

STATE OF ILLINOIS

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

For the Year Ended June 30, 2006

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OFFICE OF THE AUDITOR GENERAL
WILLIAM G. HOLLAND

REPORT ON INTERNAL CONTROL OVER FINANCIAL REPORTING AND ON
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Honorable Emil Jones, Jr., President of the Senate
Honorable Michael J. Madigan, Speaker of the House
Members of the General Assembly
Honorable Rod Blagojevich, Governor
Honorable Daniel Hynes, Comptroller

We have audited the financial statements of the governmental activities, the business-type activities, each major fund, and the aggregate remaining fund information of the State of Illinois as of and for the year ended June 30, 2006 as listed in the Table of Contents for Section II of the Illinois Comprehensive Annual Financial Report, which collectively comprise the State of Illinois' basic financial statements and we have issued our report thereon dated February 22, 2007. 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 State 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. However, we noted certain matters involving the internal control over financial reporting and its operation that we consider to be reportable conditions. Reportable conditions involve matters coming to our attention relating to significant deficiencies in the design or operation of the internal control over financial reporting that, in our judgment, could adversely affect the State of Illinois' ability to record, process, and report financial data consistent with the assertions of management in the financial statements. Reportable conditions are described in the accompanying schedule of findings as Findings 06-1, 06-2, and 06-3.

A material weakness is a reportable condition in which the design or operation of one or more of the internal control components does not reduce to a relatively low level the risk that misstatements caused by error or fraud in amounts that would be material in relation to the financial statements being audited may occur and not be detected within a timely period by employees in the normal course of performing their assigned functions. Our consideration of the internal control over financial reporting would not necessarily disclose all matters in the internal control that might be reportable conditions and, accordingly, would not necessarily disclose all reportable conditions that are also considered to be material weaknesses. However, of the reportable conditions described above, we consider Findings 06-1 and 06-3 to be material weaknesses.

We also noted other matters involving the internal control over financial reporting, which we have reported to management of the Office of the Comptroller in a separate letter dated February 22, 2007.

Compliance and Other Matters

As part of obtaining reasonable assurance about whether the State 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 that are required to be reported under *Government Auditing Standards*.

This report is intended solely for the information and use of the Auditor General, the General Assembly, the Legislative Audit Commission, the Governor, the State's Management 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.



WILLIAM G. HOLLAND
Auditor General
State of Illinois



BRUCE L. BULLARD, CPA
Director of Financial and Compliance Audits
Office of the Auditor General

Springfield, Illinois
February 22, 2007

06-1. **FINDING** (Financial Reporting Weaknesses)

The Illinois Office of the Comptroller (IOC) did not have adequate controls to assess the risk that information reported by individual agencies would not be fairly stated and compliant with generally accepted accounting principles (GAAP).

During our audits of individual agencies a wide range of financial reporting errors and noncompliance with the IOC's accounting and reporting policies were identified by the auditors and reported to management at various agencies. Among these issues were 29 findings for 17 agencies that were considered significant deficiencies in the internal controls over financial reporting. Of the 29 findings reported, 8 related to 7 agencies classified as part of the primary government and 21 related to 10 agencies classified as component units.

Good internal controls would require the IOC to have a formal system in place to identify the risk of inaccurate reporting and the risk of underlying source data not being reliable and properly maintained. Additionally, good internal controls would require the IOC to have a formal system in place to identify reporting errors and omissions material to the financial statements. These systems should be separate from the audit function to ensure appropriate levels of responsibility and independence are maintained during the preparation and auditing of the financial statements.

In discussing these conditions with IOC personnel, they indicated misstatements were caused by a separation in the responsibility for the State's internal control procedures among agencies and component units. The IOC has the statutory authority to develop and prescribe accounting policy for the State but there is no centralized automated system in place to capture all items necessary to provide underlying support to review agency financial activities. IOC estimates that the cost of a modernized statewide system would well exceed \$100 million. It is currently each State agency who maintains statutory responsibility for the proper function of accounting and other operating policies prescribed by the Comptroller. (Finding Code No. 06-1, 05-1, 04-1, 03-1, 02-1)

RECOMMENDATION

We recommend the IOC implement additional internal control procedures in order to assess the risk of material misstatements to the State's financial statements and identify such misstatements during the financial statement preparation process. The internal control procedures should include a formal evaluation of prior problems and implementation of procedures to reduce the risk of these problems reoccurring. Additionally, the IOC should enhance their periodic interaction with and assistance to management of other agencies to correct significant deficiencies in internal controls over financial reporting.

AGENCY RESPONSE

Agreed. IOC will continue to work with officials from agencies that have significant deficiencies in internal control over financial reporting to improve compliance with Comptroller statutory responsibilities and policies.

06-2. **FINDING** (Inefficient accounting system)

The Illinois Office of the Comptroller (IOC) did not have an efficient electronic system to compile the State's Comprehensive Annual Financial Report (CAFR). The IOC uses several different systems and methods to gather information and compile the financial information. The majority of these systems do not inter-relate electronically causing manual input and additional review.

The IOC electronically imports cash basis financial information from the statewide accounting management system (SAMS), a mainframe based application, into a separate database through a four step automated process. IOC personnel then review 100% of the data to ensure accuracy and completeness of the conversion. The database is accessed through the Web-based Electronic Data Gathering Environment (WEDGE) system, a front-end web-based data entry application. Adjustments and reclassifications are recorded in the database to convert the cash basis financial information to the appropriate basis of accounting (accrual or modified accrual) used in the State's fund financial statements. The majority of these adjustments and reclassifications are made by various State agency personnel to the funds administered by their respective agencies. The IOC then generates financial statements using several different programs to manage the database information, control the programming flow of the financial information, and produce final reports. Manual review indicated errors during the data conversion process. Additionally, related database tables were not synchronized requiring IOC personnel to manually update the same data in multiple locations.

The WEDGE system is supplemented by several other IOC systems. One of the electronic systems is used by the IOC to gather information from State agencies regarding intrafund activity (567/568 system). The information from this system is used to document adjustments and reclassifications made to the WEDGE system cash basis information for intrafund activity.

Another system gathers information regarding external grants and contracts using a web-based reporting form (SCO-563 form). This information is used to document adjustments and reclassifications to the WEDGE system cash basis information for external grant and contract activity. The information on the SCO-563 form is also communicated to the Office of the Auditor General for preparation of the State's Schedule of Expenditures of Federal Awards. Analysis of this information is conducted to evaluate the completeness and fair presentation of this required federal schedule for State reporting in accordance with OMB Circular A-133.

The IOC also maintains a separate electronic system to gather information regarding bond indebtedness of the State. Various electronic spreadsheets are maintained to supplement this system in order to calculate summarized accrual basis information for bond transactions (i.e. amortization of interest costs, premiums and discounts).

Most primary accounting information is communicated to the IOC through the WEDGE system. However, the process requires State university, the State pension system, investment trust fund, and private purpose trust fund information to be communicated to the IOC using manual reporting forms. In addition, manual forms are used to provide essential footnote disclosure information and to demonstrate various reconciliations of the information reported.

Good business practices and good internal controls would require a well-designed electronic system be used for financial reporting to reduce the potential for manual input errors and to provide electronic checks and balances.

In discussing these conditions with IOC personnel, they stated they agreed certain systems would benefit significantly from more electronic integration. However, they believed the relative affordability of the current manual inputs and related review processes outweighs the efficiency offered by a comprehensive, electronically interfaced statewide system due to the substantial overall costs of implementing such a system. (Finding Code No. 06-2, 05-2, 04-2, 03-2)

RECOMMENDATION

We recommend the IOC implement an electronic CAFR accounting system that significantly reduces the need for manual input and provides electronic checks and balances.

AGENCY RESPONSE

Agreed. The IOC will continue to replace manual inputs with electronic systems and to integrate these electronic systems as determined economically practical.

06-3. **FINDING** (Failure to identify a major fund)

The Illinois Office of the Comptroller (IOC) does not have adequate controls for identifying major funds for inclusion in the Comprehensive Annual Financial Report (CAFR).

During our review of the financial reporting process, we noted that the IOC did not properly identify and separately report a major fund – the Prepaid Tuition Trust Fund - in the CAFR. The IOC made necessary adjustments to properly report the fund as major.

In accordance with Governmental Accounting Standards Board (GASB) Statements 34 and 37, individual governmental and enterprise funds should be reported in separate columns as major funds based on these criteria:

- a. Total assets, liabilities, revenues or expenditures/expenses of that individual governmental or enterprise fund are at least 10 percent of the corresponding element total (assets, liabilities, and so forth) for all funds of that category or type (total governmental or total enterprise funds), and
- b. The same element that met the 10 percent criterion in (a) is at least 5 percent of the corresponding element total for all governmental and enterprise funds combined.

Office personnel stated the failure to include the Prepaid Tuition Trust Fund as a major fund in the CAFR as a separate major fund was an oversight.

Failure to identify a major fund causes the CAFR to not be reported in accordance with generally accepted accounting principles. (Finding Code No. 06-3)

RECOMMENDATION

We recommend the IOC properly identify major funds in the future to ensure the Comprehensive Annual Financial Report is fairly presented.

AGENCY RESPONSE

Agreed. IOC will properly identify major funds to ensure information presented in the CAFR is in compliance with generally accepted accounting principles.

PRIOR FINDINGS NOT REPEATED

06-4. **FINDING** (Delays in Financial Reporting)

During the prior audit, the Illinois Office of the Comptroller (IOC) did not prepare the Statewide Financial statements for the year ended June 30, 2005 in a timely manner. The financial statements were not available to the public until June 30, 2006. (Finding Code No.05-3)

During the current audit, the IOC made the financial statements for the year ended June 30, 2006 available to the public on March 1, 2007. It appears the IOC is making progress toward better controls in this area, however, issues related to delays in financial reporting have not been fully resolved, and are presented in the report on immaterial findings as immaterial finding IM06-1.