



STATE OF WISCONSIN

Legislative Audit Bureau

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Janice Mueller
State Auditor

February 2, 2011

Mr. Charles Pruitt, President
Board of Regents
University of Wisconsin System
1860 Van Hise Hall
1220 Linden Drive
Madison, Wisconsin 53706

Mr. Kevin P. Reilly, President
University of Wisconsin System
1720 Van Hise Hall
1220 Linden Drive
Madison, Wisconsin 53706

Dear President Pruitt and President Reilly:

We have completed our financial audit of the University of Wisconsin (UW) System for the years ended June 30, 2010, and 2009. On December 10, 2010, we issued an unqualified auditor's report on the fair presentation of the financial statements and notes for those two fiscal years, which is included in the UW System's 2010 Annual Financial Report.

As provided for in *Government Auditing Standards*, we are furnishing you with the auditor's report on internal control over financial reporting and on compliance and other matters. In this report, we describe four findings related to internal controls at UW System that are required to be reported under these standards: mainframe computer program change controls; business resumption planning; audit adjustment; and project classifications. Management's responses to our concerns are included in the text of the report. In future audits, we will determine the extent to which findings in the report have been resolved.

We appreciate the courtesy and cooperation extended to us by UW System staff during the audit.

Sincerely,

Janice Mueller
State Auditor

JM/CS/bm

Enclosure



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**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**

We have audited the financial statements of the University of Wisconsin (UW) System as of and for the years ended June 30, 2010 and 2009, and have issued our report thereon dated December 10, 2010. The financial statements and related auditor's opinion have been included in UW System's 2010 Annual Financial Report. Our report includes a reference to other auditors. We conducted our audits 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 UW Foundation, which are presented in a condensed format in Note 11A to the financial statements, as described in our opinion on UW System's financial statements. While the financial statements of the UW 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*.

Internal Control over Financial Reporting

In planning and performing our audits, we considered UW System's internal control over financial reporting (internal control) 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 UW System's internal control. Accordingly, we do not express an opinion on the effectiveness of UW System'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 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 UW System's financial statements will not be prevented or will not be detected and corrected on a timely basis.

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 deficiencies, significant deficiencies, or material weaknesses. We did not identify any deficiencies in internal control that we consider to be material weaknesses as defined in the preceding paragraph. However, as discussed in the following paragraphs, we identified four deficiencies in internal control over financial reporting that we consider to be significant deficiencies. 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.

Mainframe Computer Program Change Controls

UW System's process for making changes to the legacy payroll systems, which operate on the mainframe computer, does not include an independent review to assess the reasonableness of the program changes or compliance with users' requests. Further, programmers have the ability to move programs into the mainframe computer production environment. Thus, even if the reviews were performed, programmers could circumvent these procedures and make changes without oversight, review, or documentation. UW System is in the process of implementing the Human Resources System (HRS), which is anticipated to replace the legacy payroll systems near the end of fiscal year (FY) 2010-11. We recommend that UW System ensure a well-controlled program change process is established when the new system is implemented.

Management's Response: Management acknowledges and accepts the finding, but believes the risk associated with it is low and of limited duration. The legacy payroll systems will be obsolete after the implementation of HRS, and the program change control process for HRS will be different from the program change control process associated with the legacy payroll systems. For the HRS program change control process, UW System will be using a change management application known as STAT to track changes and their migration from development to testing and then to production. The HRS program change control process will be evaluated after implementation, and UW-Madison's Division of Information Technology (DoIT) security staff will work with HRS and other DoIT staff to ensure that the finding is addressed during that review period.

Business Resumption Planning

An effective business resumption plan helps to ensure that in the event of an emergency, such as a large-scale disaster or a system failure or power outage, business functions can be resumed in a timely manner. An effective business resumption plan should identify critical functions, provide detailed recovery procedures, identify personnel who would carry out the recovery efforts, and coordinate the efforts between departments and campuses. UW System continues to make progress in the development of its business resumption plan. Seven of the 13 four-year campuses, UW System Administration, and all two-year campuses have completed their plans as of November 2010, and several have indicated that the plans have been tested. However, several plans are not complete. Further, these plans rely on the recovery of critical accounting and reporting applications, such as the Shared Financial System, the accounting system used by all campuses, which are maintained by UW-Madison's DoIT. Additional testing of DoIT's recovery plan and the campus-level plans is needed to ensure these critical financial applications and operations can be resumed in a timely manner in the event of a disaster. We recommend UW System continue the development of its business resumption plan.

Management's Response: UW System and UW-Madison management agree with the recommendation and are committed to completing these plans at each campus. Management's goal is to complete plans at every campus and test DoIT's recovery plan by the end of FY 2010-11. Management acknowledges that staff turnover and competing campus priorities continue to challenge this goal. UW System's contract with the UW-Madison Police Department for coordination of the development of the plans at each campus has been extended into FY 2010-11. Management agrees that communication among UW System, DoIT, and the UW institutions is a critical component of the plan.

Audit Adjustment

In preparing the FY 2009-10 financial statements, UW System Administration financial reporting staff prepared an adjusting entry to reverse a prior year entry that estimated the reclassification of revenue between accounts on the FY 2008-09 financial statements. However, the combination of this reversing entry and adjustments that were made to the revenue accounts during FY 2009-10, caused revenues to be misstated between accounts. We identified a \$51.9 million understatement of Federal Grants and Contracts revenue, a \$43.8 million overstatement of State, Local, and Private Grants and Contracts revenue, and an \$8.1 million overstatement of Sales and Services of Educational Activities revenue on the FY 2009-10 Statement of Revenues, Expenses, and Changes in Net Assets. UW System financial reporting staff applied Financial Accounting Standards Board *Accounting Standards Codification (ASC) 250 Accounting Changes and Error Corrections*. However, because UW System's FY 2008-09 entry only reclassified revenue between accounts, it does not meet the definition of a change in an estimate as described in ASC 250, and thus FY 2009-10 revenue accounts should not have been affected. After we brought this concern to their attention, UW System Administration staff corrected these errors. We recommend UW System fully review unusual financial reporting issues to ensure the financial statements are fairly stated.

Management's Response: Management acknowledges that an error was made in the routine processing of grant revenue in FY 2008-09, causing a misstatement between revenue accounts. UW System Administration financial reporting staff estimated the error and recorded an adjustment for the FY 2008-09 financial statements. While further investigating the issue and implementing process changes in FY 2009-10, it was noted that the estimate was materially different from the actual correction needed, and the variance was included in the FY 2009-10 Statement of Revenues, Expenses, and Changes in Net Assets as if it were FY 2009-10 activity. After discussions with the auditors, management agreed to adjust revenue accounts to reflect actual FY 2009-10 amounts. Management agrees with the recommendation to ensure unusual financial reporting issues are thoroughly reviewed. However, management does not agree that this represents a significant deficiency in internal control.

Project Classifications

Generally accepted accounting principles state that costs related to the improvement of a capital asset, such as those that extend the useful life or improve the asset's efficiency or capacity, are to be capitalized. Other costs that maintain the existing level of service of an asset should be expensed. UW System Administration financial reporting staff are responsible for ensuring that replacement, repair, or renovation projects are properly classified as capitalized or expensed projects to ensure proper reporting in the financial statements.

We reviewed the classification of 72 projects that appeared to have a higher likelihood of misclassification and identified 43 projects that we believe should have been capitalized, but were instead expensed. As a result, we estimate that FY 2009-10 expenses are overstated by \$9.6 million and either Construction In Progress, Buildings, or Improvements Other Than Buildings are understated, in total, by the same amount. These 43 projects have a combined budget of \$46.8 million. If these projects continue to be misclassified and the entire budgeted amounts are expensed, an additional \$37.2 million will be expensed rather than capitalized in future years. These errors resulted because financial reporting staff did not conduct a thorough review to ensure the appropriate project classifications. We recommend UW System improve its

process to review project classifications using available information, to ensure that projects are properly classified for financial reporting purposes.

Management's Response: Management agrees with the recommendation and will implement any needed changes starting with FY 2010-11. UW System will work with the Department of Administration's Capital Accounting Section to clarify classification guidelines and processes. In addition, UW System will establish processes to consult with its Capital Planning and Budget staff, as well as campus staff, as necessary.

Compliance and Other Matters

As part of obtaining reasonable assurance about whether UW System'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*.

UW System's written responses to the findings identified in our audit are described in the preceding narrative. We did not audit the responses and, accordingly, express no opinion on them.

We noted certain additional matters which we have reported to management of UW System in separate communications, including an instance of statutory noncompliance that resulted in UW-Madison accumulating \$81.1 million in indirect cost revenues in the incorrect appropriation.

This independent auditor's report is intended solely for the information and use of UW System's management, the Board of Regents, and the Wisconsin Legislature. This report is a matter of public record and its distribution is not limited. However, because we do not express an opinion on the effectiveness of UW System's internal control or on compliance, this report is not intended to be used by anyone other than these specified parties.

LEGISLATIVE AUDIT BUREAU



by

Carolyn Stittleburg
Audit Director

December 10, 2010