

OFFICE OF THE SPECIAL DEPUTY RECEIVER  
FINANCIAL STATEMENTS AND INDEPENDENT AUDITORS' REPORT  
December 31, 2015 and 2014

## CONTENTS

|  | Page |
|--|------|
| INDEPENDENT AUDITORS' REPORT                                       | 3    |
| FINANCIAL STATEMENTS   |      |
| STATEMENTS OF ASSETS AND LIABILITIES -<br>FEDERAL INCOME TAX BASIS | 5    |
| STATEMENTS OF REVENUE AND EXPENSES -<br>FEDERAL INCOME TAX BASIS   | 6    |
| STATEMENTS OF CASH FLOWS -<br>FEDERAL INCOME TAX BASIS             | 7    |
| NOTES TO FINANCIAL STATEMENTS -<br>FEDERAL INCOME TAX BASIS        | 8    |



CPAs and  
Management Consultants  
1000 Myers Building  
1 West Old State Capitol Plaza  
Springfield, IL 62701-1268  
ph 217.789.0960  
fax 217.789.2822  
www.kebcpa.com

## Independent Auditors' Report

To the Board of Directors  
Office of the Special Deputy Receiver,  
Representing the Director of Insurance of the State of Illinois

We have audited the accompanying financial statements of the Office of the Special Deputy Receiver (the "OSD") (an Illinois not-for-profit corporation), which comprise the statements of assets and liabilities - federal income tax basis, as of December 31, 2015 and 2014, and the related statements of revenue and expenses - federal income tax basis and cash flows - federal income tax basis for the years then ended, and the related notes to the financial statements.

### **Management's Responsibility for the Financial Statements**

The OSD's management is responsible for the preparation and fair presentation of these financial statements in accordance with the income tax basis of accounting described in Note A; this includes determining that the income tax basis of accounting is an acceptable basis for the preparation of the financial statements in the circumstances. Management is also responsible for the design, implementation, and maintenance of internal control relevant to the preparation and fair presentation of financial statements that are free from material misstatement, whether due to fraud or error.

### **Auditors' Responsibility**

Our responsibility is to express an opinion on these financial statements based on our audits. We conducted our audits in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audits to obtain reasonable assurance about whether the financial statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the auditors' judgment, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and fair presentation of the financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. Accordingly, we express no such opinion. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of significant accounting estimates made by management, as well as evaluating the overall presentation of the financial statements.

---

#### Other Locations

Belleville, IL • Carbondale, IL • Columbia, IL • Harrisburg, IL • Litchfield, IL • Cape Girardeau, MO • St. Louis, MO • Milwaukee, WI

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinion.

### **Opinion**

In our opinion, the financial statements referred to above present fairly, in all material respects, the assets and liabilities of the OSD as of December 31, 2015 and 2014, and its revenue and expenses and cash flows for the years then ended, in accordance with the basis of accounting the OSD uses for federal income tax purposes, as described in Note A.

### **Basis of Accounting**

We draw attention to Note A of the financial statements, which describes the basis of accounting. The financial statements are prepared on the basis of accounting the OSD uses for federal income tax purposes, which is a basis of accounting other than accounting principles generally accepted in the United States of America. Our opinion is not modified with respect to that matter.

*Hester, Eck & Brundell LLP*

Springfield, Illinois  
September 7, 2016

Office of the Special Deputy Receiver

STATEMENTS OF ASSETS AND LIABILITIES -  
FEDERAL INCOME TAX BASIS

December 31

|  | <u>2015</u>       | <u>2014</u>         |
|--|-------------------|---------------------|
| ASSETS                                     |                   |                     |
| Cash and cash equivalents                  | \$ 491,231        | \$ 727,920          |
| Due from Estates under the OSD supervision | 341,185           | 535,724             |
| Prepaid expenses                           | <u>50,116</u>     | <u>84,155</u>       |
| Total assets                               | <u>\$ 882,532</u> | <u>\$ 1,347,799</u> |
| LIABILITIES                                |                   |                     |
| Accounts payable and accrued expenses      | \$ 232,532        | \$ 697,799          |
| Due to Estates under the OSD supervision   | <u>650,000</u>    | <u>650,000</u>      |
| Total liabilities                          | <u>\$ 882,532</u> | <u>\$ 1,347,799</u> |

The accompanying notes are an integral part of these statements.

Office of the Special Deputy Receiver

STATEMENTS OF REVENUE AND EXPENSES -  
FEDERAL INCOME TAX BASIS

Years Ended December 31

|  | <u>2015</u>      | <u>2014</u>      |
|--|------------------|------------------|
| Revenue  |                  |                  |
| Reimbursement of expenses incurred on behalf<br>of Estates under the OSD supervision | \$ 7,329,217     | \$ 7,729,306     |
| Expenses incurred on behalf of Estates<br>under the OSD supervision                  |                  |                  |
| Salaries and wages   | 4,314,974        | 4,620,178        |
| Professional fees  | 88,130           | 99,544           |
| Payroll taxes and employee benefits  | 1,627,396        | 1,543,391        |
| Rent   | 324,444          | 469,870          |
| Office administration  | 845,979          | 865,913          |
| Travel   | 5,070            | 19,046           |
| Other  | <u>123,224</u>   | <u>111,364</u>   |
| Total expenses incurred on behalf of<br>Estates under OSD supervision                | <u>7,329,217</u> | <u>7,729,306</u> |
| Excess of revenue over expenses  | <u>\$ -</u>      | <u>\$ -</u>      |

The accompanying notes are an integral part of these statements.

Office of the Special Deputy Receiver

STATEMENTS OF CASH FLOWS -  
FEDERAL INCOME TAX BASIS

Years Ended December 31

|  | <u>2015</u>              | <u>2014</u>              |
|--|--------------------------|--------------------------|
| Cash flows from operating activities   |                          |                          |
| Excess of revenue over expenses  | \$ -                     | \$ -                     |
| Adjustments to reconcile excess of revenue over<br>expenses to net cash provided by (used in) operating activities |                          |                          |
| (Increase) decrease in due from Estates<br>under the OSD supervision   | 194,539                  | (174,090)                |
| (Increase) decrease in prepaid expenses  | 34,039                   | (27,493)                 |
| Increase (decrease) in accounts payable<br>and accrued expenses  | (465,267)                | 253,897                  |
| Increase due to Estates<br>under the OSD supervision   | -                        | 250,000                  |
|  | <hr/>                    | <hr/>                    |
| Net cash provided by (used in) operating activities  | (236,689)                | 302,314                  |
| Cash and cash equivalents at beginning of year   | <u>727,920</u>           | <u>425,606</u>           |
| Cash and cash equivalents at end of year   | <u><u>\$ 491,231</u></u> | <u><u>\$ 727,920</u></u> |

The accompanying notes are an integral part of these statements.

Office of the Special Deputy Receiver

NOTES TO FINANCIAL STATEMENTS -  
FEDERAL INCOME TAX BASIS

December 31, 2015 and 2014

NOTE A - ORGANIZATION AND BASIS OF PRESENTATION

Pursuant to the Illinois Insurance Code (the "Code"), the Director of Insurance of the State of Illinois ("Director" or "Receiver"), is appointed as Conservator, Rehabilitator, or Liquidator of domestic insurance companies which have been determined by state courts to be insolvent or to meet provisions or grounds for conservation, rehabilitation, or liquidation, as specified in the Code.

The Director, as Conservator, takes possession and control of the insurance company for the purpose of determining its financial condition. The Conservator maintains possession and control of the company until the court vacates the seizure order, either when the Director obtains a rehabilitation or liquidation order with respect to the insurance company or upon its release back to company management. As Rehabilitator, the Director conducts the business of the insurance company and implements a plan of rehabilitation, if feasible. As Liquidator, the Director marshals the assets of the insurance company and liquidates such assets, as appropriate, determines the liabilities, as approved by the supervising courts, and pays court approved pro rata distributions to policyholders and other creditors.

The Director is empowered by the Code to appoint a Special Deputy as the agent to supervise the conservation, rehabilitation, or liquidation of insurance companies. The Office of the Special Deputy Receiver ("OSD"), an Illinois-chartered not-for-profit corporation, supports the activity of the Special Deputy appointed by the Director, to manage the affairs of insurance companies placed in conservation, rehabilitation, or liquidation ("Estates"). The OSD commenced corporate operations on July 1, 1991.

Generally, for those Estates whose operations have been moved to OSD's home office, the OSD pays both direct expenses of the Estates and various overhead and administrative expenses from a common bank account. For those Estates whose operations have remained at their own home office, they pay their own expenses directly from their own bank account. The OSD allocates its overhead and administrative expenses to the Estates and receives reimbursement from Estate assets. All equipment, software and other capitalized costs are purchased and owned by the Estates, and as a result, are not reflected as assets or expenses of OSD.

Office of the Special Deputy Receiver

NOTES TO FINANCIAL STATEMENTS -  
FEDERAL INCOME TAX BASIS - CONTINUED

December 31, 2015 and 2014

NOTE A - ORGANIZATION AND BASIS OF PRESENTATION - Continued

The Statements of Revenue and Expenses - Federal Income Tax Basis ("statements") includes only the overhead and administrative expenses of the OSD. The statement does not include the direct expenses of the Estates. These direct expenses are included in the Estates' own financial statements. In addition, Estates in conservation pay for their own expenses directly from their own assets.

The OSD's reimbursement of overhead and expenses from the Estates constitutes revenue. Revenue excludes deposits made directly into Estate bank accounts which are considered revenue of the individual Estate. These receipts are included in the Estates' own financial statements.

The accompanying financial statements have been prepared on the basis of accounting used for federal income tax purposes, which is a comprehensive basis of accounting other than accounting principles generally accepted in the United States of America ("GAAP"). Revenue and expenses of the OSD are recognized on this basis to the extent that they are includable or deductible for federal income tax purposes.

NOTE B - SUMMARY OF ACCOUNTING POLICIES

*1. Cash and Cash Equivalents*

The OSD considers all highly-liquid investments with a maturity of three months or less when purchased to be cash equivalents.

*2. Expense Allocation*

The allocation of expenses paid or to be paid by the OSD on behalf of individual Estates is based on the percentage of the OSD staff hours charged to an individual Estate to total hours charged to all Estates. The OSD receives funds from the assets of Estates under its control to pay its operating expenses prior to allocation of its expenses to individual Estates. The advance of such monies is included in "Due to Estates under the OSD supervision" in the statements of assets and liabilities - federal income tax basis.

Office of the Special Deputy Receiver

NOTES TO FINANCIAL STATEMENTS -  
FEDERAL INCOME TAX BASIS - CONTINUED

December 31, 2015 and 2014

NOTE B - SUMMARY OF ACCOUNTING POLICIES - Continued

*3. Compensated Absences*

The OSD accrues for compensated absences based on absences paid during the two-and-one-half months immediately following December 31, as allowed for federal income tax purposes. If the statements were in accordance with GAAP, a liability for the estimated probable future payments would be accrued if the following conditions were met:

- The employee's right to receive compensation for the future absences is attributable to services already performed by the employee.
- The employee's right to receive the compensation for the future absences is vested, or accumulates.
- It is probable that the compensation will be paid.
- The amount of compensation is reasonably estimable.

*4. Subsequent Events*

Management has evaluated subsequent events for recognition and disclosure in the financial statements through September 7, 2016, which is the date the financial statements were available to be issued. Through September 7, 2016, no subsequent events required recognition or disclosure in the financial statements.

NOTE C - CONCENTRATION OF CREDIT RISK

The OSD maintains cash balances at a banking institution in the Chicago, Illinois area. Accounts are insured up to \$ 250,000 by the Federal Deposit Insurance Corporation. From time to time, account balances may exceed the insured limits. As of December 31, 2015, and through the date of this report, the OSD has not experienced any losses in such accounts.

Office of the Special Deputy Receiver

NOTES TO FINANCIAL STATEMENTS -  
FEDERAL INCOME TAX BASIS - CONTINUED

December 31, 2015 and 2014

NOTE D - LEASES

In addition to the equipment and furnishings of Estates utilized by the OSD in its operations, certain office space and equipment are leased under noncancelable leases. Future minimum lease payments for noncancelable leases for the five years ending December 31, 2020, are as follows:

|      |            |
|------|------------|
| 2016 | \$ 746,064 |
| 2017 | 760,914    |
| 2018 | 776,177    |
| 2019 | 791,674    |
| 2020 | 807,583    |

The OSD's noncancelable lease of office space in the Merchandise Mart Plaza in Chicago, Illinois, expires January 31, 2025.

NOTE E - RELATED-PARTY TRANSACTIONS

In its capacity supporting the Special Deputy and the Director as Conservator, Rehabilitator, or Liquidator of the Estates, the OSD has complete control over cash receipt and disbursement activity between the Estates and the OSD. Such transactions are generally conducted under the supervision of state courts having jurisdiction over the insurance company receivership proceedings and are made pursuant to the Code.

NOTE F - EMPLOYEE BENEFIT PLAN

The OSD is the plan sponsor of a defined contribution retirement plan covering substantially all employees. On January 1, 2015, the plan was amended and changed its name from the Office of the Special Deputy Receiver Savings and Investment Plan to the OSD Multiple Employer 401(k) Plan (the "Plan"). Additionally, the amendment to the Plan changed the employer match from a discretionary employer match to a non-discretionary employer match. Prior to the amendment, the Plan allowed the OSD to make a discretionary matching contribution of an amount that was a percentage of each participant's contribution. For the year ended December 31, 2014, the discretionary matching contribution was 50%. After the amendment, the Plan requires the OSD to make a matching contribution on a payroll basis equal to 50% of each participant's contribution. Employees may contribute up to 100% of their salaries for any calendar year, subject to the maximum dollar amounts defined in Section 415(d) and 402(g) of the Internal Revenue Code. For the years ended December 31, 2015 and 2014, the OSD contributed \$ 263,183 and \$ 235,962, respectively, to the Plan.

Office of the Special Deputy Receiver

NOTES TO FINANCIAL STATEMENTS -  
FEDERAL INCOME TAX BASIS - CONTINUED

December 31, 2015 and 2014

NOTE G - INCOME TAXES

The OSD has recognized in the financial statements the effects of all tax positions and continually evaluates expiring statutes of limitations, audits, changes in tax law, and new authoritative rulings. The Company is not aware of any circumstances or events that make it reasonably possible that unrecognized tax benefits may increase or decrease within 12 months of the statement of assets and liabilities - federal income tax basis date. Penalties and interest assessed by taxing authorities are included in the provision for income taxes, if applicable. There were no interest or penalties paid during 2015 or 2014.

NOTE H - LETTER-OF-CREDIT

As a condition of the OSD's office lease agreement, the landlord requires a security deposit of \$ 250,000 in the form of an irrevocable letter of credit. The letter-of-credit may be used by the landlord for the purpose of curing any default or defaults of the Company under the lease. The irrevocable letter of credit, obtained from Bank of America, expired on February 1, 2016 and will be automatically renewed on an annual basis thereafter. No funds have been drawn on the letter-of-credit as of December 31, 2015 and through the date of this report.