STATE OF ILLINOIS
NORTHERN ILLINOIS UNIVERSITY

Report Required Under
Government Auditing Standards
For the Year Ended June 30, 2012
Performed as Special Assistant Auditors
for the Auditor General, State of Illinois

McGladrey

State of Illinois
Northern Illinois University
Report Required Under *Government Auditing Standards*
For the Year Ended June 30, 2012

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State of Illinois
Northern Illinois University

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Raymond W. Alden III	Executive Vice President and Provost
Eddie R. Williams	Executive Vice President, Business and Finance, and Chief of Operations
Anne C. Kaplan	Vice President, Administration
Michael P. Malone	Vice President, University Advancement
Kathryn Buettner	Vice President, University Relations
Jerry D. Blakemore	Vice President and General Counsel
Danielle Schultz	Director of Internal Audit
<u>Financial Staff</u>	
Keith Jackson	Controller

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Government Auditing Standards Report

Summary

The audit of the financial statements of the Northern Illinois University (University) was performed by McGladrey LLP in accordance with *Government Auditing Standards*. This report is an integral part of that audit.

Based on their audit, the auditors expressed an unqualified opinion on the University's basic financial statements.

Summary of Findings

The auditors identified a matter involving the University's internal control over financial reporting that they considered to be a significant deficiency. This significant deficiency is described in the accompanying schedule of findings on pages 5-6 of this report as Finding 12-1, Financial Reporting Process. The auditors did not identify any matters involving the University's internal control over financial reporting that they considered to be a material weakness.

Exit Conference

The University waived an exit conference in correspondence dated January 11, 2013. Responses to the recommendations were provided by Keith Jackson in correspondence dated January 11, 2013.

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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 William G. Holland
Auditor General
State of Illinois

And

Anthony A. Iosco, Honorable Chair of the
Legislation, Audit, External Affairs, and Compliance Committee

As Special Assistant Auditors for the Auditor General, we have audited the financial statements of the business-type activities of Northern Illinois University (University) and its aggregate discretely presented component units (University Related Organizations), collectively a component unit of the State of Illinois, as of and for the year ended June 30, 2012, which collectively comprise the University's basic financial statements and have issued our report thereon dated January 11, 2013. Our report was modified to include a reference to other auditors. 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. Other auditors audited the financial statements of the University Related Organizations, 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.

Internal Control Over Financial Reporting

Management of the University is responsible for establishing and maintaining effective internal control over financial reporting. In planning and performing our audit, we considered the University's internal control over financial reporting as a basis for designing our auditing procedures 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's internal control over financial reporting. Accordingly, we do not express an opinion on the effectiveness of the University's internal control over financial reporting.

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.

Our consideration of internal control over financial reporting was for the limited purpose described in the first paragraph of this section and was not designed to identify all deficiencies in internal control over financial reporting that might be deficiencies, significant deficiencies or material weaknesses. We did not identify any deficiencies in internal control over financial reporting that we consider to be material weaknesses, as defined above. However, we identified a deficiency in internal control over financial reporting described in the accompanying schedule of findings as finding 12-1 that we consider to be a significant deficiency in internal control over financial reporting.

A *significant deficiency* is a deficiency, or 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.

Compliance and Other Matters

As part of obtaining reasonable assurance about whether the University's 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 or other matters that are required to be reported under *Government Auditing Standards*.

The University's response to the finding identified in our audit is described in the accompanying schedule of findings. We did not audit the University's response and, accordingly, we express no opinion on it.

This report is intended solely for the information and use of the Auditor General, the General Assembly, the Legislative Audit Commission, the Governor, University management, the Board of Trustees 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.

McGladrey LLP

Schaumburg, Illinois
January 11, 2013

Schedule of Findings

Finding 12-1 Financial Reporting Process

Northern Illinois University (the University) needs to improve internal control over financial reporting.

During our review of the draft financial statements of the University provided to the auditors, several errors and omissions relating to the draft financial statements and note disclosures were identified and corrected. Some of the more significant items were as follows:

- "Net assets invested in capital assets, net of related debt" and "unrestricted net assets" required a reclassification of $9,897,000 for 2012 and a similar reclassification of $11,584,000 for 2011 related to the inclusion of accreted interest on capital appreciation bonds as part of the principal amount used in calculating the related debt portion of "Net assets invested in capital assets, net of related debt." Under generally accepted accounting principles (GAAP), accreted interest should not be included in the calculation of related debt for the purposes of this calculation. After this item was brought to the attention of the University, reclassifications were made to correct the balances of the affected accounts.

- The University did not disclose its exposures to concentrations of credit risk. The University had concentrations of credit risk related to investments in securities issued by the Federal Home Loan Bank of about $33,507,000, investments in securities issued by the Federal National Mortgage Association of about $41,140,000, and investments in securities issued by the Federal Home Loan Mortgage Corporation of about $46,629,000. The investments in securities from each of these issuers exceeded 5% of the University's total investments. Once this item was brought to the attention of the University, the University corrected the disclosure.

- The University did not disclose a subsequent event. The University signed an irrevocable letter of intent with the Foundation. Under this letter of intent, the University leased land to the Foundation for the construction of a facility. The University committed to lease the facility, upon completion, from the Foundation for a period of 90 months. Once this was brought to the attention of the University, the University added a disclosure for this event.

- The Northern Illinois University Foundation (Foundation) and the Northern Illinois University Alumni Association (Alumni Association) were unable to provide audited financial statements in a timely manner. As a result, the University's financial statements and footnotes required multiple adjustments and revisions related to the disclosure of component unit financial data. Once the Foundation and Alumni Association provided the final audited financial statements to the University, the University was to make adjustments to show correct amounts for the component units.

- The University improperly expensed about $879,000 of equipment in fiscal year 2011, which it improperly capitalized in fiscal year 2012 by recording an adjustment to increase the balance of certain capital asset accounts and reducing the amount of fiscal year 2012 expenses. Expenses between year are incorrect, with capital asets and net assets correct at the end of 2012. The University did not record this proposed adjustment.

Schedule of Findings (Continued)

Finding 12-1 Financial Reporting Process (Continued)

Governmental Accounting Standards Board Statement No. 34, *Basic Financial Statements – and Management's Discussion and Analysis – for State and Local Governments*, requires the reporting of net assets in three components – *invested in capital assets, net of related debt*; *restricted*; and *unrestricted*. The reporting of net assets *invested in capital assets, net of related debt* requires that this amount be reported as the total of capital assets, net of accumulated depreciation, reduced by the outstanding balances of any bonds, mortgages, notes, or other borrowings that are attributable to the acquisition, construction, or improvement of those assets. Furthermore, 7.22.9 of the GASB Staff Implementation Guide further clarifies that "accrued interest on any capital-related debt, including deep-discount debt, generally should not be included in the computation of the *invested in capital assets, net of related debt* component of net assets. […] Generally, the accrued interest liability would be included in *unrestricted* net assets."

GASB Statement No. 40, *Deposit and Investment Risk Disclosures – An Amendment of GASB Statement No. 3*, requires, with certain limited exceptions, that "Governments should provide information about the concentration of credit risk associated with their investments by disclosing, by amount and issuer, investments in any one issuer that represent 5 percent or more of total investments."

GASB Statement No. 56, *Codification of Accounting and Financial Reporting Guidance Contained in the AICPA Statements on Auditing Standards*, requires the disclosure of events subsequent to the date of the statement of net assets that should not result in adjustment of the financial statements, but which "may be of such a nature that their disclosure is essential to a user's understanding of the financial statements."

The Fiscal Control and Internal Auditing Act, 30 ILCS 10/3001 requires all State agencies to establish and maintain a system, or systems, of internal fiscal and administrative controls, which shall provide assurance that 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.

According to University management, the missing disclosures were due to an oversight by management when the draft financial statements were prepared.

Submitting incomplete and inaccurate draft financial statements delays completion of the audit process and delays the timely release of the University's financial reports to users. Also, insufficient and/or ineffective controls over financial reporting could lead to significant reporting inaccuracies in the financial statements and notes to the financial statements. (Finding Code 12-1, 11-1)

Recommendation

We recommend that the University improve controls over financial reporting to ensure accurate presentation and disclosure of the University's annual financial statements.

University Response

The University agrees.