

UNIVERSITY OF ILLINOIS
(A Component Unit of the State of Illinois)
Reports Required Under
Government Auditing Standards
For the Year Ended June 30, 2017
Performed as Special Assistant Auditors
for the Auditor General, State of Illinois



CliftonLarsonAllen

UNIVERSITY OF ILLINOIS

(A Component Unit of the State of Illinois)

**Reports Required Under
*Government Auditing Standards***

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UNIVERSITY OF ILLINOIS
(A Component Unit of the State of Illinois)

TABLE OF CONTENTS

| | PAGE |
|---|-------------|
| UNIVERSITY OFFICIALS | 1 |
| SUMMARY | 2 |
| 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 | 3 |
| SCHEDULE OF FINDINGS | 5 |

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UNIVERSITY OF ILLINOIS
(A Component Unit of the State of Illinois)
Government Auditing Standards Report

Government Auditing Report Summary

The audit of the financial statements of the University of Illinois (University) was performed by CliftonLarsonAllen LLP in accordance with *Government Auditing Standards*. This report is an integral part of that audit. Based on their audit and the reports of other auditors, the auditors expressed an unmodified opinion on the University's basic financial statements.

Summary of Findings

The auditors identified certain deficiencies in internal control over financial reporting that they considered to be significant deficiencies, which are described in the accompanying schedule of findings and responses on pages 5 through 15 of this report.

Exit Conference

A request to waive a formal exit conference was made by the University in a correspondence dated January 9, 2018. Responses and recommendations were provided by the University's Office of Business and Financial Services in correspondence dated January 22, 2018.



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

Honorable Frank J. Mautino
Auditor General, State of Illinois
and
Board of Trustees
University of Illinois

As Special Assistant Auditors for the Auditor General, we have audited, in accordance with the 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, the financial statements of the business-type activities of University of Illinois and the aggregate discretely presented component units, collectively a component unit of the State of Illinois, as of and for the year ended June 30, 2017, and the related notes to the financial statements, which collectively comprise the University of Illinois' basic financial statements, and have issued our report thereon dated January 30, 2018.

Our report includes a reference to other auditors who audited the financial statements of the discretely presented component units, as described in our report on the University's financial statements. Other auditors audited the financial statements of the University of Illinois Foundation (a discretely presented component unit) in accordance with *Government Auditing Standards*, as described in our report on the University's financial statements. This report does not include the results of the other auditors' testing of internal control over financial reporting or compliance and other matters that are reported on separately by those auditors. The financial statements of the University of Illinois Alumni Association; Wolcott, Wood, and Taylor, Inc.; Prairieland Energy, Inc.; Illinois Ventures, LLC; the University Research Park, LLC; and UI Singapore Research, LLC (all discretely presented component units), were not audited in accordance with *Government Auditing Standards* and accordingly this report does not include reporting on internal control over financial reporting or instances of reportable noncompliance with those entities.

Internal Control Over Financial Reporting

In planning and performing our audit of the financial statements, we considered the University of Illinois' internal control over financial reporting (internal control) to determine the audit procedures that are appropriate in the circumstances 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 University of Illinois' internal control. Accordingly, we do not express an opinion on the effectiveness of the University of Illinois' internal control.

Our consideration of internal control was for the limited purpose described in the preceding paragraph and was not designed to identify all deficiencies in internal control that might be material weaknesses or significant deficiencies and therefore, material weaknesses or significant deficiencies may exist that have not been identified. However, as described in the

accompanying schedule of findings, we identified certain deficiencies in internal control that we consider to be material weaknesses and significant deficiencies.

A deficiency in internal control 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 a combination of deficiencies, in internal control, 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 deficiency described in the accompanying schedule of findings as item 2017-005 to be a material weakness.

A significant deficiency is a deficiency, or a combination of deficiencies, in internal control 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 as items 2017-001, 2017-002, 2017-003 and 2017-004 to be significant deficiencies.

Compliance and Other Matters

As part of obtaining reasonable assurance about whether the University of Illinois' financial statements are free from 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*.

University of Illinois' Response to Findings

The University of Illinois' response to the findings identified in our audit is described in the accompanying schedule of findings. The University of Illinois' responses were not subjected to the auditing procedures applied in the audit of the financial statements and, accordingly, we express no opinion on them.

Purpose of this Report

The purpose of this report is solely to describe the scope of our testing of internal control and compliance and the result of that testing, and not to provide an opinion on the effectiveness of the University of Illinois' internal control or on compliance. This report is an integral part of an audit performed in accordance with *Government Auditing Standards* in considering the University of Illinois' internal control and compliance. Accordingly, this communication is not suitable for any other purpose.

SIGNED ORIGINAL ON FILE

CliftonLarsonAllen LLP

Peoria, Illinois
January 30, 2018

UNIVERSITY OF ILLINOIS
(A Component Unit of the State of Illinois)
CURRENT FINDINGS - GOVERNMENT AUDITING STANDARDS
For the Year Ended June 30, 2017

2017-001. Finding: Inadequate Procedures over Expense Deferrals and Other Cut-off Related Issues

The University of Illinois (the University) has not established adequate internal controls over accurately identifying and recording deferred expense transactions and reporting prepaid expenses at fiscal year-end for financial reporting purposes.

During our audit, we noted that the University's procedures to identify and record prepaid expenses include a review of all cash disbursements by University Payables (UPAY). UPAY identifies expense transactions that pertain to multiple fiscal years and codes them for further review by University Accounting and Financial Reporting (UAFR). UAFR will then post year-end journal entries to appropriately defer the identified expense transactions. In addition to the review of all cash disbursements by UPAY, UAFR also requires individual units to identify and report known accrual and deferral transactions at fiscal year-end for certain fund types. We also noted that the University's year-end accounts payable procedures include specifically reviewing cash disbursements made subsequent to year-end through the end of October to determine which accounting period the related expense transactions pertain.

In relation to our test work over expense transactions, we reviewed 225 cash disbursement transactions (totaling \$46,313,716), 60 P-Card expense transactions (totaling \$316,272), and 60 T-Card expense transactions (totaling \$428,908) recorded during the fiscal year. In relation to our test work over revenue transactions, we reviewed 60 cash receipt transactions recorded during the fiscal year (totaling \$120,935,264). We also reviewed 34 cash disbursements occurring subsequent to year-end (totaling \$72,993,712). Additionally, we separately reviewed 20 internal journal voucher transactions recorded during the fiscal year (totaling \$36,022,969).

During our review of these transactions, we noted the following items were not recorded in the proper accounting period:

University of Illinois transactions

- Two (2) general expense cash disbursements (totaling \$173,843) that were recorded as expenses for fiscal year ended June 30, 2017, should have been fully accrued as of June 30, 2016.
- Two (2) telecommunication expense cash disbursements (totaling \$78,538) that were recorded as expenses for fiscal year ended June 30, 2017, should have been partially deferred as of June 30, 2017 at an amount of \$46,512, and then recognized as expenses for the fiscal year ending June 30, 2018.
- One (1) cash receipt (totaling \$8,864) that was recorded as operating revenue for the fiscal year ended June 30, 2017, should have been partially accrued as of June 30, 2016 at an amount of \$429.
- One (1) cash receipt (totaling \$29,483) that was recorded as operating revenue for the fiscal year ended June 30, 2017, should have been fully deferred as of June 30, 2017, and then recognized as operating revenue for the fiscal year ending June 30, 2018.

UNIVERSITY OF ILLINOIS
(A Component Unit of the State of Illinois)
CURRENT FINDINGS - GOVERNMENT AUDITING STANDARDS
For the Year Ended June 30, 2017

University of Illinois P-card transactions

- Five (5) general and service expenses (totaling \$14,388) that were recorded as expenses for fiscal year ended June 30, 2017, should have been partially deferred as of June 30, 2017 at an amount of \$8,953, and then recognized as expenses for the fiscal year ending June 30, 2018.
- One (1) general expense (totaling \$1,477) that was recorded as an expense for fiscal year ended June 30, 2017, should have been fully accrued as of June 30, 2016.
- One (1) general expense (totaling \$8,755) that was recorded as an expense for fiscal year ended June 30, 2017, should have been partially accrued as of June 30, 2016 at an amount of \$2,012.

University of Illinois T-card transactions

- Three (3) general expense cash disbursements (totaling \$15,728) that were recorded as expenses for fiscal year ended June 30, 2017, should have been deferred as of June 30, 2017, and then recognized as expense for the fiscal year ending June 30, 2018.

Generally accepted accounting principles require transactions to be reported in the period they are incurred. Additionally, the Fiscal Control and Internal Auditing Act (30 ILCS 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 ensure expenses and revenues are recognized in the appropriate reporting period.

In discussing these conditions with University personnel, they stated that in many of these instances, the units associated with the exceptions did not adequately follow established procedures to record the transactions in the proper period. With respect to the P-card-related exceptions, the current P-card processing software system utilized by the University does not provide the detailed information required to monitor/identify instances requiring year-end accrual or deferral. While the University believes it has processes in place to prevent material errors in the financial statements, the highly decentralized environment with hundreds of units and large volumes of transactions does present challenges in catching all errors.

Failure to accurately analyze and record cash receipts and disbursements within the proper fiscal year may result in the misstatement of the University's financial statements. (Finding Code No. 2017-001, 2016-001, 2015-001, 2014-001, 2013-001, 12-01, 11-01, 10-03, 09-03)

UNIVERSITY OF ILLINOIS
(A Component Unit of the State of Illinois)
CURRENT FINDINGS - GOVERNMENT AUDITING STANDARDS
For the Year Ended June 30, 2017

Recommendation:

We recommend the University continue to review its process to assess the existence of current period revenues and expenses and consider changes necessary to ensure they are accurately identified and recorded for presentation in the University's financial statements.

University Response:

Accepted. The University will continue taking corrective action to address the recommendation in this finding. Regarding the P-card-related cut-off exceptions, the University believes that the small size of individual card transactions combined with the aggregate monthly volume/dollar value of such transactions represents an expense population in which the probability of a material financial statement error would be extremely remote.

UNIVERSITY OF ILLINOIS
(A Component Unit of the State of Illinois)
CURRENT FINDINGS - GOVERNMENT AUDITING STANDARDS
For the Year Ended June 30, 2017

2017-002. Finding: Inadequate Controls over Self-Approved Timesheets

The University of Illinois (the University) has not followed established adequate internal controls over Self-Approved Time Sheets.

After every pay period, the University creates a report showing employees who have approved their own timesheet. Timesheets are required for hourly employees and civil-service employees. The report lists all self-approvals for FY17 and included 53 employees with 67 occurrences of self-approval. The applicable human resources office and the relevant departments are supposed to take action to ensure a proper segregation and approval process. In 43 of the 67 occurrences, follow-up procedures failed to result in approval by the department prior to the next payroll.

The University policy states that each department is responsible for approving all web time reports or completing and approving the departmental time report for each employee from time sheets or cards filled out by the employees. Section 4 of the Office of Business and Financial Services Policy and Procedures Manual specifies that approvers cannot approve their own time.

Also, the Fiscal Control and Internal Auditing Act (30 ILCS 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 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 timely supervisory approval of employee timesheets.

University management indicated the mitigating control procedure, in which the applicable human resources office notifies the employees involved as well as the unit or college contacts and requests confirmation of supervisory approval, was not consistently followed in a timely manner.

Failure to properly review and approve timecards could result in erroneous or fraudulent transactions and/or payroll disbursements being recorded in the general ledger system. (Finding Code No. 2017-002)

Recommendation:

We recommend the University ensure its employees follow its established internal controls over self-approved timesheets to ensure compliance with University policies.

UNIVERSITY OF ILLINOIS
(A Component Unit of the State of Illinois)
CURRENT FINDINGS - GOVERNMENT AUDITING STANDARDS
For the Year Ended June 30, 2017

University Response:

Accepted. Although all self-approved timesheets were validated as being correct and have supervisory approval, the approval was not always timely. The University will continue to strengthen controls in this area.

UNIVERSITY OF ILLINOIS
(A Component Unit of the State of Illinois)
CURRENT FINDINGS - GOVERNMENT AUDITING STANDARDS
For the Year Ended June 30, 2017

2017-003. Finding: Inadequate Procedures over Maintenance of Accounts Payable Master Vendor File

The University of Illinois (the University) has inadequate controls in place to monitor and maintain the accounts payable master vendor file.

During our review of the University's accounts payable master vendor file (with 55,152 total vendors), we noted there were 12 duplicate records representing six (6) vendors. The vendors had the same name but were given different vendor identification numbers in the accounts payable system. In addition, we noted 2,742 vendors without a tax identification number (TIN) listed and 36,294 vendors with no activity within the 3 previous fiscal years.

Good business practices recommend that the accounts payable master vendor file be reviewed for possible duplicate vendor data. The Fiscal Control and Internal Auditing Act (30 ILCS 10/3001) requires each State Agency to establish and maintain an effective system of internal control, which would include controls over the master vendor file. Per University policies, vendors should also have a TIN on file when creating the vendor to ensure the vendor is not fraudulent. In addition vendors with no recent activity should be inactivated to ensure no inappropriate payments are made to outdated vendors.

University management indicated that although significant progress was made during fiscal year 2017, additional research still needs to be performed on the remaining issues related to the accounts payable master vendor file. Active efforts in this area continue but have been time-consuming due to the complexity of the data as well as the systems involved.

Failure to appropriately monitor the accounts payable master vendor file may result in an unauthorized vendor payment. (Finding Code No. 2017-003, 2016-003)

Recommendation:

We recommend the University review and implement stronger internal controls in order to monitor and maintain the accounts payable master vendor file.

University Response:

Accepted. The University will continue to strengthen the controls and maintenance procedures related to the master vendor file.

UNIVERSITY OF ILLINOIS
(A Component Unit of the State of Illinois)
CURRENT FINDINGS - GOVERNMENT AUDITING STANDARDS
For the Year Ended June 30, 2017

2017-004. Finding: Inadequate Controls Over University Procurement Card Transactions

The University of Illinois (the University) has not complied with University policies and 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 paid by the University on a monthly basis. The University's policies require employees assigned a procurement card to complete training on policies and procedures, pass a test, and 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.

During our test work over 62 procurement card transactions totaling \$318,117, we noted the following:

- Five (5) transactions (totaling \$10,963) were for charges such as gift cards, lodging, ambulance services, and PayPal transaction fees, all of which were prohibited by the University's procurement card policies.
- One (1) transaction (totaling \$2,454) was not supported by an itemized receipt, as required.
- Nine (9) transactions (totaling \$30,250) were not reconciled within seven days of appearance on the P-Card software, as required. The reconciliations were completed five to 309 days late.
- One (1) transaction for printing services (totaling \$1,050) was not in compliance with the Illinois Procurement Code and the waiver for this requirement was not obtained from the State Purchasing Officer.
- One (1) transaction (totaling \$2,589) was a purchase of equipment that was not tagged in accordance with University's policies and procedures.

The University has approximately 4,125 active procurement cards and the procurement card expenditures paid for the year ended June 30, 2017 totaled \$55,672,737.

The University policy states that the reconciler must review and reconcile each transaction with the Order Log and with the original, detailed, itemized receipt within seven business days of its appearance in the P-Card software, in order for the transaction to post in Banner for financial reporting.

In addition, the Illinois Procurement Code (30 ILCS 500/45-15) states that contracts requiring the procurement of printing services shall specify the use of soybean oil-based ink unless a State purchasing officer determines that another type of ink is required to assure high quality and reasonable pricing of the printed product.

Further, the Fiscal Control and Internal Auditing Act (30 ILCS 10/3001) requires the University to establish and maintain a system, or systems, of internal fiscal and administrative controls, to

UNIVERSITY OF ILLINOIS
(A Component Unit of the State of Illinois)
CURRENT FINDINGS - GOVERNMENT AUDITING STANDARDS
For the Year Ended June 30, 2017

provide assurance that: (1) resources are utilized effectively, and in compliance with applicable law; (2) obligations and cost 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 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 card transactions are in accordance with University policies and procedures and supporting documentation for each transaction is maintained.

University management indicated the bulleted exceptions largely resulted from human error at the individual and/or unit level by not following procurement card policies and procedures.

Failure to properly review and approve procurement card transactions in accordance with University policies could result in erroneous or fraudulent transactions being recorded in the general ledger system. (Finding Code No. 2017-004, 2016-002, 2015-002, 2014-002, 2013-002, 12-02, 11-03, 10-02, 09-02, 08-03)

Recommendation:

We recommend the University continue to review and improve its internal controls over procurement card transactions to ensure compliance with University policies so that erroneous or fraudulent transactions are not recorded in the general ledger system.

University Response:

Accepted. While the procurement card is an efficient purchasing mechanism, the University recognizes the importance of procurement card process controls, training, and transaction monitoring. The University will implement the necessary corrective action related to the recommendation made in this finding.

UNIVERSITY OF ILLINOIS
(A Component Unit of the State of Illinois)
CURRENT FINDINGS - GOVERNMENT AUDITING STANDARDS
For the Year Ended June 30, 2017

2017-005. Finding: Inadequate Control over Reporting Restricted Accounts

The University of Illinois (University) did not ensure restrictions from revenue bond covenants were properly reflected within the University's financial statements.

As of June 30, 2017, the University's Auxiliary Facilities System (System) consisted of certain facilities across campus which are not directly related to the University's instruction, research, or service units, including:

- athletic-related facilities, such as Memorial Stadium, the State Farm Center;
- recreation-related facilities, such as the Activities and Recreation Center, Campus Recreation Center East, Student Recreation Facility, and Ice Arena;
- resident halls and apartments;
- student services facilities; and,
- parking facilities.

As of June 30, 2017, the University's Health Services Facilities System (HSFS) comprises the University of Illinois Hospital and associated clinical facilities providing patient care at, but not limited to, the University of Illinois at Chicago Medical Center.

As of June 30, 2017, the System had outstanding revenue bond issues (Series 1991, Series 1999A, Series 2001A, Series 2001B, Series 2003A, Series 2005A, Series 2008, Series 2009A, Series 2010A, Series 2011A, Series 2011B, Series 2011C, Series 2013A, Series 2014A, Series 2014B, Series 2014C, Series 2015A, Series 2016A and Series 2016B) and HSFS had outstanding revenue bond issues (Series 1997B, Series 2008, and Series 2013) where the proceeds from these bonds had been used to finance certain projects.

These bond issues established a "closed system" for the System and a "semi closed system" for HSFS, where the revenues generated by both could only be used for the following purposes:

- 1) expenses necessary for the operation and reasonable upkeep and repair of the System/HSFS;
- 2) payment of principal and/or interest amounts when due;
- 3) amounts set aside limited to and used for financing the costs of renovating or replacing capital assets of the System/HSFS beyond ordinary maintenance and operation of the System;
- 4) amounts set aside limited to and used for constructing new space or additions to existing facilities within the System/HSFS; and
- 5) amounts set aside limited to and used for the purchase of moveable equipment to be installed in the facilities within the System/HSFS.

However, if any funds existed following the use of revenues for the above purposes, restrictions differed for the System and HSFS. For the System, remaining funds were to be set aside to either fund the redemption of previously issued bonds when callable, the

UNIVERSITY OF ILLINOIS
(A Component Unit of the State of Illinois)
CURRENT FINDINGS - GOVERNMENT AUDITING STANDARDS
For the Year Ended June 30, 2017

purchase of the University's bonds on the open market, or any other System purpose permitted by law. Notably, resources within the System are unavailable for use by the University outside of the System. As for HSFS, remaining funds can be used to (1) redeem outstanding bonds, (2) expenditures to improve or restore the system or (3) for any other lawful purpose as expressed by the Board. As such, these excess funds could be transferred out of HSFS for use by the University upon satisfying all required deposits.

During testing, we noted the University had controls to segregate the System and HSFS's assets and include their net position with the University's financial statements; however, the University had not designed its internal controls to ensure accurate reporting of restricted assets and restricted net position under generally accepted accounting principles relative to both the System and HSFS.

The University originally designed the control due to the implementation of Governmental Accounting Standards Board Statement No. 34 by drawing inferences from the implementation guidance published by the Governmental Accounting Standards Board that was not necessarily on point with the University's unique "closed system" situation and from discussions with other universities with closed systems.

Historically, auditors did not take exception to the design flaw until the current year. After this issue was noted during the current year, the Auditor General's Office and the Office of the State Comptroller consulted with staff of the Governmental Accounting Standards Board. After this consultation, the University (and all universities with closed systems) changed its accounting presentation in its final financial statements to show all non-capital assets associated with the System and HSFS, totaling \$185.98 million, as restricted assets and reclassified the System and HSFS's portion of the University's net position to expendable restricted net position, totaling \$168.81 million.

Governmental Accounting Standards Board Statement No. 34, Paragraph 34, Basic Financial Statements-and Management's Discussion and Analysis-for State and Local Governments, requires net position should be reported as restricted when constraints imposed upon the use of the net position are externally imposed by creditors, such as through debt covenants. Further, Governmental Accounting Standards Board Statement No. 34, Paragraph 99, Basic Financial Statements-and Management's Discussion and Analysis-for State and Local Governments, requires the reporting of restricted assets when constraints imposed upon the use of the net position are externally imposed by creditors which change the nature or normal understanding of the availability of the asset, such as assets that cannot be used to extinguish liabilities outside of those allowed by the bond covenants.

In addition, the Fiscal Control and Internal Auditing Act (30 ILCS 10/3001) requires the University establish and maintain a system, or systems, of fiscal and administrative controls to provide assurance that revenues, expenses, resources, and funds applicable to

UNIVERSITY OF ILLINOIS
(A Component Unit of the State of Illinois)
CURRENT FINDINGS - GOVERNMENT AUDITING STANDARDS
For the Year Ended June 30, 2017

operations are properly recorded and accounted for to permit the preparation of reliable financial reports and to maintain accountability over the State's resources.

The University indicated that its financial statement presentation had been consistent with its understanding of the authoritative accounting guidance, which they had believed to have been reasonable and appropriate.

Failure to report the non-capital assets and net position related to the System as restricted resulted in a material misstatement of the University's financial statements and reduced the overall reliability of Statewide financial reporting. (Finding Code No. 2017-005)

Recommendation

We recommend the University periodically review its internal controls over financial reporting to provide assurance accounts are properly classified under generally accepted accounting principles.

University Response

Accepted. The University's financial reporting classification of these components of net position had been based upon significant due diligence and belief that its interpretation and application of authoritative accounting requirements was appropriate. The University's reporting practices in this area had been in place for many years. The auditors' procedures in reaching closure on this matter included numerous meetings for discussion, including joint consultation with the State Comptroller's office and Government Accounting Standards Board. The University believes this extensive review process speaks to the complexity of this matter and a potential need for greater clarity in the authoritative accounting literature.