate Balance of Allowance for Uncollectible Accounts

The Department of Employment Security (Department) overstated its allowance for uncollectible taxes receivable by \$24.2 million.

The Department establishes an allowance for uncollectible accounts for three types of receivables: taxes, penalties and interest on taxes (P&I), and other receivables resulting from claims overpayments.

As of June 30, 2008 the Department had taxes receivable of \$495,478,000 and P&I receivable of \$44,067,000. In our audit of the Department's allowance for taxes and P&I receivable we noted that the methodology utilized by the Department to calculate its allowance of uncollectible taxes and P&I receivable did not correlate with its known history of collecting these types of receivables but instead was based on the unrelated percentage of the year-end balance over the total of prior year's balance and current year's additions to receivables.

Based on a recalculation considering the historical collection percentage of new and delinquent receivables, it was determined that the allowance for taxes receivable should be \$106,644,000, resulting in a prior period overstatement of the allowance for taxes receivable recorded of \$31,638,000 and a current period understatement of \$7,459,000. The financial statements and disclosures have been corrected.

As of June 30, 2008, other receivables amounted to \$328,523,000 and the allowance for other receivables at year-end was \$205,077,000. During our audit, we noted that the Department incorrectly added the total of unapplied claimant receipts and unapplied recoupments instead of deducting this amount in determining the balance of other receivables for calculating the allowance for uncollectible other receivables. In addition, the base amount for estimating the uncollectible percentage was not updated to reflect recent changes in overpayment statistics. These two errors resulted to an overstatement of the allowance for uncollectible other receivables of \$473,000. This error was not material to the financial statements for fiscal year 2008 and no adjustment was made to the financial statements.

According to generally accepted accounting principles (GAAP), the allowance for uncollectible accounts should represent management's best estimate of the amount of gross receivables that will not be collected. The allowance for uncollectible accounts is a significant estimate that requires a proper analysis and evaluation of available balances, historical statistics, and forecasts of changes in the annual unemployment rate for the U.S. economy. The Fiscal Control and Internal Auditing Act (30 ILCS 10/3001) requires all State agencies to establish and maintain a system, or systems, of internal fiscal and administrative controls.

According to the Department, the allowance for taxes and P&I receivable have been estimated consistently over the previous years. The Department reviews the allowance for taxes and P&I for reasonableness and over the years, there was no significant difference on the estimated amount applying the current method and the detailed analysis of the historical statistics. The report used in the calculation of the allowance for other receivables was prepared by a new staff person. In addition, the supervisor reviewing the report was also new to this process resulting in the errors in calculating the allowance for other receivables noted above.

State of Illinois
Department of Employment Security

Schedule of Findings
For the Year Ended June 30, 2008

Current Findings – *Government Auditing Standards*, continued

08-1 Inaccurate Balance of Allowance for Uncollectible Accounts, continued

Using incorrect or overly conservative estimation methodologies and base data to determine the estimated allowance for uncollectible accounts could result in a material misstatement to the financial statements. (Finding Code No. 08-1)

Recommendation

We recommend the Department evaluate its process and improve its controls over calculating the allowance for uncollectible accounts.

Department Response

We accept the recommendation. The spreadsheet has been updated with the new calculation of the estimated allowance for uncollectible unemployment insurance Taxes and P&I using agency historical data and forecasts of changes in the annual unemployment rate for the U.S. economy as published by Global Insight. The preparer and the supervisor are trained on the new estimation process. In addition, the spreadsheet errors noted in the calculation of the allowance for other receivables will be corrected in next year's worksheet.

Current Findings – Government Auditing Standards, continued

08-2 Inadequate Controls Over Computer Security

The Department of Employment Security (Department) did not properly restrict the use of Super ID access to its information systems.

The Department's Information Services Bureau (ISB) was responsible for the development and maintenance of the Department's information systems and for preserving the integrity and security of information warehoused within those systems. The Department processed over \$2 billion in employer unemployment tax revenue and unemployment benefit payments in fiscal year 2008.

A Super ID is a user ID that gives the user full access to all files, programs, tables and databases in all environments (Development, Test and Production). The Department had issued five Super IDs. Four Super IDs were assigned to the Applications Manager who supports the Human Resources, Finance, and the Revenue systems, and one Super ID was assigned to the Applications Manager who supports the Benefits system.

Department policy stated that the use of the Super ID should normally be limited to the resolution of production problems when Production Control Unit staff are either non-scheduled or unavailable. The correction of transactional-related errors should be the responsibility of the functional user and not the ISB.

During our financial audit we discovered that the ISB programmers were sharing and using Super IDs almost on a daily basis on a non-emergency basis in the Production environment for resolving transactional or application-related problems that occurred during the regular day or at night's batch processing. Since the Super IDs were shared, individual accountability over use was limited. In addition, the use of Super ID to resolve transactional or application-related problems bypassed normal application specific controls and audit trails.

Internal controls over the use of Super ID's included the assignment of a corresponding password. The Super ID password expired after 35 days and limits on the reuse of passwords were implemented. An additional internal control over Super ID's was that the system logs the use of the Super ID. The log was reviewed by the Support Services Division Manager who checked that each session logged was supported by an ISB Super TSOID Approval Form that documents the use and approval of the Super ID. We tested the weekly sessions log for the period beginning on June 9, 2008 through July 6, 2008 and noted that an ISB Super TSOID Approval Form was properly completed for all 53 uses of the Super ID noted in the system log during that period.

The Fiscal Control and Internal Auditing Act (30 ILCS 10/3001) requires all State agencies to establish and maintain a system, or systems, of internal fiscal and administrative controls. In addition, generally accepted information technology guidance endorses the development of well-designed and well-managed controls to protect computer systems and data. Effective computer security controls provide for safeguarding, securing, and controlling access to hardware, software, and the information stored in the computer system.

State of Illinois
Department of Employment Security

Schedule of Findings
For the Year Ended June 30, 2008

Current Findings – Government Auditing Standards, continued

08-2 Inadequate Controls Over Computer Security, continued

According to the Department, staffing resources are often not available to follow the normal process for fixing data errors, particularly errors occurring when converting benefit transactions in the Benefit Information System (BIS) to benefit charges in Benefit Charging System (BCS). The use of Super ID's is the most expeditious method for ensuring that benefit transactions are processed correctly in BIS. Correcting such errors is critical as benefit charges are a key component of employer tax rate calculations.

The frequent use of the Super IDs increases the risk of unauthorized access to the data, tables, files or programs of the Department and could jeopardize the integrity of the Department's data and programs. (Finding Code No. 08-2)

Recommendation

We recommend the Department allocate the resources necessary to allow production staff to correct day-to-day transactional and applications related information system's problems without compromising the security of those systems by over utilizing Super ID access rights. Further we recommend that the use of the Super ID access rights be restricted to emergency uses as required by Department policy.

Department Response

We accept the recommendation. The Department will seek additional Information Services resources, subject to budget constraints, to correct non-emergency production problems without using Super ID's.

**State of Illinois
Department of Employment Security**

**Prior Finding Not Repeated
For the Year Ended June 30, 2008**

A. Failure to Review Computerized Information Systems of Third Party Bank Trustee

The Department did not obtain an independent internal control review of the 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. (Finding Code No. 07-1)

The current period testing disclosed that the Department obtained and reviewed the SAS70 reports from the third party bank trustee processing cash receipts and other data for the Department.

Status: Implemented