Volume 18 • 2012 Annual

ILLINOIS Audit ADVISORY

Emerging and Potential Audit Issues

William G. Holland
AUDITOR GENERAL

AUDITOR GENERAL'S MESSAGE

A fundamental concept in the auditor and auditee relationship is that the auditor identifies a finding and the auditee takes corrective action to address the finding. However, as discussed in this edition of the Advisory, we are seeing an increasing number of findings being repeated from prior audits because agencies have not taken corrective action. The failure to take corrective action is a concern of members of the General Assembly and should be a concern for agency management.

In this past session of the General Assembly, my Office was given several new responsibilities. One of the most noteworthy was the responsibility to implement a new fraud hotline for the State. This edition of the Audit Advisory provides an overview of my Office's implementation of the fraud hotline.

Finally, in May 2012, the General Assembly unanimously appointed me to a third ten-year term as Auditor General, effective August 1. As I stated back in the 2002 edition of the Audit Advisory when I was reappointed to my second term, it continues to be my goal to present fair and objective audit reports. That goal cannot be achieved without developing and maintaining sound working relationships with agency officials. I sincerely appreciate the cooperation you have provided to my Office over the past 20 years.

WILLIAM G. HOLLAND
September 2012

OAG FRAUD HOTLINE

As required by Public Act 97-261, the Office of the Auditor General has established a toll-free fraud hotline for the public to report allegations of fraud in the executive branch of State government. The toll free number is **1-855-217-1895**. This hotline is available 24 hours a day, 7 days a week. Operators are generally available Monday-Friday from 8:30 a.m. to 4:30 p.m.

In addition to calling the toll-free number, other options have been established for the public to report allegations of fraud. The public may also:

- complete the Fraud Reporting Form on-line located on the OAG web-site (www.auditor.illinois.gov);
- e-mail a description of the allegation to: OAGHotline@mail.state.il.us;
- contact the Auditor General via telecommunications device for the disabled (TTY) at 1-888-261-2887; or
- send a written report via the U.S. Postal Service to the following address: Fraud Hotline, Auditor General's Office, 740 E. Ash St., Springfield, IL 62703.

Individuals reporting alleged fraud to the hotline need not identify themselves. However, if the individual chooses not to be identified, the Office's ability to follow up on the allegation may be limited.

The Fraud Hotline section of the OAG web-site has additional information regarding the reporting of fraud allegations. Such information includes entities covered by the hotline's jurisdiction (e.g., the executive branch only, not legislative and judicial branches, nor units of local government), as well as other resources the public may use to report fraud if it is outside of the jurisdiction of the OAG. Even if the Auditor General's Office does not have jurisdiction over the allegation, our hotline manager will try to direct the caller to another State, federal or local agency that may be able to help.

REPEAT AUDIT FINDINGS

In carrying out their responsibilities, auditors identify areas where agency operations can be improved, controls strengthened, or compliance with laws and regulations enhanced. When deficiencies are noted, auditors make recommendations identifying corrective action that agency management should take. However, auditors have no role in implementing the corrective action; management has the responsibility to ensure that corrective action is implemented. The OAG then follows up on findings from prior audits to determine whether they have been addressed. If they have not been corrected, the finding and associated recommendation is repeated in the next audit.

Many findings contained in the Office of the Auditor General's audit reports are not addressed in a timely manner by agency officials and thus are repeated in subsequent audits. For example, in the Office of the Auditor General's Fiscal Year 2011 audits, 415 of the 674 findings (62%) were repeated from the prior audit. Some findings have been repeated for more than five years.

See REPEAT FINDINGS on Page 2

REPEAT FINDINGS

Continued from page 1

While not a new phenomena, the percentage of findings that are repeated in subsequent audits has been increasing in recent years. In FY02 audits, 35% of the findings were repeated from the prior audit; in FY11 audits, 62% of the findings were repeated from the prior audit. The exhibit below summarizes the number of findings that have been repeated over the past 10 years.

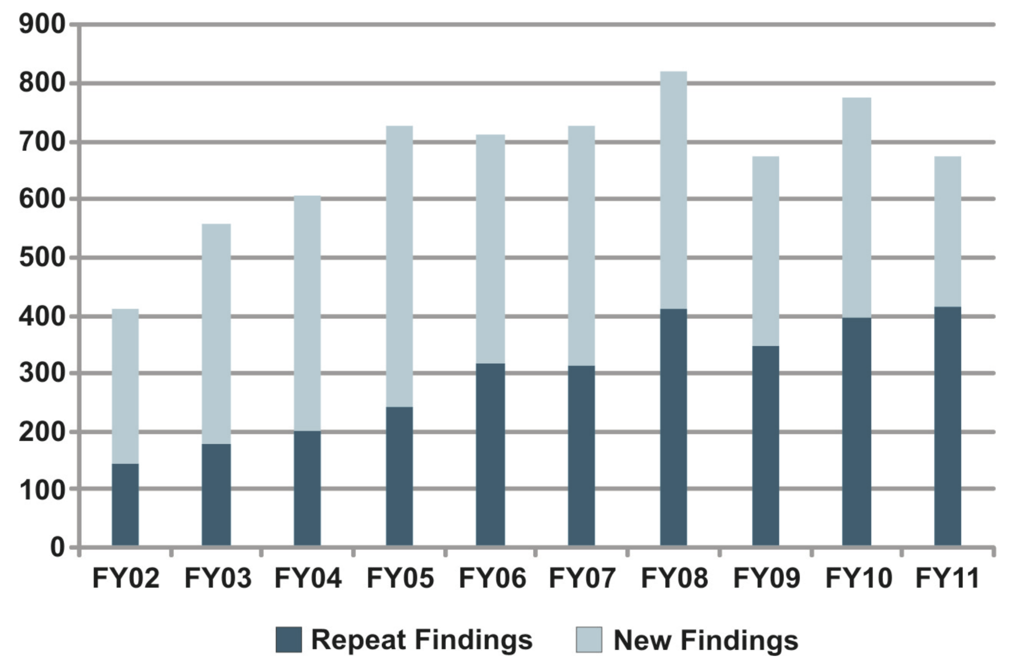
Agencies identified various reasons for why the finding was repeated (see inset, above right). The most common cause cited in FY11 repeated findings was a lack of effective oversight/poor internal controls. The second most common cause was lack of staffing and/or funding to implement the corrective action recommended. Other reasons included staff error and technology issues. In a few instances, agencies disagreed with the findings reported by the auditors and thus have not taken any action to implement the recommendation.

While informing agency officials, legislators, and the public of areas where improvements are needed is a beneficial effect of an audit, the audit's full effectiveness is diminished if identified problems go uncorrected. In addition to following up on repeated findings in subsequent audits, the Auditor General's Office is taking additional steps related to repeat findings. These efforts include highlighting repeat findings in our report digests, as well as emphasizing them in our presentations to the Legislative Audit Commission. ■

CAUSES FOR REPEAT FINDINGS

FY11 Audits

1. Lack of Oversight or Poor Internal Controls 39%
2. Lack of Staffing or Funding 26%
3. Staff Error 12%
4. Technology Issues 4%
5. All Others 19%



FULFILLING INFORMATION REQUESTS

During the course of an audit, auditors make numerous information requests of agencies. Agency officials need to make sure that the information they are providing to the auditors is complete and accurate. When agencies provide information which is incomplete or inaccurate, it not only delays the audit, it can also raise the professional skepticism of the auditors. The following are some recent examples experienced by OAG auditors:

- Electronic data files were incomplete or contained inaccuracies. Revised data needed to be requested.
- Documentation to support billings was not provided – it was subsequently made available after the audit. In another instance, documentation was provided but when auditors found it did not support the billings, two additional and conflicting sets of documentation were provided.
- An agency cited specific policies as being applicable to transactions being tested. When auditors identified noncompliance with those policies, the agency stated that those policies were not applicable and cited other policies.

Providing auditors with the correct information helps expedite the audit process, which is of benefit to both the auditors and the agency. If agency officials are unsure of what the auditors are requesting, they should immediately follow-up with the auditors to obtain clarification. ■

HIGH RISK AREAS

Our audits identify certain aspects of State government that expose the State to an unacceptable level of risk. Since 2007, we have been highlighting these high risk areas in the Audit Advisory. The four high risk areas highlighted below are: 1) Contracting Processes; 2) Subrecipient Monitoring; 3) Fraud and Abuse; and 4) Untimely Financial Reporting.

Audits have continued to identify shortcomings in the State's procurement processes, including using criteria not included in the RFP to evaluate proposals, not adequately documenting the procurement process, and errors in scoring that impacted the selection of vendors.

Regarding subrecipient monitoring, the 2011 Statewide Single Audit had 21 issues dealing with deficiencies in agencies' monitoring of subrecipients' use of federal funds. Audits have also identified weaknesses in agencies' internal controls that make processes susceptible to fraud and/or abuse.

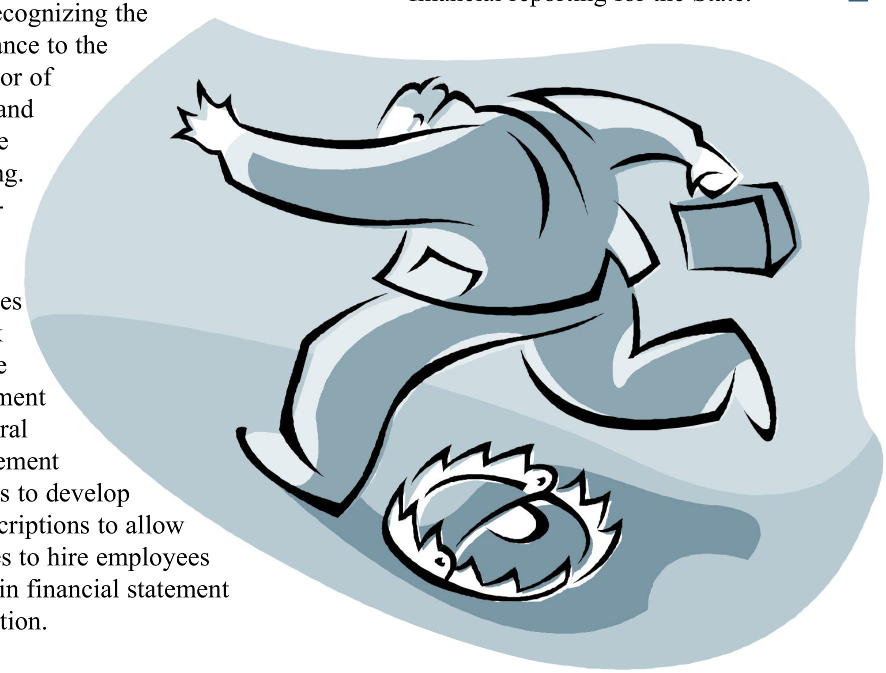
The fourth area, untimely financial reporting, continues to pose significant risks to the State of Illinois. It is also an area of high risk where significant, positive actions have occurred to begin the process to address this problem.

The issues pertaining to untimely financial reporting have been documented for years in our audit of the State's Comprehensive Annual Financial Statements, as well as in the Statewide Single Audit. In addition, in 2011 the Auditor General issued a comprehensive management audit of the State's Financial Reporting System.

As in years past, the first finding in the Auditor General's FY 2011 audit of the State's Comprehensive Annual Financial Report (CAFR) and Related Report on Internal Control and Compliance dealt with the State's inadequate financial reporting process. The report noted that the State has a highly decentralized financial reporting process.

Agencies are required to prepare a series of complicated financial reporting forms designed by the Office of the State Comptroller to prepare the CAFR. For the most part, these forms are completed for each of the State's 821 primary government/fiduciary funds and 26 component units. The forms are completed by accounting personnel within each State agency who have varying levels of knowledge, experience, and understanding of Generally Accepted Accounting Principles (GAAP) and of the State's accounting policies and procedures. Agency personnel involved with this process are not under the organizational control or jurisdiction of the Office of the State Comptroller. Finally, as noted in our 2011 management audit, the State's financial reporting "system" is actually comprised of over 260 separate systems, many of which are antiquated and not interrelated.

The Governor's Office agreed with the finding noting that the Governor's Office, the Governor's Office of Management and Budget (GOMB), and the Office of the Comptroller are working to address these challenges. The three agencies have developed a timeline for short term, mid-term and long range plans. In fiscal year 2012, all agency heads signed a letter recognizing the importance to the Governor of timely and accurate reporting. In addition, GOMB continues to work with the Department of Central Management Services to develop job descriptions to allow agencies to hire employees skilled in financial statement preparation.



The Governor's Office noted that a steering committee has been established. It is comprised of the chief information officer, members of the General Assembly as well as representatives of GOMB, the Comptroller's Office, and several operating agencies. The steering committee has met several times and has reviewed the information available from work by prior consultants. Currently a request for proposals (RFP) is being developed to secure a consultant. This consultant will develop the necessary Statewide accounting requirements and develop an RFP for software and implementation services to address the State's need. Once funding and a vendor are secured it will still take several years, and internal control issues will persist, until this process is complete.

The Comptroller's Office responded that it will continue to assist the Governor's Office in their efforts to increase the quality of GAAP packages and provide training and technical assistance to State agencies.

In addition, Public Act 97-1055, effective August 23, 2012, (SB 3794) creates a Financial Accounting Standards Board whose mission is to improve the timeliness, quality, and processing of financial reporting for the State.

ESTIMATING THE ALLOWANCE FOR UNCOLLECTIBLE RECEIVABLES

Taxes, loans and notes receivable totaled $8.4 billion in the State of Illinois' Comprehensive Annual Financial Report (CAFR) for the year ended June 30, 2011. Agency management estimated that approximately 13% or $1.06 billion of the total taxes, loans and notes receivable will not be collected in the future. How management arrives at an estimate for uncollectible accounts presents a unique challenge to management – and auditors.

Over the last several years, the Office of the Auditor General has reported numerous findings at agencies for failure to properly develop and document the basis for estimating uncollectible receivables. Some of the findings resulted in material adjustments and restatement of agency financial statements. Problems identified included:

- Management failed to adequately support the percentages used in their estimates – sometimes there was no support; other times the percentages were established years ago and could no longer be supported by management.
- Management failed to identify material uncollectible accounts.
- Methodologies did not correlate to historical facts and analysis.
- Management did not take into account changes in the insurance or collateralization supporting the collectability of receivables balances.
- Management failed to properly maintain monitoring tools, such as a "watch list" of potential doubtful accounts or historical collection data trends.

Generally accepted accounting principles (GAAP) require agency management to estimate and record any material allowance for uncollectible accounts that are probable and that can be reasonably estimated. Agency management may base their estimate of uncollectible receivables on prior experience, the debtor's ability to pay and/or on an appraisal of current economic conditions. Some of the tools management might consider using include:

- An internally generated "watch list", past due reports and receivables aging reports;
- Historical loss experience by type of loan;
- Current financial statements of borrowers;
- Evaluation of loan collateral value;
- Loan documentation and compliance exception reports; and
- Regulatory examination reports.

Office of the Auditor General
- Iles Park Plaza, 740 East Ash Street
  Springfield, Illinois 62703-3154
- Michael A. Bilandic Building,
  160 N. LaSalle Street, Suite S-900
  Chicago, Illinois 60601-3109

Phone: 217-782-6046
Fax: 217-785-8222
TTY: 1-888-261-2887
Fraud Hotline: 1-855-217-1895
E-mail: auditor@mail.state.il.us
Website: www.auditor.illinois.gov