STATE OF ILLINOIS
OFFICE OF THE
AUDITOR GENERAL
Frank J. Mautino, Auditor General

SUMMARY REPORT DIGEST

ILLINOIS FINANCE AUTHORITY

State Compliance Examination
For the Two Years Ended June 30, 2015

Release Date: February 18, 2016

FINDINGS THIS AUDIT: 8

	New	Repeat	Total
Category 1:	**2**	**1**	**3**
Category 2:	**0**	**5**	**5**
Category 3:	**0**	**0**	**0**
TOTAL	**2**	**6**	**8**

FINDINGS LAST AUDIT: 11

AGING SCHEDULE OF REPEATED FINDINGS

Repeated Since	Category 1	Category 2	Category 3
2013		15-2, 15-5	
2012	15-4	15-8	
2010		15-6, 15-7	

INTRODUCTION

This digest covers the Authority's compliance examination for the two years ended June 30, 2015. A separate financial audit as of and for the year ended June 30, 2015, was previously released on January 28, 2016. In total, this report contains eight findings, two of which were reported within the Authority's financial audit.

SYNOPSIS

- (**15-3**) The Authority did not comply with statutory provisions regarding the use of assets within the Authority's Fire Truck Revolving Loan Fund.
- (**15-4**) The Authority's internal controls to properly maintain records for monitoring covenant compliance for conduit bonds were inadequate.
- (**15-5**) The Authority failed to adhere to the internal auditing provisions of the Fiscal Control and Internal Auditing Act.
- (**15-6**) The Authority did not timely and accurately submit transaction reporting for bond principal and interest payments to the Office of the State Comptroller.

Category 1: Findings that are **material weaknesses** in internal control and/or a **qualification** on compliance with State laws and regulations (material noncompliance).

Category 2: Findings that are **significant deficiencies** in internal control and **noncompliance** with State laws and regulations.

Category 3: Findings that have **no internal control issues but are in noncompliance** with State laws and regulations.

{Financial information and Activity Measures are summarized on next page.}

ILLINOIS FINANCE AUTHORITY
COMPLIANCE EXAMINATION
For the Two Years Ended June 30, 2015

FINANCIAL INFORMATION		2015		2014		2013
Total Revenues..	**$**	**9,321,642**	**$**	**37,584,262**	**$**	**16,188,389**
Interest on loans..	$	5,183,052	$	5,944,227	$	8,072,295
% of Total Revenues......................................		55.6%		15.8%		49.9%
Interest and investment income.........................	$	642,885	$	2,208,826	$	2,523,475
% of Total Revenues......................................		6.9%		5.9%		15.6%
Closing and administrative service fees.............	$	2,491,601	$	2,756,871	$	3,850,963
% of Total Revenues......................................		26.7%		7.3%		23.8%
Transfer of funds and interest in program from the State of Illinois..	$	447,531	$	25,806,282	$	-
% of Total Revenues......................................		4.8%		68.7%		0.0%
Other revenues..	$	556,573	$	868,056	$	1,741,656
% of Total Revenues......................................		6.0%		2.3%		10.7%
Total Expenses..	**$**	**8,999,409**	**$**	**16,132,306**	**$**	**13,746,890**
Interest expense...	$	4,279,926	$	7,820,635	$	9,921,160
% of Total Expenses......................................		47.6%		48.5%		72.2%
Employee-related expenses...............................	$	1,702,215	$	1,711,969	$	1,789,531
% of Total Expenses......................................		18.9%		10.6%		13.0%
Professional services...	$	1,539,522	$	1,657,771	$	1,349,958
% of Total Expenses......................................		17.1%		10.3%		9.8%
Occupancy costs..	$	271,431	$	316,080	$	319,386
% of Total Expenses......................................		3.0%		2.0%		2.3%
Other expenses..	$	1,206,315	$	4,625,851	$	366,855
% of Total Expenses......................................		13.4%		28.6%		2.7%
Average Number of Employees (Unaudited)....		**17**		**18**		**20**

SELECTED ACTIVITY MEASURES (UNAUDITED)		2015		2014		2013
Conduit debt outstanding (in thousands)............	$	23,058,826	$	23,652,499	$	24,570,012
Number of conduit debt issues outstanding........		1,328		1,405		1,484
New bond issues (in thousands)..........................	$	2,511,315	$	1,953,962	$	2,256,325
Number of new issues		30		34		45
Total expenses/total number of issues...............	$	6,777	$	11,482	$	9,303

EXECUTIVE DIRECTOR
During Examination Period: Mr. Christopher Meister
Currently: Mr. Christopher Meister

FINDINGS, CONCLUSIONS, AND RECOMMENDATIONS

NEED TO LIMIT THE AUTHORITY'S USAGE OF RESOURCES TO RESTRICTIONS IMPOSED BY STATE LAW

The Illinois Finance Authority (Authority) did not comply with statutory provisions regarding the use of assets within the Authority's Fire Truck Revolving Loan Fund (Authority's Fund).

$8 million appropriation from the Fire Prevention Fund for deposit into the State Treasury's Fire Truck Revolving Loan Fund

During testing, the auditors noted the following timeline regarding the $8 million Fiscal Year 2015 appropriation the Office of the State Fire Marshal (Fire Marshal) received to deposit moneys from the Fire Prevention Fund into the State Treasury's Fire Truck Revolving Loan Fund (State Treasury's Fund).

$8 million expended by the Fire Prevention Fund and deposited into the State Treasury's Fire Truck Revolving Loan Fund

$8 million expended by the State Treasury's Fire Truck Revolving Loan Fund

A continuing appropriation requires cash deposits in the State Treasury's Fire Truck Revolving Loan Fund be sent to the Authority's Fire Truck Revolving Loan Fund

07-01-14	Public Act 098-0681 appropriated $8 million from the Fire Prevention Fund to the Fire Marshal for deposit into the State Treasury's Fund.
12-04-14	The State Comptroller processed a voucher submitted by the Fire Marshal to completely expend the entire $8 million appropriation from the Fire Prevention Fund. The $8 million was deposited into the State Treasury's Fund.
01-12-15	The State Comptroller processed a voucher submitted by the Fire Marshal to expend the entire $8 million now on deposit in the State Treasury's Fund to the Authority's Fund. To process this transaction, the Fire Marshal charged this expenditure against the continuing appropriation authorized by the Illinois Finance Authority Act to distribute the amount, if any, of cash received into the State Treasury's Fund to the Authority's Fund so long as the Fire Marshal and Authority entered into an interagency agreement that the moneys distributed would be used "for loans to fire departments and fire protection districts to purchase fire trucks and brush trucks and for no other purpose."
01-12-15	The Governor signed Executive Order 2015-08 requiring the Governor's Office of Management and Budget to review all grants requiring the expenditure of State funds to determine whether the grant is essential to operations.
01-15-15	The Authority received the $8 million warrant from the State Treasury's Fund for deposit into the Authority's Fund.

$8 million is in the Authority's Fire Truck Revolving Loan Fund	01-20-15	The Authority deposited the $8 million warrant into the Authority's Fund.
Fire Marshal requests the Authority return the $8 million	01-26-15	The Governor's Office of Management and Budget finished its review of the Fire Marshal's grants and determined the Fire Truck Revolving Loan Program was not essential. The Fire Marshal sent the Authority a letter requesting the Authority return the $8 million.
	01-27-15	An official with the Governor's Office of Management and Budget e-mailed the Authority's Executive Director stating the $8 million "will not (be) available for use by the Illinois Finance Authority. Please contact me with any concerns, as I understand there may be audit issues."
Authority's Executive Director notes a "legal obstacle" to returning the $8 million	02-20-15	The Authority's Executive Director sent an e-mail to officials with the Fire Marshal and Governor's offices indicating a "legal obstacle" to returning the $8 million.
	03-26-15	Public Act 099-0002 authorizes a transfer of $23 million from the Fire Prevention Fund into the General Revenue Fund by the conclusion of Fiscal Year 2015.
Governor's Office official requests the Authority return the $8 million to the Fire Marshal	04-17-15	An official with the Governor's office sent an e-mail to the Authority's Executive Director that the Governor's legal team has reviewed the transaction and requested compliance with the letter from the Fire Marshal to the Authority dated January 26, 2015.
Authority's Executive Director notes "potential for audit or legal exposure" by returning the cash **Authority returns the $8 million to the Fire Marshal**	04-21-15	The Authority's Executive Director, after briefing both the Authority's Chair of the Board of Directors and the Audit Committee Chair about the "potential for audit or legal exposure to the Authority by complying with this request," directs the Authority's Chief Financial Officer to return the $8 million to the Fire Marshal. The Authority authorizes the return of the $8 million to the Fire Marshal.
Return of the $8 million classified as an "overpayment" to deposit the $8 million into the Fire Prevention Fund as opposed to the State Treasury's Fire Truck Revolving Loan Fund **Classification and deposit circumvented the continuing appropriation requirement of the State Treasury's Fire Truck Revolving Loan Fund**	05-12-15	The State Comptroller processed the $8 million Expenditure Adjustment Transmittal, classified by the Fire Marshal as an overpayment, to redeposit these moneys against the appropriation from the Fire Prevention Fund, not the State Treasury's Fund. In accordance with the Statewide Accounting Management System, the Fire Marshal should have returned the $8 million from the original appropriation that generated the payment being refunded, which was the State Treasury's Fund as it was the appropriated fund that paid the moneys to the Authority's Fund. If this had been done, however, the Fire Marshal would have been obligated to return the money deposited into

05-12-15 (cont.)	the State Treasury's Fund back to the Authority's Fund under the continuing appropriation provisions of the Illinois Finance Authority Act. Therefore, the Fire Marshal did not charge the return of the $8 million against the proper fund and appropriation.
06-03-15	The State Comptroller processed a fund transfer from the Fire Prevention Fund into the General Revenue Fund for $12.5 million.
06-24-15	The State Comptroller processed a fund transfer from the Fire Prevention Fund into the General Revenue Fund for $5.7 million. The total transfers were $18.2 million.
08-31-15	The Fire Marshal lapsed the $8 million appropriation from the Fire Prevention Fund for deposit into the State Treasury's Fund. However, the Fire Marshal continues to show the $8 million appropriated expenditure from the State Treasury's Fund for deposit into the Authority's Fund.

Fiscal records continue to reflect the $8 million appropriated expenditure in the State Treasury's Fire Truck Revolving Loan Fund

During testing, the auditors noted the Authority used moneys deposited within the Authority's Fund for an unauthorized purpose by returning the $8 million.

Authority officials documented that they complied with the request to return the $8 million because "the pressing public policy need by the Authority to contribute to resolving the State's fiscal crisis overrides the risk of audit or legal exposure to the Authority connected with this transfer." (Finding 3, pages 26-30)

We recommended the Authority limit its usage of resources to any restriction imposed upon their use by law, or seek a legislative remedy if management perceives a need to address some other public policy concern.

Authority response

Authority officials stated they "cannot run the fire truck loan program without the assistance of the State Fire Marshal to initiate and manage the program." They noted the Authority would not have been able to loan money to purchase fire trucks if the Fire Marshal was unable to continue operations.

Fire Marshal officials agreed

Fire Marshal officials stated they agreed with the auditors' finding, but they believe they acted in the best interests of the State to preserve their ability to maintain the Fire Marshal's operations.

NEED TO ENHANCE MONITORING OF COVENANT COMPLIANCE FOR CONDUIT BONDS

The Authority did not have adequate internal controls to properly maintain records for monitoring covenant compliance for conduit bonds. Some of the more significant exceptions included the following:

Authority Functions and Duties
During testing of the Authority's records for 60 conduit bonds outstanding issued subsequent to January 1, 2004, the auditors noted the Authority could not substantiate the receipt of required documentation from borrowers or show evidence of the Authority's monitoring of the following significant bond covenants:

Missing certificates of substantial completion

- Seven of 60 (12%) bond issuances tested did not have a certification stating the project funded by the bond issuance had been completed. Within the auditor's sample, eight (88%) bond issuances contained this provision.

Missing audited financial statements

- 35 of 60 (58%) bond issuances tested were missing the borrower's audited financial statements. Within the auditor's sample, 44 (80%) bond issuances contained this provision.

Missing certifications from the independent auditors

- Nine of 60 (15%) bond issuances tested were missing a separate written certification from the independent auditors certifying the auditors have obtained no knowledge of any default by the borrower in the terms, covenants, provisions, or conditions of the agreement. Within the auditor's sample, 18 (50%) bond issuances contained this provision.

Missing annual certifications

- 27 of 60 (45%) of bond issuances tested did not have an annual certification that the borrower has performed a review of its activities during the preceding year to determine the borrower has kept, observed, performed, and fulfilled every covenant and the borrower is not in default with any covenant. In the event the borrower is in default with one or more covenants, the borrower must specify the nature and detail of each default to the Authority.

Compliance checklists not prepared by the Authority

Bond Compliance Monitoring Checklists
During Fiscal Year 2014, the Authority developed a new monitoring checklist to better monitor the Authority's compliance requirements within outstanding bonds. During testing, the auditors noted 39 of 60 (65%) bond issuances tested did not have a compliance checklist prepared by the Authority.

Bond Trustee Service Organization Control Reports (SOC-1)

Service organization internal control reports not obtained and reviewed

During the auditors review of the Authority's monitoring and covenant compliance functions for the 60 bonds tested, the auditors noted two of the six (33%) bond trustees' SOC-1 reports were not obtained and reviewed by the Authority. (Finding 4, pages 31-34) **This finding has been repeated since 2012.**

We recommended the Authority establish and maintain adequate controls over its monitoring of conduit covenant compliance and secure and review SOC-1 reports from the Authority's bond trustees.

Authority officials agree with the auditors

Authority officials agreed with our recommendations. *(For the previous Authority response, see Digest Footnote #1.)*

NEED TO IMPROVE THE AUTHORITY'S INTERNAL AUDIT FUNCTION

The Authority failed to adhere to the internal auditing provisions of the Fiscal Control and Internal Auditing Act.

Authority contracted with a public accounting firm to serve as its internal auditor

On June 27, 2014, the Authority's Executive Director appointed a public accounting firm to serve as the Authority's internal auditor for a five-year term effective on July 1, 2014. The internal auditor did not develop a two-year internal audit plan until June 11, 2015. The plan contemplated performing eight audits over three fiscal years, with two audits scheduled for Fiscal Year 2015, four audits scheduled for Fiscal Year 2016, and two audits scheduled for Fiscal Year 2017.

The auditors noted the following deficiencies:

No internal audits performed in Fiscal Year 2014

- The Authority did not have an internal auditor nor have any internal audits performed during Fiscal Year 2014.

Adopted audit plan did not include all of the Authority's major systems of internal control

- During the auditor's review of the two-year internal audit plan adopted on June 11, 2015, the auditors noted the plan did not have any audit coverage of the Authority's:
  - receipt processing functions;
  - grant programs, including certain federal agricultural loan programs accounted for in the Rural Development Revolving Loan Fund; and,
  - the Metro East Police District Commission Fund, an agency fund.

Adopted plan missed one audit that was planned for Fiscal Year 2015

  Additionally, the plan did not include one special audit begun during Fiscal Year 2015 covering bond compliance and monitoring functions.

Contractor internal auditor only performed one internal audit for 80 hours in Fiscal Year 2015

- The Authority's appointed internal auditor conducted only one of the three Fiscal Year 2015 engagements (two scheduled audits and one special audit), the annual GAAP audit, for a total of 80 professional hours of

Authority entered into contracts with another public accounting firm to perform required internal audits

work. Further, the appointed internal auditor did not perform reviews of the Authority's two major new electronic data processing systems installed during Fiscal Year 2015. In order to obtain assurance, the Authority entered into contracts with another public accounting firm to review whether the new systems had adequate audit trails and accountability.

Report not submitted

- Neither the appointed internal auditor or the other public accounting firm hired to review the two new electronic data processing systems prepared a written report on the internal auditor's Fiscal Year 2015 activities to the Authority's Executive Director by September 30, 2015. (Finding 5, pages 35-37)

We recommended the Authority work with its appointed internal auditor to ensure compliance with the requirements of State law in planning and performing the Authority's internal audits. Further, we recommended the internal auditor should prepare a timely written report on internal audit's activities during the previous fiscal year.

Authority officials agree

Authority officials agreed with our recommendations.

NEED TO ENHANCE CONTROLS OVER REPORTING OF BOND TRANSACTIONS

The Authority did not timely and accurately submit transaction reporting for bond principal and interest payments to the Office of the State Comptroller.

During testing of 60 bond issuances with 544 distinct payments requiring the filing of a *Notice of Payment of Bond Interest and/or Principal* report (Form C-08) during Fiscal Year 2014 and Fiscal Year 2015, the auditors noted the following:

Transaction reports submitted between one and 348 days late

- 66 of 544 (12%) Form C-08s tested were submitted to the Office of the State Comptroller between one to 348 days late. In accordance with the official documents for each bond, the bond trustees are responsible for completing and filing the information with both the State Comptroller and the Authority.

Missing reports

- 48 of 544 (9%) Form C-08s were missing. The Authority was unable to provide the auditors with the Form C-08s for the scheduled bond payments.

Discrepancies noted by the auditors

- 189 of 544 (35%) Form C-08s tested contained discrepancies between the amounts reported on the Form C-08 and the *Bond Interest and Redemption Schedule* (Form C-05) filed with the Office of the Comptroller. (Finding 6, pages 38-39) **This finding has been repeated since 2010.**

We recommended the Authority continue to monitor and work with the bond trustees to improve compliance with principal and/or interest reporting requirements.

Authority officials agree with the auditors

Authority officials agreed with our recommendations. *(For the previous Authority response, see Digest Footnote #2.)*

OTHER FINDINGS

The remaining findings pertain to inadequate internal controls over personal services and travel expenses. We will review the Authority's progress towards the implementation of our recommendations in our next audit.

ACCOUNTANT'S OPINION

The accountants conducted a compliance examination of the Illinois Finance Authority for the two years ended June 30, 2015, as required by the Illinois State Auditing Act. The accountants qualified their report on State compliance for Findings 2015-001, 2015-003, and 2015-004. Except for the noncompliance described in these findings, the accountants stated the Agency complied, in all material respects, with the requirements described in the report.

SIGNED ORIGINAL ON FILE

FRANK J. MAUTINO
Auditor General

FJM:djn

SPECIAL ASSISTANT AUDITORS

Our Special Assistant Auditors for this examination were E. C. Ortiz & Co., LLP.

DIGEST FOOTNOTES

#1 - Inadequate Controls over Monitoring Conduit Covenant Compliance

2013 - The Authority accepts this finding.

As a self-funded, non-appropriated State agency that operates on an enterprise/business model, the Authority has endured declining revenues in fees derived from federally tax-exempt debt issuances directly attributable to (1) a general decline in the dollar volume of tax-exempt bond issuance across sectors; (2) a general decline in the number of tax-exempt projects across sectors; and (3) a general decline in the economic benefit to borrowers from tax-exemption due to economic conditions and the national interest rate environment over the same time period from calendar year 2008 to calendar year 2013.

Between calendar year 2008 and calendar year 2014, staff head count at the Authority, has declined from 31 to 15. Authority staff does not participate in any State defined-benefit pension fund and the Authority has procured its own employee benefits.

Since the close of the audit period on June 30, 2013, the Authority has increased staff assigned to compliance generally (as well as to other financial, audit, procurement duties) from one to five. This team oversees compliance of 1,475 bonds each with their own covenants. In addition to staffing increases, the Authority has implemented or is in the process of implementing digital systems to:

- Better monitor covenant compliance with respect to conduit debt;
- Better manage and retrieve documents with respect to conduit debt; and
- Better track and calendar covenant obligations of the Authority under the conduit bond documents.

#2 - Delinquent and Inaccurate Reporting of Bond Activity

2013 - The Authority accepts this finding.

The Authority has allocated additional staffing to increase communication with the bond trustees and the Office of the Comptroller. As with the Response to Compliance Finding 2013-005, in addition to increasing staffing, the Authority has implemented or is in the process of implementing digital systems to:

- Promote more timely notification of delays and/or noncompliance in the submission of compliance documents
- Increase the accuracy of reports submitted to the Office of the State Comptroller
- Better track and calendar covenant obligations of the Authority under the conduit bond documents.

As a result, the Authority anticipates more timely notification of late C-08 submissions by borrowers and/or discrepancies in borrower's/bond trustee's reporting to the Authority of the borrower's bond principal and interest payments. Authority staff can then work with the bond trustee, the borrower and the Office of the Comptroller to accurately resolve these issues in a timely manner.