2003 Annual

Illinois

Audit Advisory

Emerging and Potential Audit Issues

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Auditor General

AUDITOR GENERAL'S MESSAGE

An important responsibility we share as public managers is to compile and report accurate and timely financial information for our individual agencies, as well as for the State as a whole. In this past audit cycle, my Office encountered significant problems with State agencies preparing inaccurate or untimely GAAP reports. This edition of the Audit Advisory highlights some of the problems encountered this past year with agencies' financial statements, as well as in the reporting of financial information to the Office of the Comptroller. Agencies need to improve their reporting of GAAP information in 2003.

State agencies need to ensure that the processes to collect and maintain computerized information are secure and that the information collected is adequately safeguarded. The Advisory examines ways to help ensure information is properly safeguarded and discusses a recently enacted statute on information collected over the Internet.

Other articles in this Advisory discuss Executive Order Number 10, the recent update to the AICPA Audit and Accounting Guide, and findings from prior audits which may be helpful in avoiding findings in future years.

Hopefully you will find the information in this Audit Advisory to be useful as we work together to serve the people of Illinois.

WILLIAM G. HOLLAND
September 2003

IMPROVEMENTS NEEDED IN PREPARATION OF GAAP FORMS AND FINANCIAL STATEMENTS

During the fiscal year 2002 audits of State agencies, significant problems were experienced with financial reporting in accordance with generally accepted accounting principles (GAAP). Fiscal year 2002 audits contained numerous findings related to problems with GAAP reporting and agency financial statements. These problems included:

- Inaccurate, incomplete, and untimely GAAP forms;
- Untimely completion of financial statements and related disclosures;
- Inadequate infrastructure records and financial reporting;
- Incomplete capital asset records and financial reporting;
- Untimely and incomplete disclosures regarding contingencies and commitments;
- Inaccurate revenue classification; and
- Inaccurate grant classification.

These problems had widespread impact. They:

- Impacted audit scheduling and resources;
- Delayed the completion of individual State agency audits;
- Caused an inordinate number of audit adjustments for agency and statewide financial statements;
- Resulted in the Auditor General's Office expending significant resources on the fiscal year 2002 statewide financials as well as delaying other planned audit work; and
- Significantly delayed the completion of the State's fiscal year 2002 Basic Financial Statements. Ultimately, without timely and accurate financial statements, the ability of the State to borrow money may be impacted.

In the fiscal year 2003 audit cycle, the Office of the Auditor General will again give close scrutiny to State agencies' GAAP forms submitted to the State Comptroller to ensure that they are timely, accurate, complete, and readily traceable to agency records. Another priority will be to ensure agencies prepare timely, accurate, and complete financial statements.

The responsibility for preparing timely and accurate GAAP forms and financial statements rests with State agencies and the Office of the Comptroller. Agencies need to dedicate sufficient resources to these functions. Addressing the problems encountered in the fiscal year 2002 audits may be impacted because of:

- The loss of experienced fiscal personnel due to the early retirement incentive in 2002; and
- Budget issues which may impact agencies' allocation of sufficient resources in the financial reporting areas. However, with advance planning, these factors can and should be addressed.

The Office of the Comptroller plans to make some changes related to the fiscal year 2003 financial reporting. Such changes may include:

- Additional automation for GAAP reporting;
- More edits and checks built into current reporting systems;
- More hands-on interaction with State agencies;
- Increased focus on timely review of agency submitted GAAP forms; and
- Less reliance on the post audit program to address financial reporting issues.

EXECUTIVE ORDER 10: CHANGES TO STATE AGENCIES' INTERNAL AUDIT FUNCTION

Implementation of Executive Order Number 10 insofar as it impacts the Executive Branch's internal audit function is on-going. While the Auditor General is neutral on the Executive Order, we have been and will continue to be in contact with the Department of Central Management Services to help ensure that issues relevant to the external audit function are considered as implementation of this Order proceeds.

Not only do internal auditors often act as liaisons to our external auditors, we also count upon finding a well-developed internal control structure in place and operational when we go to an agency to perform our external audit work.

Under the Fiscal Control and Internal Auditing Act (FCIAA), each agency head continues to be responsible for maintaining an effective system of internal control at his or her respective agency. Specifically, FCIAA provides that:

> *It is the policy of this State that the chief executive officer of every State agency is responsible for effectively and efficiently managing the agency and establishing and maintaining an effective system of internal control. [30 ILCS 10/1002]*

In short, a strong internal audit function is not only required by law but is also an agency's best defense – not only against external audit findings but, more importantly, against the waste of taxpayer dollars through inefficient or ineffective operations.

REDUCING THE NUMBER OF FINDINGS

One of the primary purposes of the Audit Advisory is to provide information that will allow State agency management to take actions to correct deficiencies before they become audit findings. A useful source of such information is audit findings that occurred at other State agencies. By reviewing these findings, agency management can conduct a self-assessment to determine whether similar problems might exist at their agency. If such problems exist, then corrective action can be taken to reduce the likelihood of similar findings at their agency.

The following are examples of conditions which resulted in findings in fiscal year 2002 audits conducted by the Office of the Auditor General. Take a few minutes to determine whether your agency might have similar problems that need to be addressed.

Submission of GAAP Reports and Financial Reporting

- Various GAAP forms were not prepared accurately or timely. No audit trail was maintained to support dollar amounts reported on GAAP forms submitted to the State Comptroller. For additional discussion of GAAP and financial reporting issues found in the fiscal year 2002 audits, see article titled "Improvements Needed in Preparation of GAAP Forms and Financial Statements" on page 1 of this issue of the Audit Advisory;
- No procedures were in place to ensure cash receipts were properly reconciled between agency and State Comptroller records; and
- Quarterly accounts receivable reports were incomplete and not reviewed.

Use of State Vehicles

- Required evidence of certification of automobile liability insurance was not obtained from employees authorized to operate a vehicle for State purposes;
- Personally assigned vehicles were not evaluated annually to determine whether the assignment was still justifiable and in the best interests of the State; and
- Accident reports were not submitted in a timely manner.

Internal Auditing

- Audits of major systems of internal accounting and administrative controls were not performed at least once every two years;
- The internal audit unit was not free from operational duties; and
- The chief internal auditor did not report directly to, or have direct communication with, the agency head.

Telecommunications

- Telecommunications policies and procedures were not specific regarding the issuance, usage, and revocation of telephones, pagers, and calling cards.

Contractor or Provider Monitoring

- Few on-site audits of providers were conducted;
- Contractors were paid even though required detailed timesheets were not submitted;
- Payments were made to contractors without supporting documentation; and
- Future fiscal year costs were prepaid using current year appropriations.

Property Control and Commodities

- Property items were disposed of before obtaining DCMS approval;
- Disposed items were not deleted from property control records;
- Property items could not be located;
- Property items were not tagged;
- Commodities sampled did not agree to inventory records;
- Donated assets were not recorded on financial or property records; and
- No comprehensive inventory of excess land had been compiled.

OVERVIEW OF THE AUDIT PROCESS

Over the past year, agencies have had to make many adjustments due to early retirements, budget cuts, and new leadership in the State of Illinois. New employees may find themselves faced with their first audit by the Office of the Auditor General (OAG).

(Cont. on p. 3)

INFORMATION SYSTEMS REVIEWS

Each year, approximately 20 expanded scope Information Systems (IS) reviews are performed in conjunction with compliance audits. The primary objective of an IS review is to ensure agency management has established an appropriate security structure and that information assets and resources are adequately protected from unauthorized or accidental disclosure, modification, or destruction. Some areas that are frequently reviewed include:

Security Administration - Primary areas include a review of security guidelines, end user security awareness, and the assignment of security personnel. A formal risk assessment conducted by an agency is a solid technique to help establish a sound foundation for security decisions;

Electronic Commerce - Primary areas include a review of electronic transactions to ensure they are secure, valid, and comply with applicable external requirements. Additional issues include procedures for assuring routine balancing of transactions, privacy provisions, and assessments of the adequacy of controls at third party service providers;

Logical Access - Primary areas include a review of logical security parameters (password content, length, change interval, etc.) and individual access rights to ensure they align with job responsibilities; and

Systems Development - Primary areas include a review to ensure that a suitable structured systems development methodology exists and is utilized to ensure that applications are developed and/or modified in a manner that promotes consistency, integrity, and security and to ensure that applications satisfy management's intentions.

Computer Security Recommendations

- **Establish a security administration function.** A clearly defined administration function can provide the necessary guidance and oversight to ensure that security objectives are achieved.
- **Develop computer security policies and procedures.** Policies should outline the basic security guidelines and identify the user's responsibility in protecting computer resources. Policies and procedures, which should be updated annually and given to all users, should include:
  - Appropriate uses of computer equipment;
  - General security provisions;
  - Routine backup of information and off-site storage of backups;
  - System development procedures;
  - Virus protection measures; and
  - Individual responsibility to protect computer resources.
- **Establish a security awareness program.** A security awareness program should be developed to keep employees aware of security issues via memoranda, e-mails, etc.
- **Establish security standards.** Standards should be established to help ensure computer security. The following examples are not intended to be all inclusive and may not be appropriate in all circumstances, but serve as general guidelines that provide State government with some minimum standards for computer security.
  - Each user should have an individual ID.
  - Passwords should be required, have a minimum length of six characters, include special characters, and be changed at least every 35 days.
  - The number of times a user can log into a system after their password expires and before they change it should be limited to no more than three attempts.
  - A password history should be maintained to prohibit re-use of passwords.
  - After five unsuccessful attempts to enter a valid password for an ID, the ID should be revoked.
  - Unless a user requires 24 hour access to a computer system, time restrictions should be set to limit when he or she can use the system.
  - If a user has no activity on a system for a maximum of 60 minutes, the session should be deactivated until a valid password is entered.
  - Access to information and resources should be limited based on the user's need and job duties.

AUDIT PROCESS (*cont. from page 2*)

All State agencies receive a financial and compliance audit at least once every two years. The General Assembly may also direct the Auditor General to conduct a performance audit of your agency.

The following are some key aspects of the audit process:

- At the beginning of the audit an entrance conference will be held to discuss the conduct of the audit; an exit conference will be held at the audit's conclusion to discuss any findings and recommendations;
- Auditors will likely request many documents related to the scope of the audit, including financial documents, policy and procedures manuals, organizational charts, information technology system documentation, contracts, and grants;
- From the date an agency receives the draft report, OAG rules allow agencies 7 calendar days to request an exit conference, 14 calendar days to have the exit conference, and 21 calendar days to submit any written comments;
- The Legislative Audit Commission, a bi-partisan commission comprised of 6 Senators and 6 Representatives, holds hearings on audits released by the Office of the Auditor General. At the hearings, auditors present the main results of the audit, agency officials make opening remarks, and then the Commission members follow up on the audit's findings; and
- Agencies should review the prior OAG audit. Special attention should be paid to ensure that prior audit findings have been addressed, since any uncorrected prior findings will be repeated in the subsequent audit.

Should you have questions about the on-going audit, contact the assigned OAG audit manager. If you would like more information on the Office of the Auditor General, visit our Web site at: http://www.state.il.us/auditor/.

AICPA AUDIT AND ACCOUNTING GUIDE UPDATED

In response to the Governmental Accounting Standards Board's (GASB) Statement No. 34, the AICPA developed a new Audit and Accounting Guide, Audits of State and Local Governments (GASB 34 Edition). The GASB 34 Edition of the Guide is effective for audits of state or local government's financial statements for the first fiscal period ending after June 15, 2003, in which the government does apply, or is required to apply, the provisions of GASB Statements 34 or 35. GASB Statement No. 35 amended Statement 34 to require public colleges and universities to follow the requirements of GASB 34.

As with prior editions of the Guide, the GASB 34 Edition provides summary information regarding governmental accounting, practical audit considerations, and audit reporting examples. The Guide is available in electronic and print versions (see the AICPA's Web site: www.cpa2biz.com).

AUDITOR GENERAL'S OFFICE RECEIVES NATIONAL AWARD

The National Conference of State Legislatures' National Legislative Program Evaluation Society (NLPES) awarded the Auditor General's Office the Certificate of Recognition of Impact for the Management Audit of Agency Use of Internet User Tracking Technology. The award is given annually by NLPES for audit reports that demonstrate significant impact on public policy, such as resulting in program improvements or legislative changes. As a result of the audit, many State agencies re-examined the information they collected over the Internet and revised or adopted privacy policies. Legislation was also introduced which addresses issues raised in the management audit. In July 2003, this legislation was signed by the Governor (see inset). The Office has received this award in each of the past five years.

State Agency Web Site Act

House Bill 32 created the State Agency Web Site Act. The Bill was passed by the General Assembly in May 2003 and signed into law as Public Act 93-0117 on July 10, 2003. The legislation addresses issues raised by the Auditor General's Management Audit of Agency Use of Internet User Tracking Technology released in January 2002. The Act contains requirements as to the types of "cookies" State agency Web sites can use. The Act defines a "cookie" as a set of computer data or instructions placed on a consumer's computer by a Web site server to collect or store information about the consumer.

While the Act allows State agencies to use transactional cookies (typically information about a user that is needed to complete a transaction but is deleted when the user's web browser is closed), it generally prohibits State agencies from using permanent cookies or other invasive tracking programs that monitor and track Web site viewing habits. A permanent cookie remains on the user's computer and is often used to recognize the user on subsequent visits to a Web site. The Act allows permanent cookies to be used if they add value to the user that is otherwise not available, and if the permanent cookies are not used to monitor and track Web site viewing habits unless all types of information collected and the State's use of that information add user value and are disclosed through a comprehensive online privacy statement. The Act also establishes an Internet Privacy Task Force which will be responsible for exploring the technical and procedural changes that are needed in the State's computing environment to ensure that visits to State Web sites remain private. The Act becomes effective on January 1, 2004.

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