Emerging and Potential Audit Issues
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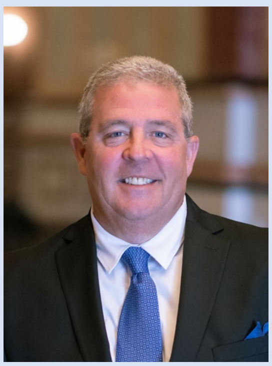
Illinois Audit Advisory

Frank J. Mautino, Auditor General

Auditor General's Message

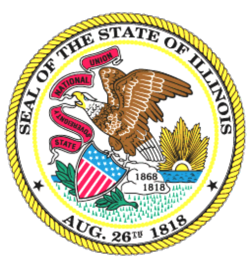
Since the beginning of Fiscal Year 2024 we have made many changes at the Office of the Auditor General. One notable change was moving locations. Our Springfield Office has moved and we are now located at 400 West Monroe Street. Other changes have involved IT upgrades and changes to audit procedures.

The success of our mission depends on our ability to work with internal auditors, agency managers, and public officials. Last year we made changes to our compliance examinations and eliminated report components in order to help save time, cost, and effort for the agencies while providing accurate information for the General Assembly and citizens of Illinois. In 2025 we will continue to update and evolve the operations of the office. We have made investments in our IT division in the form of system modernization, data analytics, and new technical staff to support our audits. In order to provide information that is timely, accurate, and useful for the general assembly and the people of the State of Illinois, the Office of the Auditor General will transition to a statewide approach to the Annual Comprehensive Financial Report (ACFR). This change is being promoted in cooperation with the Office of the Governor and the Comptroller of Illinois.



Mr. Frank Mautino

This issue of the Illinois Audit Advisory will highlight these changes. It will also give a status report on the State Actuary and its work regarding the health and assumptions underlying our pension systems.



The Office of the Auditor General remains committed to assist agencies in their mission to efficiently and effectively protect the resources of the State of Illinois.

ACFR Changes Coming Soon

The Illinois State Auditing Act (30 ILCS 5/1-1 et seq.) requires the Office of the Auditor General (OAG) to audit the Illinois Annual Comprehensive Financial Report (ACFR). In addition, the Illinois State Comptroller Act (15 ILCS 405/19.5) requires the Illinois Office of Comptroller (IOC), to publish the ACFR by December 31 for the fiscal year ended June 30. The current process used by the OAG to audit the ACFR requires separate financial statement audits of significant agencies and funds which are then utilized in the audit of the ACFR. For several years, the IOC's publication by the statutory deadline has been delayed due to various financial reporting issues at several of the significant agencies.

ACFR
Annual Comprehensive Financial Report

The OAG, the IOC, the Governor's Office of Management and Budget, and the Governor's Office have begun the process of determining how to best transition to a "Statewide" ACFR audit, with the goal of implementing the new audit process for the Fiscal Year 2025 ACFR.

This transition is imperative in order to: (1) provide timely, and therefore more useful, ACFRs; (2) align the State's processes with best practices used by other states; and (3) prepare for upcoming changes to the auditing standards established by the American Institute of Certified Public Accountants and new financial reporting requirements anticipated from the Governmental Accounting Standards Board.

Ultimately, the transition will eliminate the need for the preparation of separate agency financial statements at significant agencies of the State, with the exception of agencies such as universities, component units, and retirement systems. Financial transactions significant to the State will continue to be audited, just at the statewide level.

The agencies will continue to complete the Generally Accepted Accounting Principles (GAAP) packages and

(*Continued on page 4*)

Impact of the State Actuary

In 2012, Public Act 097-0694 was signed into law, which directed the Office of Auditor General to contract with or hire an actuary to serve as the State Actuary. Cheiron, a full-service actuarial and consulting firm, has served as the State Actuary since that time. The State Actuary is required to conduct an annual review of the actuarial valuations prepared by the State-funded retirement systems (see inset). As part of that review, Cheiron examines the actuarial assumptions and makes recommendations that the retirement systems must consider before finalizing their valuations.

State-funded Retirement Systems

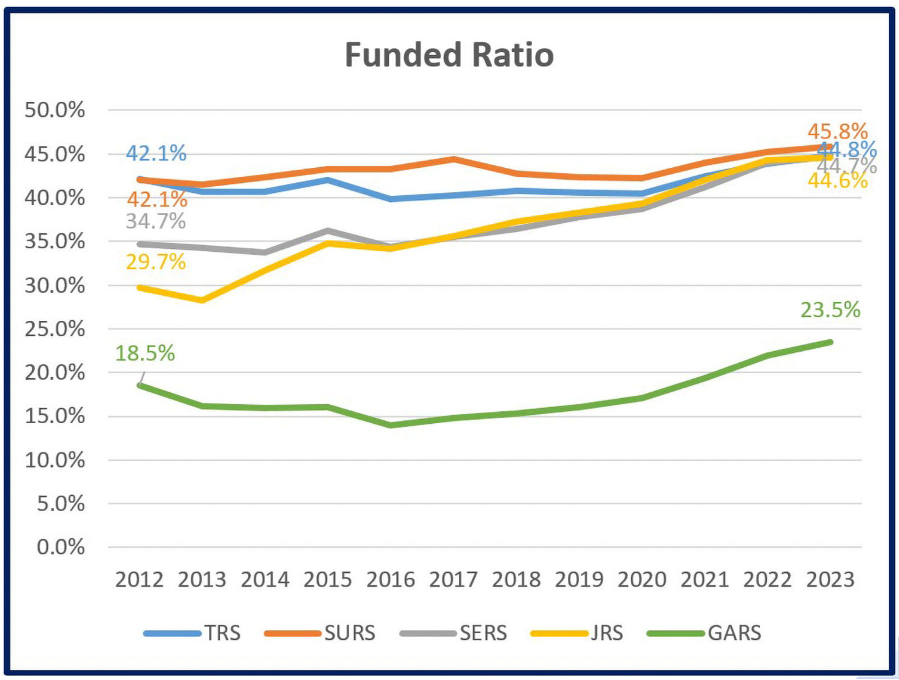
- Teachers' Retirement System (TRS)
- State Universities Retirement System (SURS)
- State Employees' Retirement System (SERS)
- Judges' Retirement System (JRS)
- General Assembly Retirement System (GARS)
- Chicago Teachers' Pension Fund (CTPF)

The work of the State Actuary has had a positive impact on the State's retirement systems. The OAG, working with Cheiron, has issued 12 State Actuary reports. Those reports have contained a total of 441 recommendations including recommendations to lower the interest rate assumptions, enhance review procedures, improve disclosures for current and future valuations, and increase transparency. The **interest rate assumption**, also referred to as the discount rate, is the most impactful assumption affecting both the unfunded liability and the required State contribution amount. Lowering the investment rate assumption increases the unfunded liability and also increases the required contribution amount. Changes in the interest rate assumptions since 2013 for the State-funded retirement systems are shown in the exhibit below.

Interest Rate Assumptions

<table>
<tr><th>System</th><th>2013</th><th>2014</th><th>2015</th><th>2016</th><th>2017</th><th>2018</th><th>2019</th><th>2020</th><th>2021</th><th>2022</th><th>2023</th></tr>
<tr><td>TRS</td><td>8.00%</td><td colspan="2">7.50%</td><td colspan="8">7.00%</td></tr>
<tr><td>SURS</td><td>7.75%</td><td colspan="4">7.25%</td><td colspan="3">6.75%</td><td colspan="3">6.50%</td></tr>
<tr><td>SERS</td><td>7.75%</td><td colspan="2">7.25%</td><td colspan="3">7.00%</td><td colspan="5">6.75%</td></tr>
<tr><td>JRS</td><td colspan="3">7.00%</td><td colspan="3">6.75%</td><td colspan="5">6.50%</td></tr>
<tr><td>GARS</td><td colspan="3">7.00%</td><td colspan="3">6.75%</td><td colspan="5">6.50%</td></tr>
<tr><td>CTPF</td><td colspan="4">7.75%</td><td>7.25%</td><td colspan="2">7.00%</td><td>6.75%</td><td colspan="3">6.50%</td></tr>
</table>

The reviews conducted by the State Actuary have coincided with a reduction in the interest rate assumptions both nationwide and for the State-funded retirement systems. Nationwide, the median assumption has fallen to 7 percent. As shown in the exhibit above, all of the systems have lowered their interest rate assumptions multiple times over the last 10 years and all are at or below 7 percent.

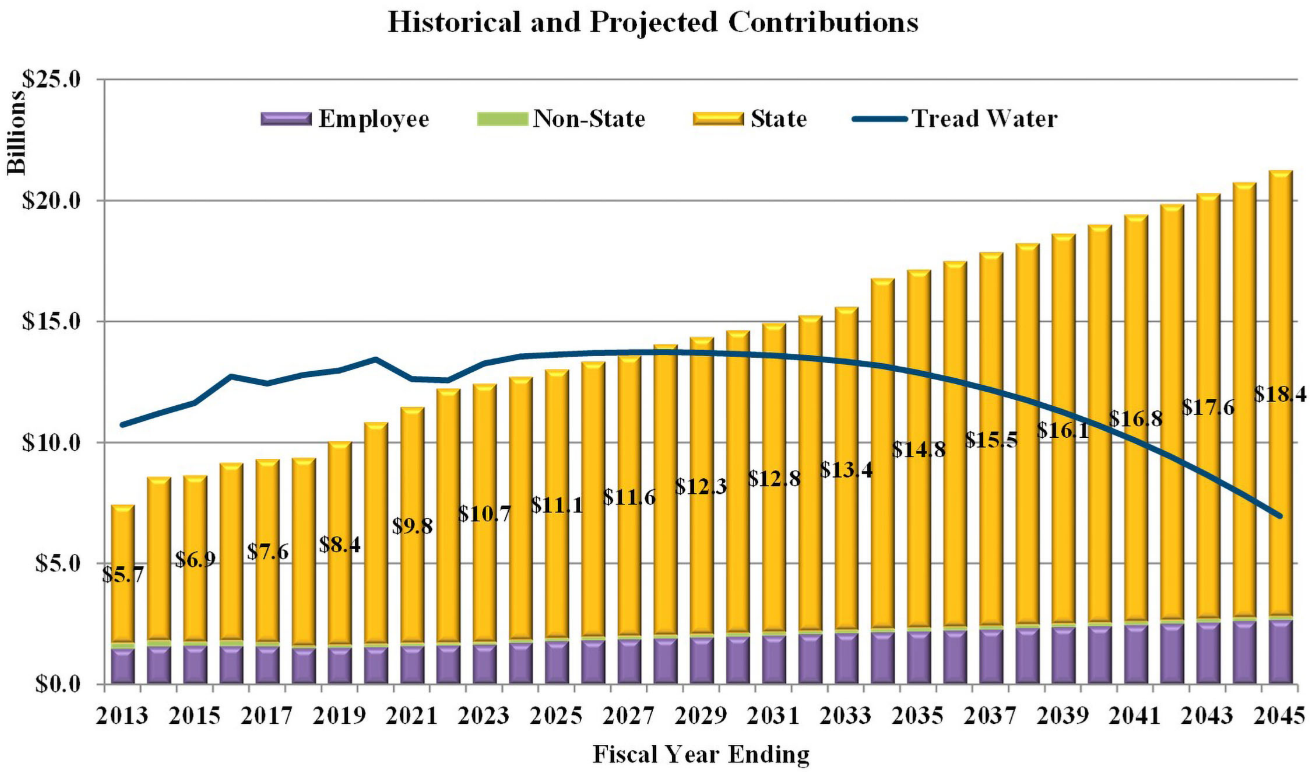


The **funded ratio** measures the value of a pension plan's assets divided by its liabilities. While the systems have lowered their interest rate assumptions, the funded ratio of the retirement systems have still improved over the last 12 years. The adjacent chart shows the funded ratio, based on the actuarial value of assets, for the five systems that receive the majority of their funding from the State. One primary driver of the improved funded ratios is the increased State contributions over the last several years. The 2012 State Actuary report stated the combined Fiscal Year 2014 State contribution for these five systems was $6.87 billion. In the 2023 report, the combined State contribution for Fiscal Year 2025 was reported as $11.14 billion, an increase of 62 percent over that time period.

One of the persistent sources of the increase in unfunded actuarial liability is due to actual contributions to the System being less than the **tread water contribution** (the amount needed to prevent the unfunded actuarial liability from increasing if all assumptions are met).

The exhibit below shows the combined historical and projected contributions for five of the systems. As the chart below shows, actual contributions have been significantly less than the tread water cost. Each year that total contributions remain below the tread water cost (blue line), the unfunded actuarial liability is expected to grow. As shown in the graph below, the contributions from the State will need to continue to increase before the total contribution reaches the tread water contribution and begins to pay down the unfunded actuarial liability.

HISTORICAL AND PROJECTED CONTRIBUTIONS COMPARED TO TREAD WATER COST



Regional Office of Education Audit Changes

The Office of the Auditor General has the responsibility of conducting annual financial statement audits of the regional superintendent of schools of each educational service region in the State. In 2021, Public Act 102-0025 was enacted which amended the School Code and gave the regional offices of education more flexibility in preparing financial statements. The Act allowed regional offices of education to utilize a cash basis, modified cash basis, or Generally Accepted Accounting Principles (GAAP) basis of accounting. Previous to the Public Act, the GAAP basis of accounting was required.

Since the Public Act went into effect, 31 of 38 regional offices have switched to either the cash basis or modified cash basis of accounting. Our Office has seen a reduction in the number of audit findings and improved timeliness in providing financial statement information to our auditors. Regional offices are required to provide financial reports to our Office no later than August 31. Regional offices that fail to meet this requirement are given a delay of audit finding. As of July 31, there have been 26 FY23 audits released and only 2 regional offices have received a delay of audit finding. This is important because delays in completing audits impact the usefulness of the financial statements and could result in repercussions from granting agencies including a loss of funding.

ACFR Changes Coming Soon

(Continued from page 1)

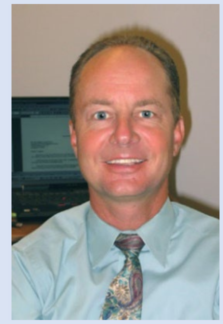
submit them to the IOC. The information from the GAAP packages will continue to be utilized by the IOC to compile the ACFR. Individual agencies will still be responsible for maintaining the support for all financial transactions and information submitted to the IOC through the GAAP package process. The ACFR auditors will do their testing and sample selections for most of the primary government on a statewide basis. As a result, agencies currently subject to an agency financial statement audit will likely end up not being asked to provide the ACFR auditors with support for as many transactions or areas as they currently do. Conversely, some agencies not currently subject to an agency financial statement audit may now be required to provide the ACFR auditors with support for certain amounts reported in their GAAP packages. The ACFR will continue to be audited in accordance with Government Auditing Standards promulgated by the United States Comptroller and auditing standards established by the American Institute of Certified Public Accountants.

While the process for the audit of the ACFR will change, the OAG's bi-annual compliance examination process will not change. Agencies will continue to undergo bi-annual compliance examinations by the OAG.

The transition process will require significant time commitments from all involved agencies and their staffs. We believe this transition is in the best interest of the State and its fiscal well-being.

Personnel

Longtime IS Audit Director Bill Sampias passed away earlier this year after a 2-year battle with prostate cancer. Bill started with the Office in 1984 and worked his entire career at the Illinois Office of the Auditor General. Bill was one of the most widely respected IT professionals in State government. In addition to his numerous accomplishments during his career, he wrote many articles for this publication. Bill was a dedicated employee and a tremendous asset to the Office. He is deeply missed.


Bill Sampias

New Addition:

In June, Dr. Ghashia Kiyani joined the Office as the Chief Data Analyst. Ghashia received her Masters degree in Political Science from Western Illinois University and her Masters in Public Administration from Kansas State University. She received her Ph.D. in Security Studies from Kansas State University. Ghashia will be developing, executing, and reporting on the Office's data analytics program.


Dr. Ghashia Kiyani

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