

UNIVERSITY OF ILLINOIS AUXILIARY FACILITIES SYSTEM
(A Segment of the University of Illinois)

Report Required under *Government Auditing Standards*

For the Year Ended June 30, 2010

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

UNIVERSITY OF ILLINOIS AUXILIARY FACILITIES SYSTEM
(A Segment of the University of Illinois)

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The annual financial statements of the University of Illinois Auxiliary Facilities System for the year ended June 30, 2010 were issued under a separate cover.

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Summary

For the Year Ended June 30, 2010

Government Auditing Report Summary

The audit of the financial statements of the University of Illinois Auxiliary Facilities System 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 material weaknesses and other deficiencies that they considered to be significant deficiencies, which are described in the accompanying schedule of findings and responses on pages 4 through 11 of this report.

Schedule of Findings and Responses

Current Year Findings:

<u>Item no.</u>	<u>Page</u>	<u>Description</u>
AFS 10-01	4	Inadequate Controls over User Access to Information Systems
AFS 10-02	7	Inadequate Controls over University Procurement Card Transactions
AFS 10-03	10	Inadequate Year end Accounts Payable Process

Exit Conference

A formal exit conference was waived by the University in a letter dated November 29, 2010. Responses to the recommendations were provided by Patrick Patterson, Maxine Sandretto and Douglas Beckmann in a correspondence dated December 1, 2010.



KPMG LLP
303 East Wacker Drive
Chicago, IL 60601-5212

**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, we have audited the financial statements of the University of Illinois Auxiliary Facilities System (the System), a segment of the University of Illinois (the University), as of and for the year ended June 30, 2010, and have issued our report thereon dated December 20, 2010. Our report was modified to include an emphasis paragraph stating that the System did not present a management's discussion and analysis that U.S. generally accepted accounting principles requires to supplement, although not be a part of, the basic financial statements and that the System's financial statements only present the financial position, changes in financial position, and cash flows of the activities that are attributable to the transactions of the System for complying with the requirements of the indentures of the System's Revenue Bonds. We conducted our audit 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 audit, we considered the System's internal control over financial reporting as a basis for designing our auditing procedures for the purpose of expressing our opinion on the financial statements, but not for the purpose of expressing an opinion on the effectiveness of the System's internal control over financial reporting. Accordingly, we do not express an opinion on the effectiveness of the System's internal control over financial reporting.

Our consideration of internal control over financial reporting was for the limited purpose described in the preceding paragraph and was not designed to identify all deficiencies in the internal control over financial reporting that might be significant deficiencies or material weaknesses and therefore, there can be no assurance that all deficiencies, significant deficiencies, or material weaknesses have been identified. However, as discussed below, we identified certain deficiencies in internal control over financial reporting that we consider to be material weaknesses and other deficiencies that we consider to be significant deficiencies.

A deficiency in internal control over financial reporting 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 over financial reporting, 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. We consider the deficiencies in the System's internal control over financial reporting described as finding number AFS 10-01 in the accompanying schedule of findings and responses to be a material weakness.

A significant deficiency is a deficiency, or combination of deficiencies, in internal control over financial reporting that is less severe than a material weakness, yet important enough to merit attention by those charged with governance. We consider the deficiencies described in the accompanying schedule of findings and responses as finding numbers AFS 10-02 and AFS 10-03 to be significant deficiencies in internal control over financial reporting.

Compliance and Other Matters

As part of obtaining reasonable assurance about whether the System's 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*.

The System's responses to the findings identified in our audit are described in the accompanying schedule of findings and responses. We did not audit the System'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 Board of Trustees of the University, others within the University, 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.

KPMG LLP

Chicago, Illinois
December 20, 2010

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For the Year Ended June 30, 2010

Finding AFS 10-01 – Inadequate Controls over User Access to Information Systems

The University has not established adequate internal controls over access to the information systems used in its financial reporting process.

The University operates an Enterprise Resource Planning (ERP) system to manage the activities of the University. The University functions in a highly distributed operating environment with several thousand users having varying types of system access. Access is granted to users of the University's information systems based on standardized user access profiles. The standardized user profiles are intended to assist the University in limiting access to the information systems based upon the assigned job functions of the specific users to which the profiles are assigned. However, the standardized user profiles currently used by the University are not designed to appropriately segregate conflicting duties and have resulted in an excessive number of users with access rights that were inappropriate based on their roles and job functions. These exceptions identified during our 2009 review consisted of user profiles with inappropriate access to update or change employee pay rates, release financial holds, apply various payments, and override three way matching. These exceptions also identified several user profiles with conflicting user access abilities to create and self approve restricted journal entries as well as update the University's charts of accounts. Lastly, the University did not have procedures to monitor user access through periodic access reviews.

During fiscal year 2010, the University began designing a process to review transactions assigned to standardized user profiles, train unit security contacts, and perform an annual access review for the ERP system. Although the Administration Information Technology Services (AITS) has designed and initiated an annual access review process, this review was not completed during fiscal year 2010 for all departments. In addition to the internal control deficiencies regarding inappropriate access to update or change employee pay rates, as well as users with conflicting access abilities to create and self approve restricted journal entries, during the current year we noted numerous deficiencies related to user access rights. For example:

- There are 132 users (out of 517 total users reviewed) who had excessive access rights that were not appropriate based upon review of each user's job functions.
- There are 26 terminated users with active accounts that were not removed in a timely manner.

Further, we noted periodic reviews of terminated employees with access to the information systems are not performed consistently and documentation is not retained. In addition, there are no procedures in place to perform a periodic review of user access rights to the purchasing system and no procedures are in place to monitor user access rights for employees who transfer positions and change job functions.

The control deficiencies and exceptions discussed above relate to the operations of the University including the Auxiliary Facilities System.

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

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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 access rights granted to University employees are appropriate and to monitor the appropriateness of access levels on a continuing basis. In addition, generally accepted information technology guidance endorses the development of well-designed and well-managed controls to protect computer systems and data. Effective computer security controls provide for safeguarding, securing, and controlling access to systems, properly segregating incompatible duties, and protecting against misappropriation.

In discussing these conditions with University personnel, they stated that they agreed with the exceptions noted in this finding and that work had been underway since the close of the 2009 audit to address most of the weaknesses identified.

Failure to properly assign and monitor user access rights may result in erroneous or fraudulent transactions being recorded in the general ledger system. Without adequate security over access rights, there is a greater risk that unauthorized changes or additions to the University's financial systems could occur and not be detected in a timely manner. If access rights are not reviewed and updated based on job responsibilities on a regular basis, there is a greater risk that journal entries in unlimited dollar amounts, as well as cash disbursements, can be recorded by unauthorized individuals. (Finding Code AFS 10-01, AFS 09-01, 08-05)

Recommendation

We recommend the University review and modify the standard user profiles to ensure (1) the profiles assigned to users appropriately limit each user's access to the systems to which they require access based upon their assigned job responsibilities, (2) the authorization limits assigned to each user are appropriate, and (3) supervisory reviews of transactions are required as appropriate. The University should also implement formally documented review procedures to ensure the profile assigned to each user is compatible with the user's assigned job function and does not present a segregation of duties conflict prior to granting system access. Additionally, we recommend the University implement procedures to perform formal reviews of user access rights on a periodic basis to ensure that the access rights granted to each user are appropriate based on their job responsibilities and that the planned level of segregation of duties is achieved on a continuing basis.

University Response

Accepted. The University's decentralized operating environment involves several thousand users, in hundreds of departments across the three campuses. These users are engaged in a variety of business and administrative functions necessary to perform the mission of the University. The University does have certain processes in place to limit the ability of users to perform many types of transactions. The University believes that many of these controls have been effective, but does agree that improvement to the user access control environment is needed and will be beneficial.

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New policies and related procedures were developed, which became effective February 2010, to require documented annual reviews of standard user profiles and individual user access rights. The implementation of these new policies and procedures began in fiscal year 2010 and continues with full implementation expected to be performed in fiscal year 2011. The University will complete the necessary corrective action to address the recommendation in this finding.

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Finding AFS 10-02 – 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 reimbursed by the University on a monthly basis. The University's policies require individuals assigned a procurement card to 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. Although the University has established policies and procedures for issuing procurement cards, incurring and paying for expenditures with procurement cards, and reviewing and approving of procurement card transactions, we noted these policies and procedures were not properly designed to prevent erroneous charges from being paid by the University and were not followed consistently by University personnel.

Specifically, we noted the procurement card system is configured to automatically record transactions in the general ledger to pre-assigned accounts (auto-reconciled) if the cardholder and/or assigned reviewer have not approved the respective transactions within seven days. The configuration of the system is inconsistent with the University policy that requires both the cardholder and reviewer to approve all procurement card transactions. During the year ended June 30, 2010, procurement card transactions that were auto-reconciled and procurement card transactions that were reconciled and approved by the same individual totaled \$2,503,511 and \$7,494,829, respectively. The University also has not implemented procedures to identify duplicate charges or to reconcile procurement card transactions with travel reimbursement forms. As a result, erroneous or duplicate charges may be paid and recorded by the University without any further detective controls to identify them. We also identified the following exceptions in our testwork over 40 procurement card transactions (totaling \$451,206):

- Three transactions (totaling \$12,098) were for charges prohibited by the University's procurement card policies.
- Original supporting documentation could not be located for one P-Card transaction (totaling \$3,978).
- One transaction (totaling \$7,700) was paid in three installments, circumventing the card holder's approved single transaction limit of \$4,999.

In addition, the University was unable to locate approved Procurement Card Authorization/Agreement and Application forms for two of 40 cardholders selected for testwork.

The University has approximately 5,170 active procurement cards and the procurement card expenditures paid for the year ended June 30, 2010 totaled \$101,588,000.

The control deficiencies and exceptions discussed above relate to the operations of the University including the Auxiliary Facilities System.

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

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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 procurement transactions are appropriately reviewed and approved to avoid erroneous or duplicate transactions from being paid and recorded.

In discussing these conditions with University personnel, they stated that due to the late timing of the fiscal year 2009 audit, ample time did not exist to implement corrective measures before the start of fiscal year 2010, resulting in repeat findings related to auto-reconciling and the ability to produce a copy of the signed agreements for all cardholders. In addition, the University is still in the process of implementing its new Travel and Expense Management System, which will provide controls, in addition to those already in place, to further eliminate the possibility of duplicate transactions with regard to travel reimbursements. The bulleted exceptions noted in this finding are a result of human error; specifically, the failure of certain employees to comply with University policy that is clearly stated and disseminated to all through required training.

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 AFS 10-02, AFS 09-02, 08-03)

Recommendation

We recommend the University revise its current process to require procurement card transactions be reviewed and approved by the card holder and an independent reviewer prior to recording the transactions in the general ledger. Such process modifications may include eliminating the auto-reconciliation function or establishing another mechanism to allow auto-reconciled transactions to be reviewed and approved prior to being recorded in the specific general ledger accounts. We also recommend the University implement procedures to identify duplicate transactions and to reconcile procurement card transactions to travel reimbursement forms.

University Response

Accepted. On July 9, 2010, the auto-reconcile function was disabled in the P-Card software. Effective that date, all P-Card transactions were required to be reconciled by the Reconciler before they would post to the General Ledger. In addition, early in fiscal year 2011, the Corporate Card Office began the process of collecting a copy of all cardholder agreement forms for all current cardholders from University units and has nearly completed that process. The two cardholders for whom paper authorization forms could not be located are authorized cardholders who were issued cards prior to October 2005. Since this date, to ensure retention of this important documentation, units have been required to fax a copy of all signed authorization forms to the central Corporate Card Office before a card would be issued. In addition, all cardholders in the system as of the fall of 2007 were required to complete online training, testing, and recertification prior to receiving renewal P-cards in February 2008.

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The University is currently engaged in the configuration and testing of a travel and expense management system, with implementation to begin February 2011. When fully implemented, all travel related expenses and employee reimbursable expenses will be captured electronically and routed through an electronic workflow process for review and settlement. This will enable the University to monitor and review employee settlements with P-Card transactions and eliminate any opportunity for duplicate payments.

The University recognizes that with approximately 5,170 active procurement cards, erroneous charges can and do occur. The University employs careful oversight and review to ensure these errors are minimal, and it takes immediate action when errors are discovered. The University will continue to be proactive in improving controls over the P-Card system and will continue to provide training and review of policies and requirements for all cardholders.

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Finding AFS 10-03 – Inadequate Year End Accounts Payable Process

The University has not established adequate internal controls over accurately identifying and recording period end accounts payable for financial reporting purposes.

During our audit, we noted the University's year end accounts payable procedures include calculating and recording an estimate of unrecorded liabilities based on the level of cash disbursements subsequent to year-end and historical data of which accounting period similar disbursements subsequent to year end have pertained to. In addition, the University performs reviews over cash disbursements subsequent to year end to track and monitor the actual level of unrecorded liabilities. The actual level of unrecorded liabilities is then compared to the estimate recorded for financial reporting purposes.

During our review of cash disbursements subsequent to year end, we identified seven subsequent disbursements (totaling \$1,212,182) which pertained to fiscal year 2010, but which were not properly identified by the University. Four of these subsequent disbursements (totaling \$1,180,130) were not identified because the University's review of these transactions did not include a review of the shipping documents and any applicable shipping terms.

The control deficiencies and exceptions discussed above relate to the operations of the University including the Auxiliary Facilities System.

Generally accepted accounting principles require expenditures 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 accurately assess whether expenditures are reported in the appropriate period.

In discussing these conditions with University personnel, they stated that the unrecorded accounts payable identified by the auditors largely related to bookstore inventory purchases. The inventory was shipped prior to fiscal year end and was physically received by the University on or after July 1, 2010 (early fiscal 2011). However, the applicable shipping terms were "FOB Shipping Point", meaning the purchase belonged to the University when the product left the vendor. Bookstore staff was not aware purchases involving this situation needed to be treated as University inventory and accrued at fiscal year end.

Failure to accurately analyze cash disbursements subsequent to year end may result in the misstatement of the University's financial position. (Finding Code AFS 10-03, AFS 09-03)

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Recommendation

We recommend the University review its current process to assess the completeness of its accounts payable at year end and consider changes necessary to ensure all period end accounts payable are accurately identified and recorded. Such procedures should include a determination of when the underlying goods or services were received including a review of shipping documentation and any applicable shipping terms.

University Response

Accepted. The University will take the necessary corrective action to address the recommendation in this finding.