STATE OF ILLINOIS
OFFICE OF THE
AUDITOR GENERAL
William G. Holland, Auditor General

SUMMARY REPORT DIGEST

STATE'S FINANCIAL REPORTING SYSTEM

MANAGEMENT AUDIT

Release Date: February 2011

SYNOPSIS

The State of Illinois' financial reporting "system" is comprised of over 260 individual financial systems, many of which are not interrelated, are antiquated, and are costly to operate. The lack of a centralized financial reporting system has considerable negative consequences, including untimely financial reporting of the true financial position of the State. The lack of timely financial reporting limits effective oversight of State finances, adversely affects the State's bond rating, and jeopardizes federal funding.

Specifically we found the following:

- Agencies reported using 263 different financial reporting systems.
- Agencies reported that only 16 percent of the systems are compliant with Generally Accepted Accounting Principles (GAAP).
- Half of the financial reporting systems in use at State agencies are more than 10 years old.
- Fifty-three percent of the financial reporting systems are not interrelated which consequently requires manual intervention to convert data from one system so it can be used in another.
- The total estimated cost of maintaining the systems in fiscal year 2010 was not determinable. Agencies provided cost estimates totaling $24 million which covered only 56 percent of the systems.

In addition to the lack of a centralized GAAP compliant financial reporting system, other factors have an adverse impact on the timeliness and accuracy of financial reporting:

- The Comptroller's Office is responsible for financial reporting but does not have authority over the agencies from which it collects information. Furthermore, there is no penalty if the agencies do not cooperate with the Comptroller. The Comptroller's Office and the Governor's Office should work together to establish financial reporting target completion dates and ensure that such dates are met.
- The State of Illinois has a complex fund structure that utilized an estimated 900 funds in fiscal year 2009. A complex fund structure increases the level of effort necessary to account for and report transactions and increases the risk of errors and omissions.
- Many State agencies have a lack of competent trained staff in the area of financial reporting and reported that the personnel system impedes their ability to hire qualified staff.

FINDINGS, CONCLUSIONS, AND RECOMMENDATIONS

REPORT CONCLUSIONS

The State of Illinois' financial reporting "system" is comprised of over 260 individual financial systems, many of which are not interrelated, are antiquated, and are costly to operate. The lack of a centralized financial reporting system has considerable negative consequences, including untimely financial reporting of the true financial position of the State. The lack of timely financial reporting limits effective oversight of State finances, adversely affects the State's bond rating, and jeopardizes federal funding.

Financial Reporting Systems at State Agencies

Senate Resolution Number 609 asked us to analyze the State's current financial reporting procedures, practices, and system. To accomplish this, we surveyed all agencies of the primary government. We received responses from 88 of the 90 agencies surveyed.

Agencies reported using 263 different financial reporting systems.

The survey results show that Illinois has a highly fragmented and decentralized financial reporting system. Agencies reported using 263 different financial reporting systems. The total number of systems is **higher** since two agencies did not respond to the survey, and there were seven other systems that we identified at four agencies that are not included in the total.

The total estimated cost of maintaining the systems in fiscal year 2010 was not determinable. Agencies provided cost estimates totaling **$24 million** which covered only 56 percent of the systems. (See Digest Exhibit 1.) There were also instances where agencies provided cost information for one cost component but either didn't know or could not calculate other cost components which further understates the total cost of maintaining the systems.

Agencies reported that only 16 percent of the systems are compliant with Generally Accepted Accounting Principles (GAAP).

The vast majority of the systems used for financial reporting are not compliant with Generally Accepted Accounting Principles (GAAP). Agencies responded that only 16 percent of the systems were GAAP compliant. This percentage is likely even lower. GAAP reporting provides a more complete picture of an entity's true financial position by capturing expenses that the government owes but has not yet paid, as well as revenue which it is owed but has not yet received. Illinois does not complete its annual GAAP-compliant financial report until almost **a year after the end of the fiscal year**. In contrast, many businesses prepare quarterly reports, as well as annual reports that are issued

Digest Exhibit 1 **COST OF MAINTAINING THE SYSTEMS**	
Cost Component	**Estimated Cost**
Personnel costs	$11,764,349
Payments to other agencies	$8,181,076
Contracts	$1,756,346
Hardware costs	$1,105,358
Other costs	$184,401
Total:	**$22,991,530**
Cost to maintain the four CMS common systems:	$1,023,145
Grand Total:	**$24,014,675** [1]

Note: [1]This total is a conservative estimate; cost estimates were provided for only 56 percent of the systems.

Source: OAG analysis of agency surveys.

within two or three months of the end of the fiscal year. A statewide system that maintains information on a GAAP basis or routinely converts information to a GAAP basis would drastically reduce the amount of time spent by agencies during the year-end GAAP conversion process.

Half of the financial reporting systems in use at State agencies are more than 10 years old.

Half of the financial reporting systems in use at State agencies are more than 10 years old. Many of these are archaic systems that were first installed more than 20 years ago. As the systems age, updating and maintaining the systems becomes an issue. Also, the ability to interface with other systems becomes more difficult. This limits flexibility and adds cost due to duplication of work.

Fifty-three percent of the financial reporting systems are not interrelated which consequently requires manual intervention to convert data from one system so it can be used in another.

Fifty-three percent of the financial reporting systems are not interrelated which consequently requires manual intervention to convert data from one system so it can be used in another. When data is converted or manually reentered, it adds time to the process and increases the likelihood of errors. This duplicate work also adds substantial costs in operating the systems. **The total estimated annual cost resulting from duplicated data entry was not determinable. For 17 percent of the systems, agencies estimated the annual cost resulting from duplicated data entry was $11.3 million.** Agencies did not include a response for 24 percent of the systems. Also, agencies noted that three percent of the systems had duplication of effort but did not provide enough information to calculate the cost.

The estimated cost for agency fiscal staff to complete the year-end GAAP conversion process was not determinable. Based on the responses received, the cost was at least $3.7 million.

Two of the larger agencies, Transportation and Human Services, did not provide a cost estimate. In addition, 23 agencies contract with consultants to provide assistance with financial reporting or in preparing GAAP packages. In fiscal year 2010, this amount totaled $991,000.

Approximately one of every three agencies felt that lack of staff and lack of trained staff impacted their ability to complete year-end reporting in a timely and accurate manner and that the State's personnel system impeded the agency's ability to hire qualified staff.

Approximately one of every three agencies felt that **lack of staff** and **lack of trained staff** impacted their ability to complete year-end reporting in a timely and accurate manner. Approximately one of every three agencies also felt that the State's personnel system impeded the agency's ability to hire qualified staff. We recommended that the Governor's Office work with agency fiscal staff to ensure that agencies have the staff needed in the area of financial reporting and to work with Central Management Services to make any needed adjustments to the current personnel system so that agencies can obtain qualified staff. Sufficient staff which are qualified and adequately trained in financial reporting are critical for any reporting system to be successful.

The State of Illinois' current financial reporting process does not allow the State to prepare a complete and accurate Comprehensive Annual Financial Report (CAFR) or the Schedule of Expenditures of Federal Awards (SEFA) in a timely manner. Failure to submit GAAP packages in a timely fashion along with failing to submit GAAP packages accurately have been major reasons for the delays in completing the CAFR. Eighteen percent of agencies responded that the systems used do not allow the agency to complete GAAP packages in a timely fashion. This 18 percent included four of the largest seven agencies based on fiscal year 2010 appropriated expenditures and cumulatively accounted for 28 percent of the State's total fiscal year 2010 appropriated expenditures. (pages 21 – 40)

<u>Comprehensive Annual Financial Report (CAFR)</u>

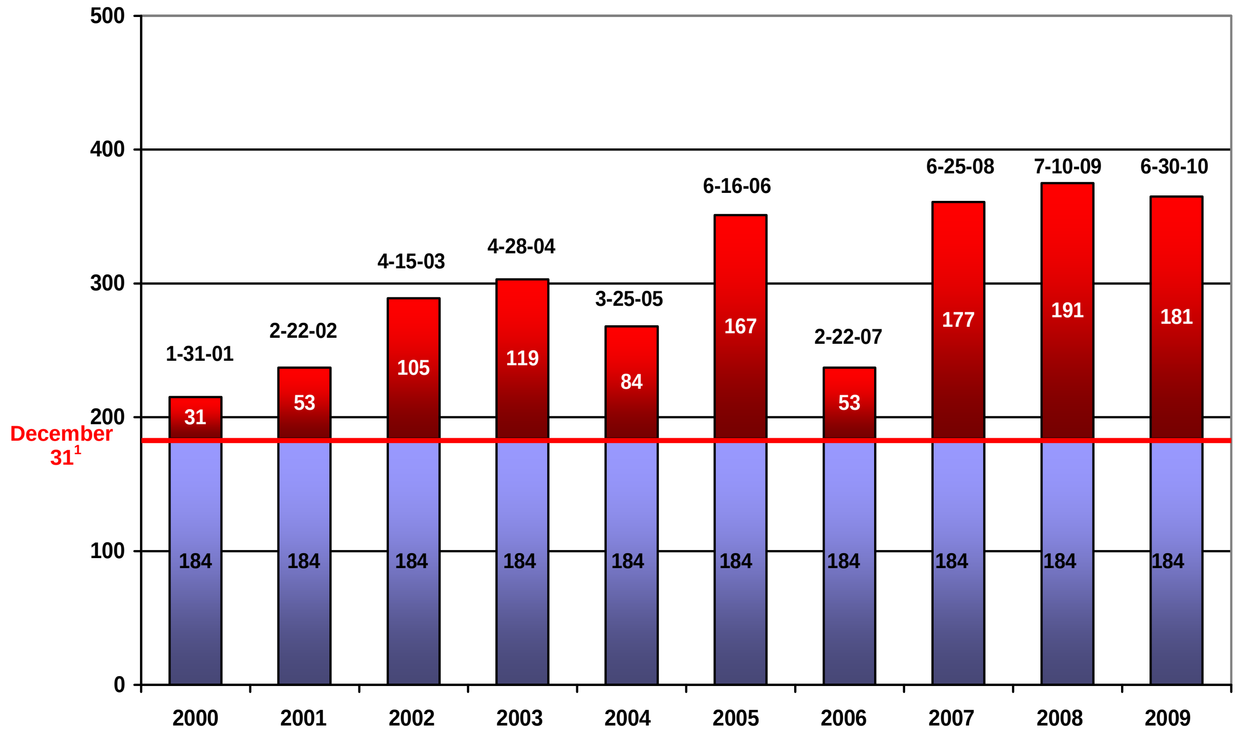
In the last three years, Illinois' CAFR was not completed until approximately one year after the end of the fiscal year. (See Digest Exhibit 2.) The delays in releasing the CAFR are significant for a number of different reasons:

The late release of the State's CAFR has an adverse affect on State financial management/oversight and is a negative factor affecting bond ratings.

- **State Financial Management/Oversight Adversely Affected.** Legislative and oversight bodies are one of the primary users of financial reports. When financial reports are not available, legislative and oversight officials are forced to use outdated information or unaudited numbers.

- **Negative Factor Affecting Bond Ratings.** The audited financial statements contained in the CAFR are one of the primary documents used by the bond rating agencies when assessing the State's financial

Digest Exhibit 2
DAYS TO COMPLETE CAFR
From End of Fiscal Year



[1] December 31 is the deadline recommended by the Government Finance Officers Association.

Source: OAG analysis of Comprehensive Annual Financial Reports.

condition. The bond rating agencies view negatively the late release of the audited financial statements. Illinois' untimely financial reports have been highlighted as negative factors in two recent reports issued by Moody's.

- **Noncompliance with Governmental Accounting Standards Board (GASB) Concepts Statement No. 1 Objectives of Financial Reporting.** Regarding timeliness, it states "If financial reports are to be useful, they must be issued soon enough after the reported events to affect decisions…the passage of time usually diminishes the usefulness that the information otherwise would have had." The untimely release of the State's CAFR is not in compliance with the most basic of financial reporting objectives. (pages 40 – 43)

Statewide Single Audit

Since 2000, Illinois has not completed the Statewide Single Audit within the required nine month deadline and has shown no improvement towards meeting the deadline. The delay in

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completing and submitting the Statewide Single Audit is significant for a number of different reasons:

- **Noncompliance with Federal Single Audit Time Requirements.** The federal government requires most entities that receive federal awards to have an audit conducted which must be submitted within nine months after the end of the fiscal year. The federal government has also considered shortening the timeframe for submitting the single audit from nine months to six months.

Untimely financial reporting could have a negative impact on federal funding.

- **Negative Impact on Federal Funding.** Each year, the State of Illinois depends heavily on funding received from the federal government. In fiscal year 2009, Illinois expended $23.7 billion in federal awards. Officials from the federal Department of Health and Human Services, which is the federal oversight agency for Illinois, noted that, although it was unlikely that a State would lose its federal funding, untimely financial reporting could have an effect on the amount of discretionary funding received. In May 2010, the Illinois Student Assistance Commission received a letter from the U.S. Department of Education regarding the single audit. The letter stated that if the audit was not submitted within 15 days, it would be classified as missing. The letter further stated that the Secretary of Education may "…suspend the payment of account maintenance fees, default fees, and claims to an entity that does not submit its audit within the required time period."

Untimely financial reporting hampers oversight and adds to the cost of administering the programs.

- **Hampers Oversight and Adds to the Cost of Administering the Programs.** One result of late reporting is increased scrutiny from the federal government. Increased scrutiny has several effects including making it more costly for the state to administer the program.

We recommended that the Governor's Office and the Office of the Comptroller develop and implement a plan to correct the problems with the current financial reporting process and begin overhauling the State's financial reporting system. (pages 43 – 46)

__Results from Other States__

Senate Resolution Number 609 asked us to survey other states to determine their methods of financial reporting and any advantages or disadvantages to those methods. To accomplish this, we surveyed the state officials responsible for preparing the Comprehensive Annual Financial Report (CAFR) in the 50 states and the District of Columbia. We received responses from 67 percent (34 of 51) of the states surveyed.

Illinois was one of only three states that reported having a decentralized financial reporting system.

Illinois was one of only three states that reported having a decentralized financial reporting system. Including Illinois, 9 percent (3 of 34) of the states responding had a decentralized financial reporting system. For 62 percent (21 of 34), the states had a centralized financial reporting system but it was not GAAP compliant. This means that the preparer of the CAFR does a conversion or reconciliation process for GAAP reporting. For 24 percent (8 of 34), the states had a centralized financial reporting system that generated GAAP compliant information. This type of system is the most desirable option.

In the last five years, 8 of our 34 responding states have either implemented or began the implementation process for a new centralized financial reporting system. The cost of implementing a new financial reporting system ranged from $7.2 million in Rhode Island to $158 million in Ohio. Of the eight states, Ohio was the only one that reported a vendor developed system. The other systems were either purchased off the shelf or purchased off the shelf and then tailored to meet the needs of the state. Georgia implemented a system that cost only $485,000 but it was not comparable to the other systems because it was a consolidation and reporting system that feeds data from an underlying system.

In addition, ongoing costs are a part of maintaining a centralized financial reporting system. We asked the eight states with newer systems how much is spent in software maintenance, application management, enhancements and other costs. Total ongoing costs for four of the states ranged from Rhode Island spending the least, with $1.65 million annually, to Tennessee spending the most at $17 million annually.

Compared to the other states over the last five years, Illinois has ranked 49th, 41st, 49th, 50th, and 49th in releasing its CAFR.

We compared Illinois' timeliness in releasing the CAFR and Statewide Single Audit with the other 49 states and the District of Columbia. In the last five years, Illinois has ranked 49th, 41st, 49th, 50th, and 49th in releasing its CAFR. Similarly, Illinois ranked second to last in releasing its most recent Statewide Single Audit, releasing it 119 days past the nine month deadline. Over the last five years, Illinois has ranked 40th (of 45), 43rd (of 45), 40th (of 46), 43rd (of 47), and 46th (of 47) in releasing the Statewide Single Audit.

We asked states if there were any consequences to an agency for not complying with reporting deadlines. Of the states responding, 14 responded yes, 19 responded no, and 1 state responded that there are consequences for CAFR late reporting but not for SEFA. (pages 48 – 63)

Implementation Issues

When conducting a system implementation project, there are practices to avoid and others to embrace that can increase the likelihood of a successful implementation. In reviewing system failures and literature espousing best practices, a few basic themes appear to come to the forefront:

- Project Management – Project management is the discipline of planning, organizing, securing and managing resources to bring about the successful completion of project goals and objectives.
- End User Participation – When end users are actively included in the development process, including the development of system specifications, design of functional requirements, and user acceptance testing, such involvement is likely to result in increased user satisfaction and the perceived usefulness of the system.
- Constant communication – Communication must flow freely and constantly between management, developers, end users, project management, and independent reviewers.

There are many different reasons why system implementations fail; however, the following list outlines some of the most common problems.

- Lack of top management commitment;
- Inadequate project management process;
- Inadequate scope management;
- A lack of experience defining the functional requirements;
- Lack of communication;
- Poor or no quality assurance process; and
- Inadequate training and education. (pages 66 – 71)

Other Issues

The amount of training offered by the Comptroller and attendance at those trainings has declined in recent years.

The amount of training offered by the Comptroller and attendance at those trainings has declined in recent years. The most recent Basic GAAP training course was only attended by 15 employees from 8 agencies. A GAAP Update training course has not been held since 2008. In our agency survey, 33 percent (25 of 75) of agencies responding indicated that additional training from the Comptroller's Office on GAAP reporting would be beneficial. We recommended that the Comptroller's Office assess its training approach and develop a new policy on agency training.

It is also critical that agencies are aware of new standards that impact financial reporting. While agencies need to take the initiative to be aware of new standards, the Comptroller's Office needs to provide information on these standards and how they will affect reporting to the Comptroller. In our agency survey, 27 percent (21 of 77) responded that they did not receive timely information from the Comptroller on new standards.

There has been a lack of cooperation amongst the principals involved in Illinois' financial reporting process.

There has been a lack of cooperation amongst the principals involved in Illinois' financial reporting process. The Comptroller collects information from agencies and completes the CAFR. However, the Comptroller does not have authority over these agencies and there is no penalty if the agencies do not comply with the Comptroller's established due dates. We recommended that the Comptroller's Office and the Governor's Office work together to establish and monitor financial reporting target completion dates. Cooperation would also aid in making sure agencies are complying with completion dates and submitting requested information in a timely manner.

The State of Illinois maintains an inordinate number of funds; an estimated 900 different funds were utilized in fiscal year 2009.

The State of Illinois maintains an inordinate number of funds. In response to our survey, the Comptroller's Office estimated that 900 different funds were utilized in fiscal year 2009. A complex fund structure increases the level of effort necessary to account for and report transactions and increases the risk of errors and omissions. Since agencies are required to complete a GAAP package for each fund in which they have activity, many agencies are required to submit multiple GAAP packages. In fiscal year 2009, **12 agencies were required to submit 30 or more GAAP packages.** We recommended that the Governor's Office and the Comptroller's Office work with the General Assembly to reduce the complexity of the State's fund structure. (pages 73 – 80)

RECOMMENDATIONS

The audit report contains five recommendations; one to the Governor's Office, one to the Comptroller's Office, and three to both. The Governor's Office and the Comptroller's Office agreed with all of the recommendations. Appendix F to the audit report contains the Governor's Office and the Comptroller's Office responses.

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AUDITORS ASSIGNED: This Management Audit was performed by the Office of the Auditor General's staff.