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Auditor General

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# Illinois Audit Advisory

*Emerging and Potential Audit Issues*

## AUDITOR GENERAL'S MESSAGE

Government exists to provide services that meet the needs of its citizens. The State of Illinois is increasingly using third parties such as contractors and grantees to provide these services. This practice is consistent with the nationwide trend toward privatizing government services. This issue of the Audit Advisory focuses on the procurement process. It also highlights important changes impacting the accounting and auditing fields.

There are many valid reasons to obtain services contractually. Contracting may be more efficient, in-house staff may lack needed expertise, or service delivery may be more effective if done at the local level.

However, while an agency may outsource its duties, that does not relieve agency officials from their ultimate responsibility to ensure those duties are properly carried out. Effective procurement requires sound planning, strong contract controls, and vigilant monitoring of contractor performance. All too often in the course of our audits we find one or more of these ingredients missing.

This issue of the Audit Advisory shares some of the lessons learned from our audits of agencies' contracting processes. Hopefully we can use these experiences to improve the efficiency and effectiveness of the services we provide to the citizens of Illinois.

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## INCREASING USE OF EMERGENCY PURCHASES

The amount of emergency purchases made by State agencies under the Illinois Procurement Code increased dramatically in 1999. From 1995 to 1999, the anticipated cost of emergency purchases increased 410 percent, from \$9.8 million to \$50 million. The number of emergency purchases increased from 111 to 285 over the same time period.

The intent of the Procurement Code (30 ILCS 500/20-30) is to ensure that competitive procurement is used, except in true emergencies, so that the State does not overpay for the goods and services purchased. Competitive procurement helps ensure that not only a qualified vendor is selected, but also that the best possible price is obtained. A recent audit concluded

**Dollar Amount of Emergency Purchases**  
Calendar Years 1995 - 1999



Source: Legislative Audit Commission Annual Reports

that one agency's planning for procurements was inadequate, given the large number of emergency purchases it made. Audits conducted by the Office of the Auditor General will continue to examine agencies' use of the emergency purchase exception in the Procurement Code. ■

### **Under the Procurement Code, an agency may make emergency procurements without competitive bidding:**

- when there exists a threat to public health or safety;
- when immediate expenditure is necessary for repairs in order to protect against further loss of or damage to State property;
- to prevent or minimize serious disruption in State services;
- to ensure the integrity of State records; or
- for quick purchase, as provided by Section 20-30 (d) of the Code.

## MONITORING OF CONTRACTOR PERFORMANCE

Contracting with outside providers may be the most efficient and effective way for the State to deliver services to Illinois citizens. However, the ultimate responsibility for ensuring that services are efficiently and effectively performed rests with the contracting agency.

Consequently, the State agency must have an effective system of monitoring controls in place to ensure that the contractor is using public funds for allowable purposes, as well as to ensure that the services are efficiently provided and

effectively fulfilling the needs of the program recipients.

For many programs, two types of monitoring may be necessary: programmatic and financial. Programmatic monitoring focuses on providing assurance to the agency that the services are being delivered or performed as required by the contract. Financial monitoring determines whether funds are spent for appropriate and allowable purposes. *(continued page 2)*

# IMPROVING CONTROLS OVER UNEMPLOYMENT BENEFITS

Audits have continued to find that State agencies are paying for questionable unemployment benefits for current and former employees. Testing done at 8 of 9 State universities in 1999 found that 42 percent of the cases reviewed (107 of 255) contained exceptions. A total of \$173,262 in payments were questioned.

The Illinois Department of Employment Security (IDES) is responsible for processing unemployment benefits to workers who become temporarily unemployed. However, each agency is responsible for reviewing unemployment claims and filing protests where appropriate. Agencies have two opportunities to review unemployment benefits: 1) when IDES sends claim notices to the agency; and 2) when IDES issues a quarterly statement detailing charges to each agency's account.

Audits have noted the following instances when unemployment benefits should have been protested by the agency:

- **Simultaneous Employment** - Individuals receiving a regular paycheck and unemployment check at the same time.

## MONITORING OF CONTRACTOR PERFORMANCE *cont.*

The method and extent of monitoring used can vary. Types of monitoring include the submission and review of audits (such as single audit reports), desk reviews of agency reports, and on-site visits. These types of monitoring reviews vary in terms of the depth and amount of agency resources required. On-site visits may well identify instances of non-compliance that would not be ascertained by simply reviewing reports submitted by the contractor or grantee. However, on-site visits generally tend to require more agency resources to complete than do the other types of monitoring.

The monitoring system should require contractors and grantees to submit, on a timely basis, reports which provide the agency with critical performance information so that performance problems can be identified as they occur, rather than at the end of a fiscal year or reporting period.

- **Resignations** - Individuals receiving unemployment benefits even though they resigned their employment.
- **Misconduct** - Individuals receiving benefits even though they were discharged due to misconduct associated with their job.

Controls over unemployment benefits can be improved by:

- Familiarizing responsible staff with the various reasons to protest unemployment claims;
- Developing formal policies and procedures for the review of unemployment activity;
- Timely reviewing and protesting of all ineligible claims;
- Reviewing quarterly IDES statements for inappropriate charges;
- Reporting vacation payouts to IDES for former employees requesting unemployment benefits; and
- Retaining all necessary documentation to evaluate whether an unemployment claim or charge was valid. ■

For example, reports should allow agency staff to determine whether services are being performed in accordance with contractual requirements (in terms of number of units provided or individuals served, and whether timeliness and other performance criteria are being met).

Agencies should establish a risk-based system to identify which type of monitoring is appropriate for its various providers. Risks to consider include providers' prior audit findings, failure to submit required reports, newness of the program, complaints about program services, failure to meet key performance measures, and size of the contract.

Regardless of the type of monitoring used, agencies must devote the resources to review the information submitted by the contractor and use appropriate follow-up as needed. ■

# GASB 33 REQUIREMENTS

In December 1998 the Governmental Accounting Standards Board (GASB) issued Statement No. 33, Accounting and Financial Reporting for Nonexchange Transactions. This Statement is effective for FY 2001 for the State of Illinois. This is a significant statement that affects the timing of the recognition of assets, liabilities, revenues and expenditures related to nonexchange transactions for state and local governments. In a nonexchange transaction, a government gives (or receives) value without directly giving (or receiving) equal value in return. Most governments receive a large proportion of their revenues through nonexchange transactions, such as: income, sales and property taxes; intergovernmental grants; entitlements and other financial assistance; and private donations.

The Statement establishes accounting and financial reporting standards to guide state and local governments' decisions about when (in which fiscal year) to report the results of nonexchange transactions involving cash and other financial resources. Up until the issuance of this Statement, financial reporting standards included only limited guidance on when to report these transactions.

Statement No. 33 defines transactions as external events. It does not apply to internal events such as nonexchange transfers of resources between funds of the same government. However, the Statement does apply to nonexchange transactions between primary and component units of government because component units are separate legal entities. Nonexchange transactions recognized as revenues, or expenses or expenditures, in a component unit's stand-alone report must be reclassified to transfers in the primary government's report.

Agencies should: 1) review their sources of nonexchange revenue and nonexchange expenses or expenditures paid to other governments and determine their classification according to Statement No. 33 as amended; and 2) update their policies and procedures to properly account for nonexchange transactions according to the Statement. ■

# STATEWIDE SINGLE AUDIT UPDATE

The State of Illinois kicked-off its implementation of auditing federal grant programs on an annual statewide basis in a meeting held on February 4, 2000, in the auditorium of the Illinois State Museum. There were 120 state employees from 43 agencies in attendance. The attendees were not only accounting and auditing staff but also those persons who are assigned the responsibility to administer the federal program within an agency. The Auditor General introduced the program by reminding attendees of the benefits to be derived from the State adopting an Annual Statewide Single Audit approach. They are:

- Reduced costs to state agencies;
- Less audit effort for agencies;
- More readily available information; and
- Annual audits of federal programs.

The audit firm of KPMG LLP was selected as Special Assistant Auditors for the first Statewide Single Audit in Illinois. This firm has prior experience in conducting statewide A-133 audits of several state governments.

The FY 2000 Single Audit will group the major programs at state agencies into three segments – Human Services, Education and All Others. To complete the FY 2000 Single Audit, three audit teams have been established covering the following defined major programs:

## Human Services

- Food Stamp Cluster
- Special Supplemental Nutrition - WIC
- Temporary Assistance for Needy Families (TANF)
- Foster Care Title IV-E
- Title IV-E Adoption Assistance
- Vocational Rehabilitation Grants to States
- Disability Insurance
- Child Care Cluster

- Title XX Social Services Block Grant
- Prevention/Treatment of Substance Abuse Block Grant
- Medicaid Cluster
- Child Support Enforcement
- Aging Cluster

## Education

- Food Distribution
- Child Nutrition Cluster
- Child & Adult Care Food
- Special Education Cluster
- Title I Grants - Grants to Local Education Agencies
- Vocational Education - Basic Grants to States (Perkins)
- Federal Family Education Loan Program
- Class Size Reduction

## All Others

- Airport Development Projects
- Highway Planning & Construction
- Community Development Block Grant - Small City
- Low Income Home Energy Assistance
- Unemployment Insurance
- Employment Service Cluster
- Capitalization Grants for Revolving Loan Funds/Drinking Water
- Job Training Partnership Act Cluster

The major spending associated with the above programs was identified in ten agencies. They are as follows:

1. Department of Human Services
2. State Board of Education
3. Department of Children & Family Services
4. Department of Public Aid
5. Department on Aging
6. Department of Transportation
7. Department of Commerce & Community Affairs
8. IL Student Assistance Commission
9. Department of Employment Security
10. IL Environmental Protection Agency

A critical part of any audit is the review of internal controls. Over 125 personnel from these ten state agencies (plus the Department of Public Health and IL Emergency Management Agency) completed a one-day training course on the COSO (Committee of Sponsoring Organizations of the Treadway Commission) approach. The COSO approach provides a framework to design, implement, and evaluate controls, which facilitates compliance with the requirements of federal laws, regulations, and programs.

Twenty-nine separate entrance conferences were held at ten agency offices by individual federal program during the period April 17th through May 9th, 2000. The ten agencies also completed control assessments along with questionnaires for each major program. These documents addressed each compliance requirement found in OMB's Circular A-133 Compliance Supplement.

As a final preparation step, the Office of the Auditor General compiled a prototype FY 1999 Schedule of Expenditures of Federal Awards from the information included in the GAAP reporting forms and the audited departmental financial statements. The agencies were informed that the FY 2000 Schedule of Expenditures of Federal Awards will be generated from the GAAP reporting forms along with verification taking place with the newly implemented "Agreed Upon Procedures" report to be obtained during agency audits.

State agencies have been receptive to the new approach and are looking forward to the benefits enumerated by the Auditor General at the February 4th meeting. ■

## CONTRACTING CONTROLS

Increased privatization of State services amplifies the need for State agencies to have an effective contracting process. Recent audits have identified instances where contracts were not properly planned and administered or where contracts did not protect the State's interests.

Contracts should be approved and signed by the agency before the performance of

services begins. Failure to review and sign contracts before the beginning of work may result in contract disputes and vendors performing and billing for services not approved by the State agency. Any contract amendments should also be approved and signed in a timely manner and, except in extraordinary circumstances, should not be effective retroactively. ■

### Contracts should include provisions to appropriately protect the State's interests, including:

- Specific levels of performance expected of the vendor;
- Submission of reports that allow agencies to assess performance for both administrative and programmatic elements;
- Definition of key terms;
- Precise delineation of the amount and method by which the contractor will be paid; and
- Penalty, damages, and incentive provisions, where appropriate.

# GASB 34 IMPLEMENTATION

Like all governmental auditors in the United States, the Office of the Auditor General (OAG) is preparing for the day when GASB 34 becomes the new reporting model for governments. For the State of Illinois, FY 2002 is the year for implementation. FY 2002 begins on July 1, 2001, which is less than 12 months away.

What has the OAG been doing in preparation for GASB 34? The short answer to this question is "as much as possible." GASB 34 will significantly impact the OAG post audit program. But the key to resolving GASB 34 audit impacts will be somewhat determined by conclusions reached by others.

For example, the AICPA has a Task Force in place to revise the AICPA Audit and Accounting Guide for "Audits of State and Local Governmental Units" to incorporate GASB 34 changes. Some items the OAG is focusing on at this time include:

- Determining materiality for audit planning and financial reporting;
- Auditing GASB 34 beginning balances;
- Auditing Exchange Type transactions in governmental entities;
- Auditing budget information in financial statements versus Required Supplementary Information;

- Auditing infrastructure assets, including required footnote disclosures; and
- Issues associated with auditing government-wide financial statement information which may not appear in agency specific financial statements.

Specifically, the OAG is:

- (1) training its staff to be knowledgeable in GASB 34, as well as in GASB Statements 33, 35 & 36;
- (2) monitoring the Office of Comptroller's implementation of GASB 34;
- (3) monitoring information from the AICPA Task Force;
- (4) evaluating the impact of audit coverage obtained from individual agency audits which will assist to render an opinion on the State's General Purpose Financial Statements; and
- (5) assessing the changes needed in the OAG's Audit Program caused by the GASB 34 alternatives selected by the Office of the Comptroller and the audit guidance set forth by the AICPA.

Many decisions are yet to be made by the State Comptroller, the State agencies, and the AICPA. The OAG will make additional Audit Program changes once these organizations complete their decision-making activities in their implementation of the new governmental reporting model. ■

# OAG RECEIVES NATIONAL AWARD

In July 2000, the Office of the Auditor General received the Certificate of Recognition of Impact from the National Legislative Program Evaluation Society (NLPES) for the Management Audit of Pilsen-Little Village Community Mental Health Center, Inc.

The award is given annually by NLPES for an audit report that demonstrates significant dollar savings, program improvements, and impact from a legislative and public perspective.

The audit of Pilsen-Little Village, a social service provider which receives funding from three State agencies, identified many questionable uses of State funds and highlighted the need for improved State monitoring of contractor and grantee expenditures.

The Office previously received the NLPES Certificate of Recognition of Impact for the 1998 Management Audit of Tuition and Fee Waivers. ■

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