STATE OF ILLINOIS
NORTHERN ILLINOIS UNIVERSITY

Report Required under *Government Auditing Standards*

For the Year Ended June 30, 2016

Performed as Special Assistant Auditors
for the Auditor General, State of Illinois

THE POWER OF BEING UNDERSTOOD
AUDIT | TAX | CONSULTING

RSM

State of Illinois
Northern Illinois University
Report Required Under *Government Auditing Standards*
For the Year Ended June 30, 2016

Table of Contents

State of Illinois
Northern Illinois University

Agency Officials

Douglas D. Baker	President
Lisa C. Freeman	Executive Vice President and Provost
Mike Mann	Associate Vice President, State Government Relations & Board Liaison
Anne C. Kaplan	Vice President, Outreach, Engagement, and Regional Development
Brett Coryell	Vice President, Information Technology
Jerry Blazey	Interim Vice President, Research and Innovation Partnerships
Sean T. Frazier	Associate Vice President and Director, Intercollegiate Athletics
Eric A. Weldy	Vice President, Student Affairs and Enrollment Management
Vernese Edghill-Walden	Senior Associate Vice President, Academic Diversity & Chief Diversity Officer
Catherine Squires	Vice President, University Advancement
Harlan Teller	Interim Vice President, Marketing and Communications
Jerry D. Blakemore	Vice President and General Counsel
Danielle Schultz	Director of Internal Audit

Financial Staff

Alan Phillips	Vice President, Administration and Finance
Lawrence Pinkelton (incoming 10/16/15)	Associate Vice President, Budget and Finance
Shyree Sanan	Controller

NIU Office is located at:

300 Altgeld Hall
DeKalb, Illinois 60115

State of Illinois
Northern Illinois University

Government Auditing Standards Report

Financial Statement Report

Summary

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

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

Summary of Findings

The auditors identified certain deficiencies in the University's internal control over financial reporting that they considered a material weakness, item 2016-001 Financial Reporting Process, and a significant deficiency, item 2016-002 Inadequate Controls over Compensated Absences Data.

Exit Conference

The University waived an exit conference in correspondence dated January 6, 2017. Responses to the recommendations were provided by Shyree Sanan in correspondence dated January 11, 2017.

RSM

RSM US LLP

Independent Auditor's 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

Cherilyn G. Murer, Honorable Chair of the
Compliance, Audit, Risk Management, and Legal Affairs Committee

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 Northern Illinois University (University) and its aggregate discretely presented component units, collectively a component unit of the State of Illinois, as of and for the year ended June 30, 2016, and the related notes to the financial statements, which collectively comprise the University's basic financial statements, and have issued our report thereon dated January 17, 2017. Our report contains emphasis of matter paragraphs for the accounting treatment of the appropriations granted under Public Act 099-0524 and for the lack of an appropriations bill to fund the University's fiscal year 2017 operations. Our opinion is not modified with respect to either of these matters. Our report includes a reference to other auditors who audited the financial statements of the University's discretely presented component units, 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

In planning and performing our audit of the financial statements, we considered the University's 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's internal control. Accordingly, we do not express an opinion on the effectiveness of the University's internal control.

Our consideration of internal control was for the limited purpose described in the first paragraph of this section 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 were not identified. However, as described in the accompanying schedule of findings, we identified certain deficiencies in internal control that we consider to be a material weakness and a significant deficiency.

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 2016-001 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 deficiency described in the accompanying schedule of findings as item 2016-002 to be a significant deficiency.

Compliance and Other Matters

As part of obtaining reasonable assurance about whether the University's 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.*

Northern Illinois University's Response to Findings

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

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 results of that testing, and not to provide an opinion on the effectiveness of the University's 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's internal control and compliance. Accordingly, this communication is not suitable for any other purpose.

SIGNED ORIGINAL ON FILE

Schaumburg, Illinois
January 17, 2017

Schedule of Findings

Finding 2016-001 Financial Reporting Process

Northern Illinois University's (the University) internal controls over financial reporting are not sufficient to prevent misstatements.

During our audit of the significant balances comprising the University's financial statements we noted the following errors and deficiencies:

Errors Related to the Recording of Capital Assets

- The University improperly capitalized $1,267,471 of asbestos remediation costs as a capital asset instead of expensing them in fiscal year 2015. As the amount was not material to the financial statements, an audit adjustment was booked in fiscal year 2016 to remove the costs from capital assets by expensing them rather than restating opening net position. This corrects the year-end balance of capital assets and net position but results in current year operating expenses being overstated by $1,267,471.

Governmental Accounting Standards Board Statement No. 49, *Accounting and Financial Reporting for Pollution Remediation Obligations*, states that, except in certain circumstances, "pollution remediation outlays, including outlays for property, plant, and equipment, should be reported as an expense." None of the circumstances applied to the University.

- The University has improperly capitalized net library book activity (additions – disposals) as an addition each year instead of separately tracking additions and deletions. This impacts the financial statements as the University is keeping older, fully depreciated books on its asset listing and expensing a portion of its additions each year instead of capitalizing them. Additionally, in fiscal year 2016, there was a formula error in the University's calculation and disposals were added to additions instead of subtracted. When informed of the error, the University recorded a correcting entry which reduced net capital assets by $3,013,864 and increased operating expenses by the same amount. This partially corrected the error and an unrecorded audit adjustment was proposed to fully correct the misstatement. This results in net capital assets and opening net position being understated by $2,512,884 and $1,844,552 respectively, and current year operating expenses being overstated by $668,332.

Schedule of Findings (Continued)

Finding 2016-001 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,* as amended by Governmental Accounting Standards Board Statement No. 37, *Basic Financial Statements — and Management's Discussion and Analysis — for State and Local Governments: Omnibus - an Amendment of GASB Statements No. 21 and No. 34,* states that, "capital assets should be reported at historical cost. The cost of a capital asset should include ancillary charges necessary to place the asset into its intended location and condition for use. Ancillary charges include costs that are directly attributable to asset acquisition — such as freight and transportation charges, site preparation costs, and professional fees."

- The University improperly capitalized the amounts noted below as fiscal year 2016 capital asset additions. They were evaluated together for the purposes of determining a proposed adjustment:
  - $3,100,743 of costs already capitalized as an addition in fiscal year 2015
  - $49,850 of costs billed in error by a vendor and refunded to the University
  - $32,908 of costs for which the University cannot provide a vendor invoice
  - $11,520 of employee training costs
  - $1,970 of overhead allocation for which there is not sufficient documentation to support that the costs were necessary to place the asset into service

  No adjustment was recorded which results in net capital assets being overstated at year-end by $3,012,275 and operating expenses being understated by the same amount. The year-end misstatement is less than the amount of errors noted above due to the depreciation the University recorded on the assets during the fiscal year totaling $184,716.

Governmental Accounting Standards Board Statement No. 51, *Accounting and Financial Reporting for Intangible Assets*, states that application training is a post-implementation/operation stage activity and that, "outlays associated with activities in the post-implementation/operation stage should be expensed as incurred."

Schedule of Findings (Continued)

Finding 2016-001 Financial Reporting Process (Continued)

- The University expensed $398,006 of leasehold improvements for one of its facilities in fiscal year 2015 instead of capitalizing the cost to capital assets and amortizing it over the life of the lease. The improvement should have been considered an intangible asset as the University has a legal right to use the improvements over the course of the lease. This results in a year-end understatement of net capital assets and ending net position of $250,430 and a $53,664 understatement of operating expenses. No adjustment was proposed as the dollar amounts were not individually significant to the financial statements.

Governmental Accounting Standards Board Statement No. 51, *Accounting and Financial Reporting for Intangible Assets*, states that an intangible asset should be recognized on the statement of net position if it "arises from a contractual or legal right" and should be treated as a capital asset and amortized over the life of the lease.

Errors Related to Revenue Recognition

- The University participates in the Perkins Loan program under which it makes loans to students using both institutional and federal funds. The University has a receivable recorded for the loans and interest owed by students under the program and a liability recorded for the amount of the receivable that must be repaid to the federal government when the program is closed. In fiscal year 2005 the University recognized revenue of $784,920 for interest and fees students owed on the loans and increased the recorded loan receivable by the same amount. This receivable was to be reversed in fiscal year 2006 when the University received the interest and fees but was never reversed resulting in revenue being recorded twice. No adjustment was recorded in fiscal year 2016 to remove the receivable which results in an overstatement of net student loans, government loan fund advances, and opening net position by $784,920, $675,031, and $109,889, respectively. The overstatement of the receivable is split between the University's opening net position and amount owed to the federal government as the liability is adjusted each year based on the net income or loss generated by the loan program.

Schedule of Findings (Continued)

Finding 2016-001 Financial Reporting Process (Continued)

- The University improperly excluded $453,805 from its calculation of revenues earned over the course of the summer session and are therefore only partially earned as of year-end. This resulted in the University recognizing $290,901 more summer session tuition and fees revenue in fiscal year 2016 than was earned and understating unearned tuition and fees by the same amount. No adjustment was proposed as the dollar amount was not individually significant to the financial statements.

- The University did not set up a receivable for $69,996 of operating revenue earned in fiscal year 2015 and recognized it as revenue in fiscal year 2016 when it was received. No adjustment was proposed as the dollar amount was not individually significant to the financial statements.

- The University did not recognize $41,481 of revenue that was earned during fiscal years 2014 and 2015 for services provided to the Illinois Board of Examiners. This resulted in beginning and ending net position being understated by $41,481. No adjustment was proposed as the dollar amount was not individually significant to the financial statements.

- The University recorded $8,217 of billed revenue as unearned; however, the University provided services for the amount billed in fiscal year 2016 and thus should have considered the revenue earned. No adjustment was proposed as the dollar amount was not individually significant to the financial statements.

- The University recognizes parking pass revenues on a cash basis instead of on an accrual basis. Parking passes that can be used in fiscal year 2017, and for which a portion of the revenue should have been classified as unearned, went on sale starting December 2015. Management has not determined the specific dollar amount of the sales that should have been classified as unearned. It should be noted that total sales between December 1, 2015 and June 30, 2016 totaled $271,447 and the error amount would be less. No adjustment was proposed as the dollar amount was not individually significant to the financial statements.

Governmental Accounting Standards Board Statement No. 34, *Basic Financial Statements - and Management's Discussion and Analysis - for State and Local Governments,* as amended by Governmental Accounting Standards Board Statement No. 37, *Basic Financial Statements — and*

Schedule of Findings (Continued)

Finding 2016-001 Financial Reporting Process (Continued)

Management's Discussion and Analysis — for State and Local Governments: Omnibus - an Amendment of GASB Statements No. 21 and No. 34, states that, "the statement of net position and the statement of revenues, expenses, and changes in net position should be prepared using the economic resources measurement focus and the accrual basis of accounting. Revenues, expenses, gains, losses, assets, and liabilities resulting from exchange and exchange-like transactions should be recognized when the exchange takes place."

Errors Noted Related to Classification and Presentation

- The University did not properly eliminate all inter-university transactions from the financial statements. The proposed adjustment was not recorded resulting in operating revenues and expenses being overstated by $2,087,937.

- The University did not properly record expenses related to credit card and bank fees. We noted the University records credit card fees as a reduction of operating revenue and then records an adjusting entry to recognize credit card fee expense and increase revenue back to the gross amount. The adjusting entries booked by the University did not fully recapture all of the improperly reduced revenue amounts which resulted in operating revenues and expenses being understated by $57,888. No adjustment was proposed as the dollar amount was not individually significant to the financial statements.

- The University did not properly eliminate a transfer of resources between University departments. This transfer decreased the amount of revenue and expense reported by the University by $20,806. No adjustment was proposed as the dollar amount was not individually significant to the financial statements.

Governmental Accounting Standards Board Statement No. 34, *Basic Financial Statements - and Management's Discussion and Analysis - for State and Local Governments,* as amended by Governmental Accounting Standards Board Statement No. 37, *Basic Financial Statements — and Management's Discussion and Analysis — for State and Local Governments: Omnibus - an Amendment of GASB Statements No. 21 and No. 34*, states that, "eliminations should be made in

Schedule of Findings (Continued)

Finding 2016-001 Financial Reporting Process (Continued)

the statement of activities to remove the "doubling-up" effect of internal service fund activity. The effect of similar internal events (such as allocations of accounting staff salaries) that are, in effect, allocations of overhead expenses from one function to another or within the same function also should be eliminated, so that the allocated expenses are reported only by the function to which they were allocated."

Further, 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, to 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 errors noted above were due to several factors. The Controller's Office experienced high staff turnover due to retirements and a competitive market which resulted in loss of institutional knowledge and technical expertise. Budget constraints and cost curtailment initiatives requiring additional review of critical positions delayed refill of positions to meet year-end objectives. In addition, manual processes and underutilized systems capacity are prone to human error.

Inaccuracies in the recorded amounts of the University's financial statement balances 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. (Finding Code No. 2016-001, 2015-001, 2014-001, 2013-001, 2012-001, 2011-001)

Recommendation

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

Schedule of Findings (Continued)

Finding 2016-001 Financial Reporting Process (Continued)

University Response

The University accepts the auditor's recommendation. Management has conducted a comprehensive review of each component of this finding and is taking the following corrective actions that will eliminate all material exceptions:

1) University will modify procedures to track and report capital projects and all fixed assets to ensure proper accounting for capital assets.
2) University has begun to modify written policies and procedures, and develop communication and training programs around revenue recognition to ensure proper year-end recognition of revenue.
3) University has assessed opportunities for system enhancements and will work towards implementation of various functionalities and ERP modules that will streamline workflows, create efficiencies, and reduce opportunities for human errors.
4) And finally the University has initiated recruitment efforts to fill critical positions to meet year-end financial reporting objectives.

Schedule of Findings (Continued)

Finding 2016-002 Inadequate Controls over Compensated Absences Data

Northern Illinois University (the University) did not use accurate information to determine its year-end accrual for compensated absences.

We tested a sample of nine employees to determine if the University was properly accounting for leave time earned and used during the year and noted errors for five of the nine employees. For two of the employees, the hours earned during the pay period ended June 30, 2016 were excluded from their year-end accrued balance and for the remaining three employees the vacation time taken during the first pay period in fiscal year 2017 was subtracted from their June 30, 2016 balances.

We discussed these issues with the University and asked that the accrued balances be reexamined. The University then identified a total of 57 employees whose June 30, 2016 balances did not include all the hours earned as of year-end and 626 employees whose June 30, 2016 balance had been reduced by vacation time taken in fiscal year 2017. These errors resulted in a $193,816 understatement of the compensated absences accrual and operating expenses. No adjustment was proposed as the total error amount was not significant to the financial statements.

Governmental Accounting Standards Board Statement No. 16, *Accounting for Compensated Absences*, states that "vacation leave and other compensated absences with similar characteristics should be accrued as a liability as the benefits are earned by the employee."

Further, 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, to 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 errors noted above were due to both a system change and the timing of when the report was produced.

Using inaccurate data to determine amounts recorded in the financial statements could cause the financials to be misstated. (Finding Code No. 2016-002)

Schedule of Findings (Continued)

Finding 2016-002 Inadequate Controls over Compensated Absences Data (Continued)

Recommendation

We recommend the University improve its processes to account for accrued leave to ensure year-end balances are accurate.

University Response

The University accepts the auditor's recommendation. Management has updated procedures necessary to ensure system inputs and all corresponding management reporting is accurate.