STATE OF ILLINOIS
UNIVERSITY OF ILLINOIS

REPORT REQUIRED UNDER
GOVERNMENT AUDITING STANDARDS
FOR THE YEAR ENDED JUNE 30, 2007

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

State of Illinois
University of Illinois

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STATE OF ILLINOIS
UNIVERSITY OF ILLINOIS
UNIVERSITY OFFICIALS
Year Ended June 30, 2007

B. Joseph White	President
Thomas R. Bearrows	University Counsel
Julie A. Zemaitis	Executive Director of University Audits
Stephen K. Rugg (through 08/15/07)	Vice President for Administration
Walter K. Knorr	Vice President and Chief Financial Officer and Comptroller
Chester S. Gardner	Vice President for Academic Affairs
David L. Chicoine	Vice President for Economic Development and Corporate Relations
Douglas E. Beckmann	Senior Associate Vice President for Business and Finance
Heather J. Haberaecker	Executive Assistant Vice President for Business and Finance at Chicago
Michael B. Bass	Executive Assistant Vice President for Business and Finance at Urbana-Champaign
Michael D. Bohl	Assistant Vice President for Business and Finance at Springfield
Pat Patterson	Controller

Administrative offices are located at:

<u>Central Administration</u>
238 Henry Administration Building
506 South Wright Street
Urbana, Illinois 61801

<u>Springfield Campus</u>
Building Services Building
Room 59
Springfield, Illinois 62794-9243

<u>Chicago Campus</u>
809 South Marshfield
Room 608
Chicago, Illinois 60612

<u>Urbana-Champaign Campus</u>
104 Coble Hall
801 South Wright Street
Champaign, Illinois 61820

STATE OF ILLINOIS
UNIVERSITY OF ILLINOIS

Government Auditing Report Summary

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

Based on their audit, the auditors expressed an unqualified opinion on the University's basic financial statements, issued under a separate cover.

Summary of Findings

The auditors identified matters involving the University's internal control over financial reporting that they considered to be significant deficiencies. The significant deficiencies are described in the accompanying Schedule of Findings on pages 7 through 13 of this report, as finding 07-1, Insufficient Internal Controls over Utilities; finding 07-2, Lack of Segregation of Duties over Utilities; finding 07-3, Controls for Reporting Accrued Compensated Absences; finding 07-4, Exchange Transactions; and finding 07-5, University P-Card. The auditors also consider findings 07-1 and 07-2 to be material weaknesses.

Exit Conference

A formal exit conference was waived by the University in a letter dated February 8, 2008. The findings and recommendations were discussed at a pre-exit conference on January 31, 2008 with the following people in attendance:

University of Illinois

Julie Zemaitis	Executive Director of University Audits
Walter Knorr	Vice President and Chief Financial Officer And Comptroller
Douglas E. Beckmann	Senior Associate Vice President for Business and Finance
Michael B. Bass	Executive Assistant Vice President for Business and Finance at Urbana-Champaign
Heather J. Haberaecker	Executive Assistant Vice President For Business and Finance at Chicago
Douglas Vinzant	Senior Associate Vice President, Planning and Budgeting
Pat Patterson	Controller
Rita Hunt	Director Human Resource Policy & Administration, Associate Vice President Resources, University Administration
J. David Stewart	Interim Associate Vice President for Human Resources
Kay Williams	Director of Grants and Contracts, Post Award, Urbana
Vanessa Peoples	Director of Grants and Contracts, Chicago
Heather Humphrey	External Relations Coordinator
Robert McAuley	Associate Dean and Chief Information Officer
Arnim Dontes	Associate Dean for Fiscal Affairs
Andre Pavkovic	Director of Technology Change Management

University of Illinois (continued)

Ginger Velazquez	Assistant Director of Business and Finance, Urbana
Holly Schueneman	Assistant Director for Business and Finance, Chicago
Michael Moss	Senior Coordinator, OBFS Administration Planning and Support
Carol Hannah	Administrative Assistant to Senior Associate Vice President Business and Finance, University Administration

Clifton Gunderson LLP

Jeffrey Bonick	Partner
Hope Wheeler	Partner
Nancy Jones	Senior Manager
Matthew Burnburg	Manager, IT Security

Sulaski & Webb – Subcontractor

Dawn Carlson	Partner

Office of the Auditor General

Thomas L. Kizziah	Audit Manager
Kathleen Devitt	Audit Manager, Information Systems

The responses to the recommendations were provided by Heather Haberaecker, Executive Assistant Vice President for Business and Finance at Chicago, in an email dated February 8, 2008.

Clifton Gunderson LLP
Certified Public Accountants & Consultants

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*

Honorable William G. Holland
Auditor General
State of Illinois

As Special Assistant Auditors for the Auditor General, we have audited the financial statements of the business-type activities and the aggregate discretely presented component units of the University of Illinois, as of and for the year ended June 30, 2007, which collectively comprise the University of Illinois' basic financial statements and the financial statements of the University of Illinois Auxiliary Facilities System, the University of Illinois Willard Airport Facility, and the University of Illinois Health Services Facilities System as of and for the year ended June 30, 2007, and have issued our reports thereon dated February 8, 2008. We conducted our audits in accordance with 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.

Internal Control Over Financial Reporting

In planning and performing our audits, we considered the University of Illinois' internal control over financial reporting in order to determine our auditing procedures for the purpose of expressing our opinion on the financial statements and not to provide an opinion on the internal control over financial reporting. Accordingly, we do not express an opinion on the effectiveness of the University's internal control over financial reporting.

Our consideration of the internal control over financial reporting was for the limited purpose described in the preceding paragraph and would not necessarily identify all deficiencies in the internal control over financial reporting that might be significant deficiencies or material weaknesses. However, as discussed below, we identified certain deficiencies in internal control over financial reporting that we consider to be significant deficiencies.

A control deficiency 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 misstatements on a timely basis. A significant deficiency is a control deficiency, or combination of control deficiencies, that adversely affects the entity's ability to initiate, authorize, record, process, or report financial data reliably in accordance with generally accepted accounting principles such that there is more than a remote likelihood that a misstatement of the entity's financial statements that is more than inconsequential will not be prevented or detected by the entity's internal control. We consider the deficiencies described in findings 07-1, 07-2, 07-3, 07-4, and 07-5 in the accompanying schedule of findings to be significant deficiencies in internal control over financial reporting.

A material weakness is a significant deficiency, or combination of significant deficiencies, that results in more than a remote likelihood that a material misstatement of the financial statements will not be prevented or detected by the entity's internal control.

Our consideration of the internal control over financial reporting was for the limited purpose described in the first paragraph of this section and would not necessarily identify all deficiencies in the internal control that might be significant deficiencies and, accordingly, would not necessarily disclose all significant deficiencies that are also considered to be material weaknesses. However, of the significant deficiencies described above, we consider findings 07-1 and 07-2 to be material weaknesses.

Compliance and Other Matters

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

We are currently conducting State and Federal compliance examinations of the University as required by the Illinois State Auditing Act. The results of those examinations will be reported to management under separate cover.

The University's responses to the findings identified in our audit are described in the accompanying schedule of findings. We did not audit the University's responses and, accordingly, we express no opinion on them.

This report is intended solely for the information and use of the Auditor General, the General Assembly, the Legislative Audit Commission, the Governor, University management, the University Board of Trustees and federal awarding agencies and pass-through entities, and is not intended to be and should not be used by anyone other than these specified parties.

Clifton Gunderson LLP

Peoria, Illinois
February 8, 2008

07-1 Finding: Insufficient Internal Controls over Utilities (University Administration)

University policies for monitoring and reporting budget deficits and for limitations on transfers were ineffective or not complied with resulting in a utilities budget deficit of $117.6 million as of June 30, 2007.

The following issues were noted:

- The University does not have a policy in place to assign responsibility for reporting budget deficits, to specific individuals, for activities that cross campuses and the University Administration (UA) accounts.
- The current policy expectations for the Board of Trustees (BOT) include quarterly reporting of budget versus actual spending at the University-wide "object" level, which does not highlight utility results. The fourth quarter Comptroller's Reports that should have highlighted the deficits: 1) were not prepared as required by policy, and 2) were not discussed with or presented to the BOT in a way that would highlight the results of utilities. Consequently, this deficit continued to build annually beginning in fiscal year 2004, to a deficit of $117.6 million as of June 30, 2007.
- The current BOT policy does not provide sufficient guidance on when BOT approval is required for transfers between state funds and other unrestricted funds.
- The University's accounting for utilities expenditures is excessively complex. The account structure is spread across all campuses and UA. Further, neither the Executive Summary Letter nor the college level reports, required annually for reporting to the President, included this deficit.

The applicable business policies and practices are as follows:

Section 1.7 of the Business and Financial Administration Manual, requires that Units must annually submit a formal Business Plan for funds with deficits in excess of $10,000.

- The BOT requires a fourth quarter Comptroller's Report which would highlight the results of utilities for the year.
- Good business practice dictates that BOT establishes and implements a policy that clearly defines when BOT approval is required for transfers between state funds and other unrestricted funds.
- Good business practices would require an accounting structure that would enable management to identify and address expenditure deficits in a timely manner.

07-1 Finding: Insufficient Internal Controls over Utilities (University Administration) - continued

University management stated that university utility related expenses have exceeded budgeted revenues and the shortfall has been funded from University and campus financial reserves. Utility accounting staffing levels did not keep pace with the university's increasingly complex utility operations and finances. The complex nature of the utility budget and accounting structure made it difficult to provide an accurate picture of the situation and delayed reporting.

The absence of reporting of the utility deficit prevented the University's Board of Trustees and University senior management from performing their oversight role in monitoring the differences between budgeted and actual expenses, responding to the deficit before it reached the current level, and fulfilling their responsibility to maintain accountability over the State's resources. Additionally, since there was no reconciliation to the University-wide financial reports the omission was not discovered and therefore, the utility deficit was not reported to the BOT until April, 2007. (Finding Code No. 07-1)

Recommendation:

We recommend that the Business and Financial Administration Manual and BOT policies, respectively, be revised to include a policy for comparison of budget and actual expenditures and for annual budget deficit elimination for activities that cross campuses and UA, and to clearly indicate whether the limitation on transfers is cumulative. We further recommend University management simplify the accounting and reporting for utilities, and any other activities, if any, that cross campuses and UA.

University Response:

Accepted. The University will revise the budget oversight policies referenced in the finding. The revised policies will more clearly define University-wide budgetary authority and reporting requirements. As an initial step, the University presented a fiscal year 2007 budget versus actual comparison presentation to the Board at their November 2007 meeting. Utility budget and accounting activities are being adjusted to improve clarity and transparency. A regular reporting cycle will be established to communicate budget versus actual results to senior management and to the Board of Trustees.

07-2 Finding: Lack of Segregation of Duties over Utilities (University Administration)

Significant control over the University utility operations was with one individual.

The President of Prairieland Energy, Inc. (a University Related Organization) was also the Associate Vice President for Facilities Planning and Programs of the University. These two roles vested the responsibility for all utility accounting, reporting, rate setting, budgeting, and approval activities in the same individual. The individual's supervisor also did not communicate significant utility deficits to the University Board of Trustees (BOT) or the President of the University.

Good business practices require an appropriate segregation of duties. Further, management oversight should be established sufficient to ensure timely recording and reporting of financial activity. Segregation of duties and appropriate oversight are critical elements in establishing an effective system of internal controls.

University management stated that utility staffing did not keep pace with the University's increasingly complex utility operations and finances. Utility budget oversight was overly reliant on a single individual.

Inadequate segregation of duties along with insufficient oversight resulted in a failure to communicate the overspending and unfavorable budget variances to University management and BOT. (Finding Code No. 07-2)

Recommendation:

We recommend the University review the organizational structure for utility operations and make appropriate revisions to establish an adequate segregation of duties and enhance management oversight.

University Response:

Accepted. The University has reviewed the organization and staffing of utility oversight and operations. A revised organization chart for utility operations has been established and searches for additional positions are underway. The new organization structure includes a finance and administrative position. This position will provide improved segregation of duties and will support consistent budget/expense oversight and reporting. In addition, a study is currently underway that is designed to provide greater clarity surrounding the roles and responsibilities of the University and Prairieland Energy, Inc. and provide for the necessary segregation of duties between the two entities.

07-3 Finding: Controls for Reporting Accrued Compensated Absences (University Wide)

The University of Illinois (University) did not have adequate controls in place for identifying and reporting the University's liability for accrued compensated absences.

The University maintains its records of employees' vested vacation and sick time on its Banner information system. At the end of each fiscal year, the University queries the system in order to extract data, which is then used to adjust the accrued compensated absence liability on the University's financial statements. The University performs certain calculations of the raw data prior to making the adjustments. Although the University had procedures to assess the reasonableness of the accrual, there was no procedure in place to ensure the raw data was verified against a control total.

It was determined that the query used to extract information for all employees who had a status change during the fiscal year however, this query did not extract data for approximately 750 employees who did not have a status change during the fiscal year. The liability for accrued compensated absences reported on the University's financial statements totals $201,980,064. We proposed an adjusting entry of $1,870,288 to correct the understated liability associated with the 750 employees. The University did not adjust their financial statements and the proposed adjustment amount has been included on the auditor's schedule of passed adjustments.

Proper internal controls require management to establish appropriate procedures to ensure that accurate financial statements are presented in accordance with generally accepted accounting principles.

University personnel stated that the query to extract the data was designed with the assumption that each employee would have an annual status change in the Banner system, which proved not to be the case for this fiscal year.

Failure to implement control procedures which include a verification of the raw data against an appropriate control total may result in a misstatement of University financial statements. (Finding Code No. 07-3)

Recommendation:

We recommend the University implement additional controls to ensure that financial information is complete and accurate

University Response:

Accepted. When calculating and recording accrued compensated absences for FY08, the number of employees from the Banner history tables with accrued benefits will be summarized and compared to the number of employees used in the accrual calculation. Comparing the number of employees used in the accrual calculation to the control total derived from the Banner history tables will ensure that all eligible employees are properly included.

07-4 Finding: Exchange Transactions (University Wide)

The University has not recorded certain exchange transactions in their financial records or reported them in their financial statements.

During our testing related to the Division of Intercollegiate Athletics (DIA) at the Urbana Campus, we noted that DIA receives the use of over 50 "courtesy vehicles" from area car dealerships in exchange for season tickets to men's football and basketball games. During the current year, these transactions were not reduced to writing and were not accounted for on the University's financial records. According to DIA personnel, they have estimated the annual value of these exchanges to be $111,000.

During our examination, we also became aware that Sangamon Auditorium at the Springfield Campus receives advertising from area media agencies in exchange for event tickets and other services. The Auditorium has prepared Trade Agreements for these exchanges; however, the value of the transactions has not been recorded on the University's financial records. Auditorium personnel estimate the value of these exchanges to be $52,000.

Governmental Accounting Standards Board Statement No. 34, *Basic Financial Statements—and Management's Discussion and Analysis—for State and Local Governments,* requires that all "revenues, expenses, gains, losses, assets, and liabilities resulting from exchange and exchange-like transactions should be recognized when the exchange takes place."

University personnel stated that the departments did not fully understand the accounting requirements for these exchange transactions.

Failure to record exchange transactions on the University's financial records is a departure from generally accepted accounting principles and could result in a significant understatement of revenues and expenses. (Finding Code No. 07-4)

Recommendation:

We recommend the University identify the departments engaging in these types of exchange transactions and properly quantify and record the transactions. In addition, the University should review its Policies and Procedures, and revise them as necessary, to ensure the proper accounting for exchange transactions. Further, the University should ensure all departments fully understand the policies and procedures for exchange transactions.

University Response:

Accepted. The University is surveying departments to determine the frequency and types of non-cash exchange transactions at the University and will develop the necessary policies and procedures. The University plans to implement the Policies and Procedures beginning in FY08 and will provide the necessary training for the University community.

STATE OF ILLINOIS
UNIVERSITY OF ILLINOIS
SCHEDULE OF FINDINGS
Year Ended June 30, 2007

07-5 Finding: University P-Card (University Wide)

P-Card transactions were not always handled in accordance with University of Illinois Office of Business and Financial Services Policies and Procedures.

The University of Illinois uses a credit card, referred to as a P-Card, to simplify small dollar purchases. University employees may be issued a P-Card with the approval of their Department Head and Fiscal Officer. The P-Card works like any personal credit card and is billed monthly to the University. Vendors are paid directly by the issuing bank and the University pays the bank with a single monthly payment. Purchases are tracked through the P-Card web based computer software and are automatically posted to the University's general ledger system. The University's P-Card program has five defined roles: (1) department card manager, (2) cardholder, (3) software reconciler, (4) software approver, and (5) financial statements reconciler. The University has established a Corporate Card Office to provide management over the University P-Card Program.

As of June 24, 2007, there were 5,879 active P-Cards and the year-to-date volume of P-Card transactions totaled $122,162,347.

We examined 80 P-Card transactions from all areas of the University. The following problems were noted:

- 3 transactions included sales tax paid by the University.
- 2 transactions were for the payment of continuous services with the P-Card set up as the default method of payment.
- 3 transactions were for purchases made by someone other than the cardholder.
- 7 transactions had the cardholder established as the software reconciler of their own transactions. In addition, 1 transaction had the cardholder established as both the software reconciler and the software approver of their own transactions.
- 4 transactions were shown in the P-Card web based computer software as automatically reconciled by the system, rather than by an employee. One of those transactions was also automatically approved by the system, rather than by an employee.
- 1 transaction for airfare was coded to a supplies expense account code.

The University of Illinois Office of Business and Financial Services Policies and Procedures (Section 7.6) state that the P-Card may only be used by the person to whom it is issued. The Policies and Procedures state that the cardholder may not hold the role of software reconciler, software approver, or financial statements reconciler for his/her own transactions. In addition, the Policies and Procedures state that "it is strictly prohibited to place a P-Card account number on file with any vendor unless otherwise specifically stated by policy."

07-5 Finding: University P-Card (University Wide) – continued

The Illinois Department of Revenue granted the University a governmental exemption from sales and use taxes on purchases for University use. "University of Illinois" and the University's sales tax exemption number are printed on P-Cards. The Policies and Procedures require all P-Card purchases to be "in compliance with all procurement, allowable expenditure and funding, payroll, and tax-related policies."

University personnel stated that P-Card transactions have a second review; however, that review may be outside the P-Card web based software, which is also allowed by University Policies and Procedures. University personnel also stated that P-Card web based computer software has specific procedures required to show transactions as appropriately reconciled. If those procedures are not followed completely, transactions may appear in the system as though they have not been reconciled.

University personnel cited unfamiliarity with approved policies, oversight, and a lack of consistent application of procedures as the causes for the other conditions noted.

Failure to adhere to established policies and procedures could result in the University incurring unnecessary costs and the misuse of University assets. (Finding Code Nos. 07-5, 06-2)

Recommendation:

We recommend the University emphasize to its employees the importance of a timely and adequate review, approval, and reconciliation of all transactions. Further, the University should ensure that the Policies and Procedures, including all modifications, are clearly understood and followed by all personnel involved in the P-Card Program.

University Response:

Accepted. In order to improve the understanding of the Policies and Procedures by all personnel involved in the P-Card program, the University has implemented a mandatory retraining program for all existing cardholders and a mandatory training program for all new cardholders. The training will also be required for P-Card renewals, which occur once every two years. All trainings and retrainings must be completed by each employee prior to the issuance of their P-Card.

07-6 Finding: Inappropriate Charges Paid by the University (Chicago Campus)

During the prior examination, we noted the University had incurred expenditures for personal items and based on fictitious documents due to inadequate internal controls resulting in questioned costs of $13,124, of which $11,099 was paid with federal grant funds. (Finding Code No. 06-1)

During our current examination, we noted the questioned costs had been returned to the federal agency and the former employees have been convicted. We did not note any similar instances during the current examination.

07-7 Finding: Testing Center (Urbana Campus)

During the prior examination, we noted the University had inadequate internal controls in place pertaining to examinations administered and revenues collected at the Testing Center at the Urbana Campus which resulted in a loss of revenue of approximately $90,000. (Finding Code No. 06-3)

During our current examination, we noted the University implemented new procedures to provide segregation of duties and timely revenue reconciliations at the Testing Center. In addition, the University is pursuing restitution through appropriate legal channels. We did not note any similar instances during the current examination.