

OFFICE OF THE SPECIAL DEPUTY RECEIVER  
FINANCIAL STATEMENTS AND INDEPENDENT AUDITORS' REPORT  
December 31, 2011 and 2010

## CONTENTS

	Page
INDEPENDENT AUDITORS' REPORT	3
FINANCIAL STATEMENTS	
STATEMENTS OF ASSETS AND LIABILITIES - FEDERAL INCOME TAX BASIS	4
STATEMENTS OF REVENUE AND EXPENSES - FEDERAL INCOME TAX BASIS	5
STATEMENTS OF CASH FLOWS - FEDERAL INCOME TAX BASIS	6
NOTES TO FINANCIAL STATEMENTS - FEDERAL INCOME TAX BASIS	7



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 statements of assets and liabilities - federal income tax basis of the Office of the Special Deputy Receiver (the "OSD") as of December 31, 2011 and 2010, and the related statements of revenue and expenses - federal income tax basis and cash flows - federal income tax basis for the years then ended. These financial statements are the responsibility of the OSD's management. 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 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 significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

As discussed in Note A, these financial statements have been prepared on the basis of accounting used by the OSD for federal income tax purposes, which is a comprehensive basis of accounting other than 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 assets and liabilities of the OSD at December 31, 2011 and 2010, and its revenue and expenses and cash flows for the years then ended, on the basis of accounting described in Note A.

*Kerber Eck + Braeckel LLP*

Springfield, Illinois  
July 18, 2012

---

Other Locations

Jacksonville, IL • Belleville, IL • Carbondale, IL • Cape Girardeau, MO • St. Louis, MO • Milwaukee, WI

Office of the Special Deputy Receiver

STATEMENTS OF ASSETS AND LIABILITIES -  
FEDERAL INCOME TAX BASIS

December 31

	<u>2011</u>	<u>2010</u>
ASSETS		
Cash and cash equivalents	\$ 191,420	\$ 226,787
Due from Estates under the OSD supervision	501,740	548,572
Prepaid expenses	<u>155,088</u>	<u>79,794</u>
Total assets	<u>\$ 848,248</u>	<u>\$ 855,153</u>
LIABILITIES		
Accounts payable and accrued expenses	\$ 448,248	\$ 455,153
Due to Estates under the OSD supervision	<u>400,000</u>	<u>400,000</u>
Total liabilities	<u>\$ 848,248</u>	<u>\$ 855,153</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>2011</u>	<u>2010</u>
Revenue		
Reimbursement of expenses incurred on behalf of Estates under the OSD supervision	\$ 7,122,454	\$ 8,218,715
Expenses incurred on behalf of Estates under the OSD supervision		
Salaries and wages	4,486,909	5,174,255
Professional fees	15,438	36,569
Consulting fees	-	95,505
Payroll taxes and employee benefits	1,475,434	1,814,251
Rent	765,651	851,891
Office administration	285,894	132,802
Travel	6,232	10,351
Other	<u>86,896</u>	<u>103,091</u>
	<u>7,122,454</u>	<u>8,218,715</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>2011</u>	<u>2010</u>
Cash flows from operating activities		
Excess of revenue over expenses	\$ -	\$ -
Adjustments to reconcile excess of revenue over expenses to net cash used in operating activities		
(Increase) decrease in due from Estates under the OSD supervision	46,832	(104,904)
(Increase) decrease in prepaid expenses	(75,294)	50,091
Decrease in accounts payable and accrued expenses	<u>(6,905)</u>	<u>(145,970)</u>
Net cash used in operating activities	(35,367)	(200,783)
Cash and cash equivalents at beginning of year	<u>226,787</u>	<u>427,570</u>
Cash and cash equivalents at end of year	<u>\$ 191,420</u>	<u>\$ 226,787</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, 2011 and 2010

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, the OSD pays both direct expenses of the Estates and various overhead and administrative expenses from a common bank account. The OSD allocates its overhead and administrative expenses to the Estates and reimburses itself 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.

The Statement of Revenue and Expenses - Federal Income Tax Basis (statement) 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. 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.

Office of the Special Deputy Receiver

NOTES TO FINANCIAL STATEMENTS -  
FEDERAL INCOME TAX BASIS - CONTINUED

December 31, 2011 and 2010

NOTE A - ORGANIZATION AND BASIS OF PRESENTATION - Continued

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 statement of assets and liabilities - federal income tax basis.

*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.



Office of the Special Deputy Receiver

NOTES TO FINANCIAL STATEMENTS -  
FEDERAL INCOME TAX BASIS - CONTINUED

December 31, 2011 and 2010

NOTE B - SUMMARY OF ACCOUNTING POLICIES - Continued

4. *Subsequent Events*

Management has evaluated subsequent events for recognition and disclosure in the financial statements through July 18, 2012, which is the date the financial statements were available to be issued. See Note C below for a discussion of a subsequent event.

NOTE C - 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. The landlord, Merchandise Mart L.L.C. is redeveloping the 14th floor of the building and requested to move OSD to an alternative location in the Merchandise Mart. The OSD requested a reduction in space and a corresponding reduction in rent expense. A lease amendment to the existing lease was subsequently executed May 17, 2012 that reduced the rental space by 44% from 27,639 square feet to 15,365 square feet. The base rent will be reduced by the 44% reduction in square footage leased, effective with the relocation date that is expected to be around July 30, 2012. As a result, a cost savings of over \$ 800,000 in base rent will be achieved over the remaining term of the lease, plus an additional amount for an annual reduction in OSD's share of the Merchandise Mart's operating costs, estimated to range from \$ 10,000 to \$ 20,000. The amendment also provides OSD with an option to lease additional space adjacent to the new premises. Future minimum lease payments for noncancelable leases, incorporating the new lease amendment are as follows:

2012	\$ 531,553
2013	388,632
2014	397,376
2015	33,176

The OSD's noncancelable lease of office space in the Merchandise Mart Plaza in Chicago, Illinois, expires January 31, 2015.

Office of the Special Deputy Receiver

NOTES TO FINANCIAL STATEMENTS -  
FEDERAL INCOME TAX BASIS - CONTINUED

December 31, 2011 and 2010

NOTE D - 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 E - EMPLOYEE BENEFIT PLAN

The Office of the Special Deputy Receiver Savings and Investment Plan (the "Plan") is a defined contribution retirement plan covering substantially all employees. The Plan allows the OSD to make a discretionary matching contribution of an amount that is a percentage of each participant's contribution. For the years ended December 31, 2011 and 2010, the discretionary matching contribution was 50%. 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, 2011 and 2010, the OSD contributed \$ 253,770 and \$ 293,244 respectively, to the Plan.

NOTE F - INCOME TAXES

The Company 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 2011 or 2010.

The Company files income tax returns in the U.S. federal jurisdiction and Illinois. The federal and state income tax returns prior to 2008 are closed.