

**Report 16-2
February 2016**

State of Wisconsin

Fiscal Year 2014-15 Financial Statements

STATE OF WISCONSIN



Legislative Audit Bureau ■

State of Wisconsin

Fiscal Year 2014-15 Financial Statements

Joint Legislative Audit Committee Members

Senate Members:

Robert Cowles, Co-chairperson
Mary Lazich
Alberta Darling
Kathleen Vinehout
Janet Bewley

Assembly Members:

Samantha Kerkman, Co-chairperson
John Macco
John Nygren
Melissa Sargent
Terese Berceau

LEGISLATIVE AUDIT BUREAU

State Auditor
Joe Chrisman

**Special Assistant to
the State Auditor**
Anne Sappenfield

**Deputy State Auditor
for Financial Audit**
Bryan Naab

**Financial Audit
Directors**
Kendra Eppler
Sherry Haakenson
Carolyn Stittleburg

**Assistant Financial
Audit Director**
Erin Scharlau

**Quality Assurance
Coordinator**
Lisa Kasel

**Information
Technology Audit
Coordinator**
Sharon Conway

**Investigative Data
Specialist**
Joseph Johnson

**Publications and
Design Coordinator**
Susan Skowronski

The Bureau is a nonpartisan legislative service agency responsible for conducting financial audits and performance evaluations of state agencies. The Bureau's purpose is to provide assurance to the Legislature that financial transactions and management decisions are made effectively, efficiently, and in compliance with state law and that state agencies carry out the policies of the Legislature and the Governor. Audit Bureau reports typically contain reviews of financial transactions, analyses of agency performance or public policy issues, conclusions regarding the causes of problems found, and recommendations for improvement.

Reports are submitted to the Joint Legislative Audit Committee and made available to other committees of the Legislature and to the public. The Audit Committee may arrange public hearings on the issues identified in a report and may introduce legislation in response to the audit recommendations. However, the findings, conclusions, and recommendations in the report are those of the Legislative Audit Bureau.

The Bureau accepts confidential tips about fraud, waste, and mismanagement in any Wisconsin state agency or program through its hotline at 1-877-FRAUD-17.

For more information, visit www.legis.wisconsin.gov/lab.

Team Leaders

Rochelle Cushman
Bruce Flinn
Jenny Frank
Brian Geib
Michelle Hoehne
Rachael Inman
Emily Pape
Joshua Petersen
Tammi Richmond
Jenna Schmidt
Justin Schroeder
Amelia Slaney

Auditors

Shellee Bauknecht
Jeffrey Beckett
Jeremy Brandenburg
Miranda Brownlow
Kevin Cords
Timothy Coulthart
Kyle Everard
Garrett Gardner
Jacob Gasser
Kendra Glander
Fatima Hassan
Nathan Heimler
Rachel Jacobson
Nick Johnson
Jason Keel
Rita Klawitter
Michael Kuen
BreeAnn Mueller
Amanda Murkley
Heather Murray
Katie Natzke
Kimberly Olson
Zachary Picknell
Jason Pummer
Michael Rateike
Eric Sippel
Aaron Stoltenberg
Jonathon Thomas
Joseph Westby
Stephanie Yost



Contact the Bureau at 22 East Mifflin Street, Suite 500, Madison, Wisconsin 53703;
AskLAB@legis.wisconsin.gov; or (608) 266-2818.

CONTENTS

Letter of Transmittal	1
------------------------------	----------

Auditor's Report	3
-------------------------	----------

Independent Auditor's Report on Internal Control over
Financial Reporting and on Compliance and Other Matters

Appendix

Summary Letter

OPINIONS PUBLISHED SEPARATELY

The financial statements and our opinions on them are included in the
State of Wisconsin's Comprehensive Annual Financial Report (CAFR)
for the fiscal year ended June 30, 2015



STATE OF WISCONSIN
Legislative Audit Bureau

Celebrating
50 Years of
Service

1966-2016

22 East Mifflin Street, Suite 500 ■ Madison, WI 53703 ■ (608) 266-2818 ■ Hotline: 1-877-FRAUD-17 ■ www.legis.wisconsin.gov/lab

Joe Chrisman
State Auditor

February 15, 2016

Senator Robert Cowles and
Representative Samantha Kerkman, Co-chairpersons
Joint Legislative Audit Committee
State Capitol
Madison, Wisconsin 53702

Dear Senator Cowles and Representative Kerkman:

We have completed our financial audit of the State of Wisconsin as of and for the fiscal year (FY) ended June 30, 2015, and issued unmodified opinions dated December 17, 2015, on the State's financial statements. These financial statements were prepared by the Department of Administration (DOA) in accordance with generally accepted accounting principles (GAAP) and are included in the State's FY 2014-15 Comprehensive Annual Financial Report (CAFR), which may be found on DOA's website.

On December 18, 2015, we wrote to you to summarize the balances of the General Fund and the Transportation Fund, which are the State's two largest governmental funds; the amount of the State's long-term debt; and the State's net pension asset. This summary letter is included as the Appendix to this report.

Although we found that all internal control weaknesses we reported in the prior year were resolved, we identified internal control weaknesses during our audit that are required to be reported under *Government Auditing Standards*. The Independent Auditor's Report on Internal Control over Financial Reporting and on Compliance and Other Matters, which begins on page 3, discusses each concern and includes the response from management of the responsible agency.

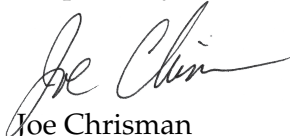
We identified weaknesses in information technology (IT) security policies, procedures, and controls related to DOA (Finding 2015-001) and the University of Wisconsin (UW) System (Finding 2015-002). Because such weaknesses increase the risk that unauthorized or erroneous transactions could be processed; accounting, payroll, and student data could be changed; or personally identifiable information could be accidentally or maliciously exposed, we considered these weaknesses to be significant deficiencies in internal controls. We include recommendations for DOA to improve its IT policies and standards; the settings used to enforce its policies; and its oversight and monitoring of agency IT operations. We include recommendations for UW System Administration to assist UW institutions in implementing changes to IT controls and develop a UW System-wide IT security program.

We also identified several errors in the financial information submitted to DOA's State Controller's Office (SCO) by the Department of Health Services (DHS) for inclusion in the

CAFR (Finding 2015-003). In addition, we found that the Capital Accounting Services Section within SCO did not have sufficient procedures and controls in place to ensure that all appropriate accruals were made to the financial statements for the Capital Improvement Fund and that the accruals made were materially correct (Finding 2015-004). Because these errors were significant and not prevented, or detected and corrected in a timely manner, we considered there to be significant deficiencies in each agency's financial reporting process. We include recommendations for DOA's Capital Accounting Services Section and DHS to take steps to assess and implement additional or changed processes to address the identified weaknesses.

We appreciate the courtesy and cooperation extended to us by DOA and other state agencies during the audit. During the FY 2015-16 audit, we will follow up on the progress in implementing our recommendations.

Respectfully submitted,

A handwritten signature in black ink, appearing to read "Joe Chrisman". The signature is fluid and cursive, with a long horizontal stroke extending to the right.

Joe Chrisman
State Auditor

JC/BN/ss



STATE OF WISCONSIN

Legislative Audit Bureau

22 East Mifflin Street, Suite 500 ■ Madison, WI 53703 ■ (608) 266-2818 ■ Hotline: 1-877-FRAUD-17 ■ www.legis.wisconsin.gov/lab

Celebrating
50 Years of
Service

1966-2016

Report 16-2

Joe Chrisman
State Auditor

Independent Auditor's Report on Internal Control over Financial Reporting and on Compliance and Other Matters

Honorable Members of the Legislature

The Honorable Scott Walker, Governor

We have audited the financial statements and the related notes of the governmental activities, the business-type activities, the aggregate discretely presented component units, each major fund, and the aggregate remaining fund information of the State of Wisconsin, which collectively comprise the State's basic financial statements, as of and for the year ended June 30, 2015, and have issued our report thereon dated December 17, 2015.

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*, which is issued by the Comptroller General of the United States. The basic financial statements and related auditor's opinions have been included in the State of Wisconsin's Comprehensive Annual Financial Report (CAFR) for the fiscal year ended June 30, 2015.

Our report includes a reference to other auditors who audited the financial statements of the Environmental Improvement Fund, the College Savings Program Trust, the Wisconsin Housing and Economic Development Authority, the University of Wisconsin Hospitals and Clinics Authority, and the University of Wisconsin Foundation, as described in our report on the State of Wisconsin's basic financial statements. The financial statements of the Environmental Improvement Fund, the College Savings Program Trust, the Wisconsin Housing and Economic Development Authority, and the University of Wisconsin Hospitals and Clinics Authority were audited in accordance with auditing standards generally accepted in the United States of America and *Government Auditing Standards*. This report does not include the results of the other auditors' testing of internal control over financial reporting or compliance and other matters that were reported on separately by those auditors. Although the financial statements of the University of Wisconsin Foundation were audited in accordance with auditing standards generally accepted in the United States of America, they 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 associated with the University of Wisconsin Foundation.

Internal Control over Financial Reporting

Management of the State of Wisconsin is responsible for establishing and maintaining effective internal control over financial reporting (internal control). In planning and performing our audit of the financial statements, we considered the State's internal control to determine the audit procedures that are appropriate in the circumstances for the purpose of expressing our

opinions on the financial statements, but not for the purpose of expressing an opinion on the effectiveness of the State's internal control. Accordingly, we do not express an opinion on the effectiveness of the State's internal control.

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 misstatements, or to 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 State's basic financial statements will not be prevented, or that a material misstatement will not be detected and corrected on a timely basis. 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.

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 over financial reporting that might be material weaknesses or significant deficiencies and, therefore, material weaknesses or significant deficiencies may exist that were not identified. Given these limitations, we did not identify any deficiencies in internal control that we consider to be material weaknesses. However, material weaknesses may exist that have not been identified.

We did identify certain deficiencies in internal control, described in the accompanying Findings and Responses Schedule as Findings 2015-001, 2015-002, 2015-003, and 2015-004, that we consider to be significant deficiencies. Because the University of Wisconsin (UW) System's financial activity is also reported separately from the State's CAFR, Finding 2015-002 is also included in the Independent Auditor's Report on Internal Control over Financial Reporting and on Compliance and Other Matters for UW System's financial statements.

Compliance and Other Matters

As part of obtaining reasonable assurance about whether the State's basic financial statements are free from material misstatement, we performed tests of 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*.

We also noted certain additional matters related to financial reporting errors that did not rise to the level of a significant deficiency. These are discussed on page 14 of the accompanying Findings and Responses Schedule.

Responses to Findings

Agency-specific responses to the findings identified in our audit are described in the accompanying Findings and Responses Schedule. The 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

This report is an integral part of an audit performed in accordance with *Government Auditing Standards* and should be used when considering the State's internal control and compliance. 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 State's internal control or on compliance. Accordingly, this report is not suitable for any other purpose.

LEGISLATIVE AUDIT BUREAU

A handwritten signature in black ink, appearing to read "Joe Chrisman". The signature is fluid and cursive, with a long horizontal stroke extending to the right.

Joe Chrisman
State Auditor

December 17, 2015

FINDINGS AND RESPONSES SCHEDULE

This schedule includes four significant deficiencies related to internal control over financial reporting that are required to be reported by auditing standards generally accepted in the United States of America and *Government Auditing Standards*. Two additional matters related to financial reporting follow these findings. Findings 2014-001, 2014-002, and 2014-003 from the prior year were resolved.

Finding 2015-001: Information Technology Controls Related to the Department of Administration

Criteria:

Section 16.97, Wis. Stats., specifies the Department of Administration's (DOA's) responsibilities for the State's information technology (IT) services, including DOA's responsibility to ensure that all state data processing facilities develop proper privacy and security procedures and safeguards. Additionally, Executive Order 99, which was issued on April 26, 2013, created the Information Technology Executive Steering Committee (ITESC). One of ITESC's goals is to "create and maintain" statewide IT policies.

Condition:

As part of our limited security review for the State of Wisconsin's financial statement audit for FY 2014-15, we identified weaknesses in IT security policies, standards, and procedures, as well as current IT settings. We determined that the detailed results of our review were too sensitive to communicate publicly. Therefore, we communicated the results in a confidential interim audit memorandum to the Division of Enterprise Technology (DET) within DOA.

Questioned Costs:

None.

Context:

DET provides a variety of services to state agencies, including managing the mainframe computer for all agencies and managing servers for DOA and other agencies, including the departments of Corrections, Health Services, Natural Resources, and Revenue. DET is in the process of taking over responsibility for managing the servers for additional agencies, including the departments of Children and Families and Workforce Development.

DET also maintains DOA-related systems and performs programming and security functions. In addition, DET has an ongoing role related to the State Transforming Agency Resources (STAR) enterprise resource management system, which includes statewide accounting and payroll functions.

Effect:

Although it can be difficult to determine how IT concerns such as those we identified affect the financial statements and material federal compliance areas, ineffective general IT controls may permit controls over individual systems to operate improperly and may allow financial statement misstatements and noncompliance to occur and not be detected. For instance, weaknesses in IT security policies, procedures, and controls increase the risk that unauthorized or erroneous transactions could be processed or changes could be made to accounting, payroll, or other data. In addition, failure to provide an appropriate level of protection for systems and data increases the risk that personally identifiable information could be accidentally or maliciously exposed.

Cause:

As noted, DET's responsibility has been changing to include more agencies' resources. Further, the development of security policies, standards, and procedures is complex and time consuming and must consider the needs of all agencies. During FY 2014-15, DET's Bureau of Security started a project to review DET's high-level policies and is currently working to improve the controls within DET operations. At the time of our review, this project was not yet completed.

Recommendation:

We recommend the Department of Administration's Division of Enterprise Technology develop timelines and plans for:

- completing and regularly updating information technology policies, standards, and procedures;
- reviewing information technology procedures and settings used at the Division of Enterprise Technology to ensure controls conform to the policies and standards, including specific concerns identified during our review;
- implementing information technology policies and standards, where appropriate, on a statewide basis; and
- providing oversight of and monitoring executive branch agencies' information technology operations.

Response from the Department of Administration:

Many of the detailed recommendations provided by the auditors are in alignment with work that is either planned or already underway within DET. A detailed response was provided to address each issue identified in the interim audit memorandum.

Finding 2015-002: Information Technology Controls at the University of Wisconsin System

Criteria:

The University of Wisconsin (UW) System consists of 13 four-year universities, 13 two-year colleges, UW-Extension, and UW System Administration. UW System Administration maintains the Shared Financial System (SFS), which is UW System's accounting system, and the Human Resource System (HRS), which is UW System's payroll and personnel system. These systems are used by all UW institutions. In addition, each institution maintains its own student information system (SIS) to administer federal student financial aid programs, as well as other computer applications. To provide proper internal control, IT security policies and procedures are necessary to ensure software and data stored and processed by the institutions are protected from accidental or intentional misuse or destruction. In addition, IT controls should be established to prevent inappropriate or inadvertent access to systems and data.

Condition:

We identified weaknesses in IT security policies, procedures, and controls for several computer applications at several UW institutions. We determined that the detailed results of our review

were too sensitive to communicate publicly. Therefore, we communicated these results in confidential interim memoranda to the institutions involved.

We did not audit the IT security policies and procedures at all UW institutions or the IT controls over all computer applications used by the institutions. However, we believe there is a potential that similar weaknesses may exist at those institutions we did not review.

Questioned Costs:

None.

Context:

UW institutions operate in a highly computerized environment and are responsible for maintaining confidential and sensitive information, such as student data.

Effect:

Although it can be difficult to determine how IT concerns such as those we identified affect the financial statements and material federal compliance areas, ineffective general IT controls in areas such as these may permit controls over individual systems to operate improperly and may allow financial statement misstatements and noncompliance to occur and not be detected.

Weaknesses in IT security policies, procedures, and controls increase the risk that unauthorized or erroneous transactions could be processed or changes could be made to accounting, payroll, and student data. In addition, failure to provide an appropriate level of protection for UW systems and data increases the risk that personally identifiable information could be accidentally or maliciously exposed.

Cause:

IT staff at each UW institution are responsible for ensuring IT security policies, procedures, and controls are properly developed and maintained. Those institutions that have smaller IT staff may find challenges in meeting these responsibilities, maintaining proper separation of duties, and monitoring sufficiently all security policies and procedures. In addition, with changing technologies, monitoring and assessment of current processes are necessary to evaluate changing data security risks.

Recommendation:

In addition to recommendations we made to individual UW institutions, we recommend UW System Administration work with the Council of Chief Information Officers, the Chief Business Officers at each institution, and others as appropriate, to assist UW institutions in implementing timely corrective actions related to our institution-specific recommendations, and to develop a UW System-wide information technology security program, including:

- UW System-wide information technology security policies and settings, as appropriate;
- guidance and training to all UW institutions regarding information technology security policies and settings; and
- procedures for assessing the level of protection provided for UW systems and data.

Response from University of Wisconsin System:

In responding to the confidential interim memoranda, the UW institutions involved indicated agreement with the recommendations and provided timelines for implementing corrective actions.

UW System Administration agrees with the recommendation that UW System Administration work with the Chief Information Officers and Chief Business Officers at the institutions to improve IT controls and develop a UW System-wide security program. The recommendation supports the direction in which UW System Administration and the Chief Information Council are working to improve IT security. For example, UW System hired a Chief Security Information Officer in March 2015 to focus on and lead UW System-wide efforts related to IT security.

In addition, the following are some actions UW System Administration is planning to take regarding IT security:

- The UW System Administration Chief Information Officer and Chief Information Security Officer have been developing a UW System-wide or Board of Regents level policy to provide institutions with guidance, standards, and parameters for future decision-making about IT security. The policy will be presented at the February 2016 Board meeting.
- The Chief Information Officers will be holding a visioning session in the near future to consider an overarching IT security strategy.
- The newly instituted Data and Privacy Security Council will also be meeting in the near future. The cross-unit group includes Chief Information Officers and staff from the legal and audit offices at UW System Administration. Further representation is being sought from a wide range of other groups (e.g. student affairs, human resources, etc.). The Council will identify and analyze risks related to IT security and propose and implement solutions that appropriately address these concerns.

Finding 2015-003: Financial Reporting for the Department of Health Services

Criteria:

The Department of Health Services (DHS) is responsible for maintaining effective internal controls to ensure the financial information submitted to the State Controller's Office (SCO) in DOA for inclusion in the State's basic financial statements is fairly presented and that misstatements are prevented, or detected and corrected in a timely manner.

Condition:

Overall, the financial information submitted by DHS to SCO for inclusion in the State's basic financial statements is accurate and complete. However, during our FY 2014-15 audit, we identified several errors in the financial information submitted to SCO. The most significant error related to the liability for Medicaid services performed but not yet paid for as of June 30, 2015.

Questioned Costs:

None.

Context:

DHS administers the Medical Assistance program, also known as Medicaid, which is the largest federal program administered by the State. DHS's financial information is incorporated into the State's basic financial statements, along with other agencies' information.

Effect:

Because DHS did not appropriately accrue for unpaid Medicaid claims, the Human Relations and Resources expenditure account was overstated by \$258.1 million and the Intergovernmental Revenue account was overstated by \$150.4 million on the Statement of Revenues, Expenditures and Changes in Fund Balance. In addition, Accounts Payable was overstated by \$258.1 million and Due From Other Governments was overstated by \$150.4 million on the Balance Sheet. As a result of these misstatements, the Fund Balance was understated by \$107.7 million. Staff subsequently corrected the financial information submitted to SCO for the unpaid Medicaid claims error identified.

Cause:

The financial reporting errors related to Medicaid occurred, in part, due to insufficient staff review. The information provided to the accountant to accrue the liability was incorrect, causing the liability to appear significantly larger than anticipated. The accountant identified the large increase and performed an additional review. However, in error, the information used to accrue the liability was accepted as correct. In addition, a comprehensive and thorough secondary review of the financial information was not performed prior to submitting it to SCO. Although the accountant discussed the liability with the section chief after the large increase was identified, the error was not detected.

Recommendation:

We recommend the Department of Health Services take greater care when preparing financial information to be included in the State's basic financial statements. Specifically, the Department should:

- obtain sufficient explanations for fluctuations in the larger, more complicated adjusting journal entries; and
- perform a comprehensive and thorough secondary review of the financial information prior to submitting it to the State Controller's Office for inclusion in the State's basic financial statements.

Response from the Department of Health Services:

The auditors note the most significant error prompting their finding involved the statement of liability for Medicaid services performed, but not yet paid, as of June 30, 2015. DHS agrees that the process, including the quality control review, needs refinement and DHS is committed to working on this to avoid errors moving forward.

It is worth noting that accuracy in estimating the unpaid liability for health care benefits is problematic based on DHS's inability to predict the volume and value of health care claims not yet received for dates of service in a fiscal period. The time lag for claims received by DHS is often greater than six months since providers have 365 days to bill for health care claims once a service is rendered. To address this issue, DOA requested DHS no longer attempt an estimate, but rather run a retrospective query of claims activity several months after fiscal year-end. This direction results in DHS waiting until completion of the month of September, following the fiscal year ending in June, before the final querying can be done. The timing of this puts pressure on DHS's quality control efforts.

With this in mind, DHS agrees refinements in the querying process are necessary in order to make more transparent the year-over-year changes based on the claims query results. Therefore, DHS's view is overall corrective action will involve both work with the fiscal agent to make the claims querying process more robust and transparent, while also engaging DOA to reevaluate DHS's view of proper reporting for this challenging estimate.

In addition, the Bureau of Fiscal Services (BFS) will take additional steps to perform a secondary review. Anomalies will be reviewed by the Cost Allocation and Financial Reporting Section supervisor and brought forward to the deputy and director of BFS to assure reasonability.

Finding 2015-004: Financial Reporting for the Capital Improvement Fund

Criteria:

The Capital Accounting Services Section (Capital Accounting) within DOA's SCO is responsible for preparing financial statements for the Capital Improvement Fund (CIF) that are in accordance with generally accepted accounting principles (GAAP). These statements are provided to SCO for use in compiling the State of Wisconsin's financial statements.

To assist state agencies in preparing the necessary information, SCO has developed the *Uniform GAAP Conversion Policies and Procedures Manual*, which outlines the State's financial reporting policies and procedures. The GAAP manual requires, among other things, that agencies "review subsequent year's July and August vouchers to identify additional payables to be

accrued that relate to goods or services received prior to June 30 but recorded on the central accounting system in the next fiscal year.” Accruals that are identified by agencies are submitted to Capital Accounting for reporting in the CIF statements. In addition, Capital Accounting performs a review of certain transactions to determine whether amounts need to be accrued. Capital Accounting should have sufficient procedures and controls in place to ensure that all appropriate accruals are included in the financial statements and that the statements are materially correct.

Condition:

Capital Accounting did not have sufficient procedures and controls in place to ensure that all appropriate accruals were made and that the accruals made were materially correct. In addition, Capital Accounting did not have a consistent process in place to review the accuracy and completeness of information submitted to it by agencies.

Questioned Costs:

None.

Context:

The CIF accounts for revenues from general obligation bond proceeds, which are primarily used for the acquisition or construction of major capital facilities and for repair and maintenance projects.

Effect:

Capital Accounting did not prevent, or detect and correct in a timely manner, misstatements in the accruals for the CIF. This resulted in at least three misstatements in the Statement of Revenues, Expenditures, and Changes in Fund Balances:

- Transportation expenditures and Due to Other Funds were overstated by \$4.3 million;
- Education expenditures and Fund Balance were overstated by \$1.4 million; and
- Environmental Resources expenditures and Accounts Payable and Other Accrued Liabilities were understated by \$600,000.

After we brought these concerns to its attention, Capital Accounting agreed to make a correction for the \$4.3 million overstatement of Transportation expenditures and Due to Other Funds. Capital Accounting determined the other errors to be immaterial in relation to the financial statements for the CIF.

Cause:

Due to the complexity of the CIF, and due to Capital Accounting’s reliance on state agencies to identify accruals, it may have been difficult for Capital Accounting to ensure that all appropriate transactions were considered for accrual. Further, Capital Accounting staff acknowledged that they did not have a thorough understanding of the transactions and accruals related to the Department of Transportation (DOT) due to the particularly complex nature of DOT activity.

Recommendation:

We recommend the Department of Administration's Capital Accounting Services Section:

- reassess current accrual procedures and controls, and implement sufficient procedures and controls to help ensure that the appropriate accruals have been made and that the accruals made are materially correct;
- reassess guidance provided to agencies related to accruals and ensure sufficient guidance is provided to agencies, as necessary; and
- work with individual agencies, such as the Department of Transportation, to gain a sufficient understanding of how accruals are determined.

Response from the Department of Administration:

The extent to which the Capital Accounting Services Section can prevent or detect errors made by state agencies in their GAAP accruals is limited, especially in cases when agencies, such as DOT or UW System, rely on internal systems to derive accruals.

Nevertheless, Capital Accounting will reassess current accrual procedures and seek improvements that will better serve toward the prevention and detection of accrual errors. In addition, Capital Accounting will reassess guidance provided to state agencies related to accruals in order to ensure such guidance is sufficient. Finally, Capital Accounting will work with specific agencies, such as DOT, to gain a sufficient understanding of how accruals are determined.

Additional Matters

The Department of Employee Trust Funds (ETF), which administers various employee benefit programs provided to state and local employees, including the Wisconsin Retirement System, is responsible for maintaining effective internal controls to ensure the financial information it prepares for inclusion in the State's CAFR is accurate. ETF has implemented procedures for preparing the financial statements, including oversight and review by management. However, we identified several errors that required adjustment to the financial statements, and that were not detected and corrected by ETF as part of the review process. We further communicated our concerns and recommendation to ETF management.

DOT is responsible for maintaining effective internal controls to ensure the financial information it prepares for inclusion in the State's CAFR is accurate. For the FY 2014-15 CAFR, we found that DOT did not have sufficient procedures and controls in place to ensure that all appropriate financial information was prepared accurately across funds that account for transportation activities. DOT did not prevent, or detect and correct in a timely manner, misstatements in classifying or preparing financial information. For example, we identified two significant misclassifications in the CAFR's government-wide financial statements and found that Transportation Fund amounts were not reclassified as restricted following a November 2014 constitutional amendment prohibiting use of transportation revenues for other purposes. We further communicated our concerns and recommendation to DOT management.



STATE OF WISCONSIN

Legislative Audit Bureau

22 East Mifflin Street, Suite 500 ■ Madison, WI 53703 ■ (608) 266-2818 ■ Hotline: 1-877-FRAUD-17 ■ www.legis.wisconsin.gov/labCelebrating
50 Years of
Service

1966-2016

Joe Chrisman
State Auditor

December 18, 2015

Senator Robert Cowles and
Representative Samantha Kerkman, Co-chairpersons
Joint Legislative Audit Committee
State Capitol
Madison, Wisconsin 53702

Dear Senator Cowles and Representative Kerkman:

We conducted a financial audit of the State of Wisconsin as of and for the fiscal year ended June 30, 2015, and issued unmodified opinions dated December 17, 2015, on the State's financial statements. These financial statements were prepared by the Department of Administration (DOA) in accordance with generally accepted accounting principles (GAAP) and were included in the State's fiscal year (FY) 2014-15 Comprehensive Annual Financial Report (CAFR), which DOA published on its website.

The CAFR helps to describe the State's fiscal condition and contains information on over 90 funds. In this letter, we discuss the balances of the General Fund and Transportation Fund, which are the State's two largest governmental funds; the amount of the State's long-term debt; and the State's net pension asset.

As reported on a GAAP basis, and as shown on page 44 of the CAFR, the General Fund deficit increased from \$1.4 billion as of June 30, 2014, to \$1.8 billion as of June 30, 2015. In its Management's Discussion and Analysis (MD&A) on page 29, DOA noted that total revenue, which was derived primarily from taxes and the federal government, increased by \$310.2 million and totaled \$24.6 billion for FY 2014-15. Total expenditures and transfers increased by \$1.2 billion primarily due to increases in Medical Assistance costs and school aids payments, and totaled \$25.0 billion for FY 2014-15.

On a GAAP basis, and as shown on page 44 of the CAFR, the balance of the Transportation Fund increased from \$691.2 million as of June 30, 2014, to \$777.5 million as of June 30, 2015. The majority of the Transportation Fund's balance was reclassified on the Balance Sheet as "restricted" following the November 2014 constitutional amendment relating to uses of the Transportation Fund. DOA indicates in its MD&A on page 31 that 2013 Wisconsin Act 20 authorized a one-time transfer of \$133.3 million from the General Fund to the Transportation Fund. This transfer largely contributed to the overall increase of the Transportation Fund during FY 2014-15. Total transportation-related expenditures increased from \$3.0 billion in FY 2013-14 to \$3.2 billion in FY 2014-15. Of this total, \$2.6 billion was reported in the Transportation Fund and was funded largely by motor fuel taxes,

Senator Robert Cowles and
Representative Samantha Kerkman, Co-chairpersons
Page 2
December 18, 2015

registration fees, and federal revenues. Transportation revenue bonds and general obligation bonds, which are reported in separate funds, funded the remaining \$628.8 million in expenditures.

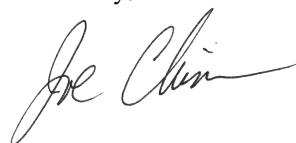
The State's long-term debt remained at \$13.6 billion as of June 30, 2015, as shown in the MD&A on page 34. Both outstanding annual appropriation bonds and revenue bonds decreased. However, these decreases were offset by the issuance of \$1.8 billion in new general obligation bonds and notes.

The Governmental Accounting Standards Board issued new accounting standards for public pension plans and participating employers. Under these new standards, the Wisconsin Retirement System (WRS) reported a net pension asset of \$2.5 billion, as we discussed in our report 15-12. The State's proportionate share of the WRS net pension asset was \$686.9 million, of which \$324.1 million was for governmental activities and \$362.8 million was for business-type activities, as shown in the CAFR on page 39. The net pension asset for the State, which is reported on the Statement of Net Position, is not available to finance the day-to-day operations of the State. Additional information on the net pension asset is presented in the CAFR in Note 14 on page 123.

In early 2016, we will issue the Independent Auditor's Report on Internal Control over Financial Reporting and on Compliance and Other Matters, which is required under *Government Auditing Standards*.

We appreciate the courtesy and cooperation extended to us by the Department of Administration and other state agencies during the audit.

Sincerely,



Joe Chrisman
State Auditor

JC/BN/bm

cc: Senator Mary Lazich
Senator Alberta Darling
Senator Kathleen Vinehout
Senator Janet Bewley

Representative John Macco
Representative John Nygren
Representative Melissa Sargent
Representative Terese Berceau

Scott Neitzel, Secretary
Department of Administration

Jeffery Anderson, Deputy State Controller
Department of Administration