



UNIVERSITY OF ILLINOIS
(A Component Unit of the State of Illinois)

Report Required Under *Government Auditing Standards*

Year ended June 30, 2014

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

UNIVERSITY OF ILLINOIS
(A Component Unit of the State of Illinois)

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The annual financial statements of the University of Illinois for the year ended June 30, 2014 were issued under a separate cover.

UNIVERSITY OF ILLINOIS
(A Component Unit of the State of Illinois)

University Officials

Robert A. Easter	President
Walter K. Knorr	Vice President/ Chief Financial Officer and Comptroller
Michael B. Bass	Senior Associate Vice President for Business and Finance and Deputy Comptroller
Patrick M. Patterson	Controller and Senior Assistant Vice President for Business and Finance
Julie A. Zemaitis	Executive Director of University Audits
Phyllis M. Wise	Chancellor and Vice President, University of Illinois, Urbana-Champaign Campus
Ginger Velazquez	Interim Assistant Vice President for Business and Finance, Urbana-Champaign Campus
Paula Allen-Meares	Chancellor and Vice President, University of Illinois, Chicago Campus
Heather J. Haberaecker	Executive Assistant Vice President for Business and Finance, Chicago Campus
Susan J. Koch	Chancellor and Vice President, University of Illinois, Springfield Campus
Michael E. Bloechle	Director of Business Services, Springfield Campus

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Champaign, Illinois 61820

UNIVERSITY OF ILLINOIS
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Summary

Year ended June 30, 2014

Government Auditing Report Summary

The audit of the financial statements of the University of Illinois (University) was performed by KPMG LLP in accordance with *Government Auditing Standards*. This report is an integral part of that audit.

Summary of Findings

The auditors identified certain deficiencies in internal control over financial reporting that they considered to be significant deficiencies, which are described in the accompanying schedule of findings and responses on pages 5 through 11 of this report.

Schedule of Findings and Responses

Current year findings:

<u>Item No.</u>	<u>Page</u>	<u>Description</u>
2014-001	5	Inadequate Procedures over Expense Deferrals and Other Cut-off Related Issues
2014-002	8	Inadequate Controls over University Procurement Card Transactions
2014-003	10	Inadequate Procedures over Financial Reporting of Investment Activity

Exit Conference

A request to waive a formal exit conference was made by the University in a correspondence dated December 11, 2014. Responses to the recommendations were provided by the University's Office of Business and Financial Services in a correspondence dated December 16, 2014.



KPMG LLP
Aon Center
Suite 5500
200 East Randolph Drive
Chicago, IL 60601-6436

**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***

The Honorable William G. Holland
Auditor General of the State of Illinois
and
The Board of Trustees
University of Illinois:

As Special Assistant Auditors for the Auditor General of the State of Illinois, we have audited, in accordance with the 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, the financial statements of the business-type activities and the aggregate discretely presented component units of the University of Illinois (the University), a component unit of the State of Illinois, as of and for the year ended June 30, 2014, and the related notes to the financial statements, which collectively comprise the University's basic financial statements, and have issued our report thereon dated December 19, 2014. Our report includes a reference to other auditors who audited the financial statements of the discretely presented component units, as described in our report on the University's financial statements. Other auditors audited the financial statements of the University of Illinois Foundation (a discretely presented component unit) in accordance with *Government Auditing Standards*, as described in our report on the University's financial statements. This report does not include the results of other auditors' testing of internal control over financial reporting or compliance and other matters that are reported on separately by those auditors. The financial statements of The University of Illinois Alumni Association; Wolcott, Wood, and Taylor, Inc.; Prairieland Energy, Inc.; Illinois Ventures, LLC; The University Research Park, LLC; and UI Singapore Research, LLC (all discretely presented component units) were not audited in accordance with *Government Auditing Standards*.

Internal Control over Financial Reporting

In planning and performing our audit of the financial statements, we considered the University's internal control over financial reporting (internal control) to determine the audit procedures that are appropriate in the circumstances 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 University's internal control. Accordingly, we do not express an opinion on the effectiveness of the University's internal control.

A deficiency in internal control 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 and correct, misstatements on a timely basis. A material weakness is a deficiency, or combination of deficiencies, in internal control, such that there is a reasonable possibility that a material misstatement of the entity's financial statements will not be prevented, or detected and corrected, on a timely basis. A significant deficiency is a deficiency, or a combination of deficiencies, in internal control that is less severe than a material weakness, yet important enough to merit attention by those charged with governance.



Our consideration of internal control was for the limited purpose described in the first paragraph of this section and was not designed to identify all deficiencies in internal control that might be material weaknesses or significant deficiencies, and therefore, material weaknesses or significant deficiencies may exist that were not identified. Given these limitations, during our audit, we did not identify any deficiencies in internal control that we consider to be material weaknesses. However, material weaknesses may exist that have not been identified. We did identify certain deficiencies in internal control, described in the accompanying schedule of findings and responses as finding numbers 2014-001, 2014-002, and 2014-003 that we consider to be significant deficiencies.

Compliance and Other Matters

As part of obtaining reasonable assurance about whether the University's financial statements are free from 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*.

The University's Responses to Findings

The University's responses to the findings identified in our audit are described in the accompanying schedule of findings and responses. The University's responses were not subjected to the auditing procedures applied in the audit of the financial statements, and accordingly, we express no opinion on the responses.

Purpose of this Report

The purpose of this report is solely to describe the scope of our testing of internal control and compliance and the results of that testing, and not to provide an opinion on the effectiveness of the University's internal control or on compliance. This report is an integral part of an audit performed in accordance with *Government Auditing Standards* in considering the University's internal control and compliance. Accordingly, this communication is not suitable for any other purpose.

KPMG LLP

Chicago, Illinois
December 19, 2014

UNIVERSITY OF ILLINOIS
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Schedule of Findings and Responses
Year ended June 30, 2014

Finding 2014-001 – Inadequate Procedures over Expense Deferrals and Other Cut-off Related Issues

The University has not established adequate internal controls over accurately identifying and recording deferred expense transactions and reporting prepaid expenses at fiscal year-end for financial reporting purposes.

During our audit, we noted that the University's procedures to identify and record prepaid expenses include a review of all cash disbursements by University Payables (UPAY). UPAY identifies expense transactions that pertain to multiple fiscal years and code them for further review by University Accounting and Financial Reporting (UAFR). UAFR will then post year end journal entries to appropriately defer the identified expense transactions. In addition to the review of all cash disbursements by UPAY, UAFR also requires individual units to identify and report known accrual and deferral transactions at fiscal year-end for certain fund types. We also noted that the University's year-end accounts payable procedures include specifically reviewing cash disbursements made subsequent to year-end through the end of October to determine which accounting period the related expense transactions pertain.

In relation to our testwork over expense transactions, we reviewed 188 cash disbursement transactions (totaling \$92,035,032 debits and \$9,485,555 credits), 40 P-Card expense transactions (totaling \$74,597), and 40 T-Card expense transactions (totaling \$61,817) recorded during the fiscal year. We also reviewed 89 cash disbursements occurring subsequent to year-end (totaling \$97,515,256). Additionally, we separately reviewed 74 internal journal voucher expense transactions recorded during the fiscal year (totaling \$45,259,569 debits and \$32,317,240 credits).

In relation to our testwork over revenue transactions, we reviewed 20 cash receipt transactions recorded during the fiscal year (totaling \$32,688,087) and 35 accounts receivable revenue transactions (totaling \$2,901,554 credits and \$13,364 debits). Additionally, we separately reviewed 65 internal journal voucher revenue transactions recorded during the fiscal year (totaling \$149,844,271 credits and \$211,727,565 debits).

During our review of these transactions, we noted the following items were not recorded in the proper accounting period:

University of Illinois transactions

- Three (3) supplies and services expenses cash disbursements (totaling \$741,253) that were recorded as expenses for the fiscal year ended June 30, 2014, should have been partially deferred as of June 30, 2014 at an amount of \$376,097 and recognized as an expense for the fiscal year ending June 30, 2015.
- One (1) cash receipt (totaling \$24,221) that was recorded as operating revenue for the fiscal year ended June 30, 2014, should have been accrued for at June 30, 2013. In addition, this transaction was incorrectly classified as revenue and should have been recorded as a reduction of an expense as the cash receipt represented a partial refund of an expense. The effect of this recording error is an overstatement of operating revenue for the fiscal year ended June 30, 2014, and an understatement of accounts receivable and net position as of June 30, 2013.

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Schedule of Findings and Responses

Year ended June 30, 2014

University of Illinois P-Card transactions

- Two (2) supplies and services expenses cash disbursements (totaling \$1,375) that were recorded as expenses for the fiscal year ended June 30, 2014, should have been deferred as of June 30, 2014 and recognized as an expense for the fiscal year ending June 30, 2015.
- Two (2) supplies and services expenses cash disbursements (totaling \$2,999) that were recorded as expenses for the fiscal year ended June 30, 2014, should have been partially deferred as of June 30, 2014 at an amount of \$1,689, and then recognized as an expense for the fiscal year ending June 30, 2015.

University of Illinois T-Card transactions

- One (1) supplies and services expenses cash disbursement (totaling \$1,026) that was recorded as expense for the fiscal year ended June 30, 2014, should have been deferred as of June 30, 2014 at an amount of \$1,026, and then recognized as an expense for the fiscal year ending June 30, 2015.

University of Illinois Health Services Facilities System transactions:

- One (1) supplies and general expenses cash disbursement (totaling \$158,937) was inaccurately accrued at June 30, 2013 for the amount of \$161,598. The inaccurate accrual of \$161,598 resulted in an understatement of supplies and general expenses (totaling \$2,661) for the fiscal year ended June 30, 2014, and an overstatement of both accounts payable as of June 30, 2013 and supplies and general expenses for the fiscal year ended June 30, 2013.

Generally accepted accounting principles require transactions to be reported in the period they are incurred. Additionally, the Fiscal Control and Internal Auditing Act (Illinois Compiled Statutes Chapter 30 Section 10/3001), requires the University to establish and maintain a system, or systems, of internal fiscal and administrative controls, which shall provide assurance that: (1) resources are utilized efficiently, effectively, and in compliance with applicable law; (2) obligations and costs are in compliance with applicable law; (3) funds, property, and other assets and resources are safeguarded against waste, loss, unauthorized use, and misappropriation; (4) revenues, expenditures, and transfers of assets, resources, or funds applicable to operations are properly recorded and accounted for to permit the preparation of accounts and reliable financial and statistical reports and to maintain accountability over the State's resources; and (5) funds held outside the State Treasury are managed, used, and obtained in strict accordance with the terms of their enabling authorities and that no unauthorized funds exist. The University's system of internal controls should include procedures to ensure expenses and revenues are recognized in the appropriate reporting period.

In discussing these conditions with University personnel, they stated that the units associated with the exceptions did not adequately understand/follow the procedures to record the transactions in the proper period. While the University believes it has processes in place to prevent material misstatements in the financial statements, the highly decentralized business environment with hundreds of units and large volumes of transactions, does present challenges to catching all errors.

Failure to accurately analyze and record cash disbursements within the proper fiscal year may result in the misstatement of the University's financial statements. (Finding Code 2014-001, 2013-001, 12-01, 11-01, 10-03, 09-03)

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Schedule of Findings and Responses
Year ended June 30, 2014

Recommendation:

We recommend the University continue to review its process to assess the existence of current period expenses and consider changes necessary to ensure prepaid expenses are accurately identified and recorded for presentation in the University's financial statements.

University Response:

Accepted. The University has already implemented significant process enhancements in this area. Through analysis of the exceptions identified in the audit, the University will work to develop and implement corrective actions to further improve the related year-end processes.

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Schedule of Findings and Responses
Year ended June 30, 2014

Finding 2014-002 – Inadequate Controls over University Procurement Card Transactions

The University has not established adequate internal controls over procurement card transactions.

The University operates a procurement card program which allows individuals throughout the University to make smaller purchases (defined as less than \$4,999) on a credit card which is directly paid by the University on a monthly basis. The University's policies require employees assigned a procurement card to complete training on policies and procedures, pass a test, and sign an agreement stipulating they will use the card in accordance with University policy. This agreement is also required to be authorized by the individual's supervisor or the department head. The University's policies require transactions incurred on the procurement card to be approved in the University's procurement card system by the individual cardholder and an assigned reviewer.

During our testwork over 40 procurement card transactions totaling \$74,597, we noted the following:

- One transaction (totaling \$663) was for a charge prohibited by the University's procurement card policies;
- One purchase (totaling \$43,851) was paid in two or more installments (9 transactions each for \$4,872.37), circumventing the card holder's single transaction limit of \$4,999;
- Two transactions (totaling \$5,521) were purchases of equipment that were not tagged in accordance with University's policies and procedures; and
- Two transactions (totaling \$2,243) included a charge of \$132 for sales tax which is a prohibited charge because the University is tax-exempt.

The University has approximately 4,270 active procurement cards and the procurement card expenditures paid for the year ended June 30, 2014 totaled \$64,720,934.

The Fiscal Control and Internal Auditing Act (30 ILCS 10/3001), requires the University to establish and maintain a system or systems of internal fiscal and administrative controls, which shall provide assurance that: (1) resources are utilized effectively, and in compliance with applicable law (2) obligations and cost are in compliance with applicable law; (3) funds, property, and other assets and resources are safeguarded against waste, loss, unauthorized use, and misappropriation; (4) revenues, expenditures, and transfers of assets, resources or funds applicable to operations are properly recorded and accounted for to permit preparation of accounts and reliable financial and statistical reports and to maintain accountability over the State's resources; and (5) fund held outside the State Treasury are managed, used, and obtained in strict accordance with the terms of their enabling authorities and that no unauthorized funds exist. The University's system of internal controls should include procedures to ensure procurement card transactions are in accordance with University policies and procedures and supporting documentation for each transaction is maintained.

In discussing these conditions with University personnel, they stated that the bulleted exceptions noted in this finding were a result of human error.

Failure to properly review and approve procurement card transactions could result in erroneous or fraudulent transactions being recorded in the general ledger system. (Finding Code 2014-002, 2013-002, 12-02, 11-03, 10-02, 09-02, and 08-03)

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Schedule of Findings and Responses
Year ended June 30, 2014

Recommendation:

We recommend the University review its current process for reviewing and approving procurement card transactions and consider any changes necessary to ensure charges are made in accordance with University policies and procedures.

University Response:

Accepted. The University recognizes the importance of process controls and transactions monitoring, and has implemented a number of enhancements in this area. Further corrective action will be taken in connection with the recommendation in this finding.

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Schedule of Findings and Responses
Year ended June 30, 2014

Finding 2014-003 – Inadequate Procedures over Financial Reporting of Investment Activity

The University has not established adequate procedures to reconcile investment sales and purchases, as reported within its statement of cash flows, to appropriate source detail.

During our audit, we noted inconsistencies between the University-prepared schedule to roll-forward reported investment balances as of June 30, 2013 to June 30, 2014, and the independent third party confirmation we received from the University's master trustee that details investment activity for the year ended June 30, 2014. The University-prepared schedule to roll-forward reported investment balances is used by the University to support the amounts reported as proceeds from sales and maturities of investments and purchases of investments within the University's statement of cash flows.

At our request, University management performed additional analysis over the underlying detail used to prepare their schedule to roll-forward reported investment balances and utilized additional reports provided by the University's master trustee to quantify the reconciling differences noted by us. As a result of this analysis, the University noted that the amounts reported as proceeds from sales and maturities of investments and purchases of investments were each overstated by approximately \$207 million within the statement of cash flows for the year ended June 30, 2014.

The University's original reported amounts of proceeds from the sales and maturities of investments and purchases of investments for the year ended June 30, 2014 were \$1,844,225,000 and \$2,388,452,000, respectively. We noted that the amounts in the University-prepared schedule were derived from the University's investment accounting application, which is updated daily with transaction settlement reports obtained from the University's master trustee. The daily settlement reports provided to the University from the master trustee include, on occasion, investment transaction adjustments posted within the master trustee's accounting system to reflect correcting adjustments made subsequent to the initial transactions reported to the University within prior daily settlement reports. It was noted that, on occasion, these adjustments were not appropriately reflected within the University's records as adjustments, but alternatively, reflected as additional investment sales and purchases, or vice-versa, and thus grossing-up recorded investment sales and purchases. The University's revised reported amounts of proceeds from the sales and maturities of investments and purchases of investments for the year ended June 30, 2014 are \$1,637,201,000 and \$2,181,428,000, respectively. These revised amounts were derived from periodic reporting reports provided by the University's master trustee. The University's master trustee stated that the periodic reporting reports present transaction activity as it impacts the University's portfolio including proper accounting for the effects of certain adjustments posted during and subsequent to the end of the reporting period.

The Fiscal Control and Internal Auditing Act (30 ILCS 10/3001), requires the University to establish and maintain a system, or systems, of internal fiscal and administrative controls, which shall provide assurance that: (1) resources are utilized efficiently, effectively, and in compliance with applicable law; (2) obligations and costs are in compliance with applicable law; (3) funds, property, and other assets and resources are safeguarded against waste, loss, and unauthorized use; (4) revenues, expenditures, and transfers of assets, resources, or funds applicable to operations are properly recorded and accounted for to permit the preparation of accounts and reliable financial and statistical reports and to maintain accountability over the State's resources; and (5) funds held outside the State Treasury are managed, used, and obtained in strict accordance with the terms of their enabling authorities and that no unauthorized funds exist. The University's system of

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Schedule of Findings and Responses

Year ended June 30, 2014

internal controls should include procedures to ensure that proceeds from the sales and maturities of investments and purchases of investments are appropriately reflected within its financial statements.

In discussing these conditions with University officials, they indicated that a system was in place for calculating purchases and sales of investments for the statement of cash flows that included controls to ensure all investments transactions were reconciled with cash activity. However, that system did not allow for eliminations between purchases and sales of the master trustee's periodic transaction adjustments.

Failure to implement the appropriate internal controls to reconcile investment activity records to the appropriate source detail may result in a misstatement of the University's financial statements. (Finding Code 2014-003)

Recommendation:

We recommend the University review its current process to reconcile its investment accounting records to appropriate source detail to ensure the accuracy of the amounts reported within its financial statements.

University Response:

Accepted. While the changes related to this recommendation do not impact the total dollar amount reported for net cash used in investing activities, the University agrees that these changes will result in more accurate line-item reporting of purchases and sales of investments within their statement of cash flows. The University has implemented the necessary process changes in connection with this audit recommendation.