STATE OF WISCONSIN
Legislative Audit Bureau

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Janice Mueller
State Auditor

December 14, 2007

Mr. Michael L. Morgan, Secretary
Department of Administration
101 East Wilson Street, 10th Floor
Madison, Wisconsin 53702

Mr. Stephen Censky, State Controller
Department of Administration
101 East Wilson Street, 5th Floor
Madison, Wisconsin 53702

Dear Mr. Morgan and Mr. Censky:

We have completed a financial audit of the State of Wisconsin as of and for the fiscal year ended June 30, 2007. We have issued an unqualified auditor's report on the fair presentation of the basic financial statements. The financial statements and related opinion are included in the State of Wisconsin's Comprehensive Annual Financial Report, which is published by the Department of Administration.

During the course of our audit, we identified a variety of internal control concerns at various state agencies that are required to be reported under *Government Auditing Standards*. As provided for in these standards, we are furnishing you with the auditor's report on internal control over financial reporting and on compliance and other matters. The state agencies' responses to our concerns and recommendations are included in the text of the report so that readers may see the State's intended resolution of the matters discussed. 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 the Department of Administration and other state agencies during the audit.

Sincerely,

Janice Mueller

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State Auditor

JM/CS/ss

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 State of Wisconsin's basic financial statements as of and for the year ended June 30, 2007, and have issued our report thereon dated December 14, 2007. The basic financial statements and related auditor's opinion have been included in the State of Wisconsin's Comprehensive Annual Financial Report for fiscal year 2006-07. We did not audit the following financial statements: the Wisconsin Department of Transportation Revenue Bond Program and Commercial Paper Program, which represent 12 percent of the liabilities of the governmental activities and 3 percent of the expenditures of the aggregate remaining fund information; the Badger Tobacco Asset Securitization Fund, which represents 10 percent of the liabilities of the governmental activities and 1 percent of the expenditures of the aggregate remaining fund information; the Environmental Improvement Fund, which is a major fund and represents 19 percent of the assets and 20 percent of the liabilities of the business-type activities; and the College Savings Program Trust, which represents 2 percent of the assets of the aggregate remaining fund information. Those financial statements were audited by other auditors whose reports thereon have been furnished to us, and our opinions, insofar as they relate to the amounts audited by others, are based solely upon their reports. In addition, we did not audit the financial statements of the discretely presented component units. Those financial statements were audited by other auditors. Our opinion on the aggregate discretely presented component units, insofar as it relates to the amounts audited by others, is based upon the reports of the Wisconsin Housing and Economic Development Authority, the University of Wisconsin Hospitals and Clinics Authority, and the University of Wisconsin Foundation.

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. The financial statements of the Wisconsin Housing and Economic Development Authority, which were audited by other auditors, were also audited in accordance with these standards. The financial statements of the other funds and component units that were audited by other auditors upon whose reports we are relying were audited in accordance with auditing standards generally accepted in the United States of America, but not in accordance with *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 may have been reported on separately by those auditors.

Internal Control over Financial Reporting

In planning and performing our audit, we considered the State's internal control over financial reporting as a basis for designing our auditing procedures for the purpose of expressing our opinions on the State's basic financial statements but not for the purpose of expressing an opinion on the effectiveness of the State's internal control over financial reporting. Accordingly, we do not express an opinion on the effectiveness of the State's internal control over financial reporting.

Our consideration of internal control over financial reporting was for the limited purpose described in the preceding paragraph and would not necessarily identify all deficiencies in internal control over financial reporting that might be significant deficiencies and, accordingly, would not necessarily disclose all significant deficiencies that are also considered material weaknesses. However, as discussed below, we identified certain deficiencies in internal control over financial reporting that we consider to be significant deficiencies.

A control deficiency 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 misstatements on a timely basis. A significant deficiency is a control deficiency, or combination of control deficiencies, that adversely affects the entity's ability to initiate, authorize, record, process, or report financial data reliably in accordance with generally accepted accounting principles such that there is more than a remote likelihood that a misstatement of the entity's financial statements that is more than inconsequential will not be prevented or detected by the entity's internal control. We consider the deficiencies described in the accompanying schedule of findings and responses to be significant deficiencies in internal control over financial reporting.

A material weakness is a significant deficiency, or combination of significant deficiencies, that results in more than a remote likelihood that a material misstatement of the financial statements will not be prevented or detected by the entity's internal control. We believe that none of the significant deficiencies described in the accompanying schedule of findings and responses is a material weakness.

Compliance and Other Matters

As part of obtaining reasonable assurance about whether the State of Wisconsin's basic 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 State's written responses to findings identified are described in the accompanying schedule of findings and responses. We did not audit the responses and, accordingly, express no opinion on them.

We noted certain additional matters, which we will report or have already reported to the management of certain state agencies in separate communications.

This independent auditor's report is intended for the information and use of the management of the State of Wisconsin, the Wisconsin Legislature, federal awarding agencies, and pass-through entities. This report, upon submission to the Joint Legislative Audit Committee, is a matter of public record and its distribution is not limited. However, because we do not express an opinion on the effectiveness of the State's internal control or on compliance, this report is not intended to be used by anyone other than these specified parties.

LEGISLATIVE AUDIT BUREAU

December 14, 2007 by Bryan Naab

Bryan Naab
Deputy State Auditor for Financial Audit

SCHEDULE OF FINDINGS AND RESPONSES

This schedule includes all significant deficiencies related to internal control over financial reporting and compliance and other matters that are required to be reported by auditing standards generally accepted in the United States of America and *Government Auditing Standards*. Repeat findings from the prior year are indicated with an asterisk (*).

Finding WI-07-01: Internal Control Weaknesses in Financial Reporting by State Agencies

Criteria:
The Department of Administration (DOA) is responsible for preparing and maintaining the Uniform GAAP Conversion Policies and Procedures Manual, which includes the State's policies and procedures used to prepare financial statements in accordance with generally accepted accounting principles (GAAP). The management of each state agency is responsible for maintaining effective internal controls to ensure agencies follow the Uniform GAAP Conversion Policies and Procedures Manual and that the information provided to DOA for inclusion in the State's financial statements is fairly presented and that misstatements are prevented or detected in a timely manner.

Condition:
In some instances, state agencies do not have sufficient procedures and controls in place to ensure compliance with the Uniform GAAP Conversion Policies and Procedures Manual. In other instances, agency staff and management do not fully understand the requirements for accurately reporting financial activity or have not taken sufficient steps to obtain information needed to report in compliance with the manual. In addition, some agencies did not appropriately review financial information for significant or material errors prior to submitting the information to DOA for inclusion in the State's financial statements.

Questioned Costs:
None

Context:
The State's financial statements present financial activity for the State as a whole, in accordance with GAAP. Financial reporting for the State is complex, with many technical accounting issues. Each state agency is responsible for submitting accurate information to DOA in a timely manner so it can be included in the financial statements.

Effect and Cause:
Some state agencies did not prevent or detect in a timely manner misstatements in the financial information provided to DOA for inclusion in the State's financial statements. Agencies agreed to make corrections after the auditors brought the errors to their attention. Significant errors identified by auditors and the cause of these errors are presented in the following table:

Agency	Fund	Misstatement	Cause
DOA	***Government-wide Statement of Net Assets***	The Invested in Capital Assets Net of Related Debt account was overstated by $431.5 million and Unrestricted Net Assets were understated by $431.5 million.	Staff did not accurately determine the amount of debt related to capital assets because of database query errors, misclassified projects, and miscommunication between state agencies.
Department of Transportation (DOT)	***Government-wide Statement of Activities***	Operating Grants and Contributions were overstated by $152.2 million and Capital Grants and Contributions were understated by $152.2 million.	Staff did not identify a formula error in a spreadsheet and did not reverse a prior-year entry. The errors were not identified in the agency's review process.
Department of Veterans Affairs	***Veterans Mortgage Loan Repayment Fund***	Current Loans Receivable were overstated by $73.6 million and Non-current Loans Receivable were understated by $73.6 million on the Balance Sheet. Proceeds from Issuance of Debt and Repayment of Bonds and Notes were both understated by $61.7 million in the Statement of Cash Flows.	Staff made a keying error and inappropriately netted certain cash inflows and outflows on the Statement of Cash Flows. Management's review was not sufficient to detect these errors.
Office of the Commissioner of Insurance	***Injured Patients and Families Compensation Fund***	Investment sales and purchases were understated by $69.6 million in the Statement of Cash Flows.	Staff did not obtain information from the Investment Board to appropriately classify activity.
University of Wisconsin (UW) System	***UW System***	Gifts were overstated by $44.2 million and Capital Contributions were understated by $44.2 million in the Statement of Revenues, Expenses, and Changes in Fund Equity.	UW-Madison did not verify information in the gift/grant system that is used to classify gifts for capital projects before providing this information to UW System Administration for financial reporting.
Department of Revenue	***General Fund and Transportation Fund***	A number of Balance Sheet errors were identified by auditors that required corrections by staff, including an understatement of $39.5 million in both Taxes Receivable and Accounts Payable and Other Accrued Liabilities.	The Department of Revenue did not sufficiently plan and make changes in the financial reporting process that were required because of implementation of a new tax processing system. Management's review was not sufficient to detect these errors.

Recommendation:
We recommend that state agencies with identified control weaknesses improve their internal controls over the financial reporting process.

Management's Response:
Agency management agreed to implement improvements to controls over the financial reporting process.

Finding WI-07-02: Improvement in Security at the State's Data Centers*

Criteria:
The State's computer data centers—one administered by DOA and one by UW-Madison—should establish both data and physical security policies and procedures to ensure that software and data stored and processed by the data centers are protected from accidental or intentional misuse or destruction.

Condition:
While control improvements have been made, continued effort is needed at the data centers to improve both data and physical security policies and procedures. For instance, we found data security policies and procedures need to be developed and implemented for some platforms and locations. Further, we found the environmental controls at some sites should be improved to reduce the risk that computer resources may be damaged.

Questioned Costs:
None

Context:
The data centers provide centralized computer processing facilities in which critical data, including accounting and payroll data, are stored and processed.

Effect:
Data security control weaknesses increase the risk that unauthorized or erroneous changes could be made to accounting, payroll, and other transactions and data. Physical and environmental control weaknesses increase the risk that financial systems or sensitive data may be lost or unavailable to the users due to theft or damage to devices.

Cause:
Efforts to address many of the identified issues are long-term projects. While improvements have been made, because of time constraints some areas of concern remain.

Recommendation:
We recommend the computer data centers continue to review their security and improve controls.

Management Response:
DOA has taken steps and is developing plans to address all the concerns identified.

UW-Madison agrees with this recommendation. The data center strives to keep abreast of new technological developments and to implement available security controls to help reduce risks.

Finding WI-07-03: Programmer Access to the State's Central Accounting System and Central Payroll System Data and Programs*

Criteria:
To provide proper internal control, programmer duties should be separated from production and data control duties.

Condition:
Programmers for the State's central accounting system and central payroll system have access to production data and programs that would allow them to make unauthorized or inadvertent changes to the data. DOA has begun several projects that, when completed, may mitigate risks in some areas. For example, during fiscal year (FY) 2006-07, DOA took steps to limit programmer direct access to several payroll datasets. Changes to those datasets are now made through the use of a new log-on identification, which logs who made changes to accessed files. However, DOA has not yet assigned staff to monitor the log and review the changes made by programmers. In addition, some programmers also have access to modify the production programs, which could allow them to change the programs or output in order to avoid detection of unauthorized program changes. Although DOA has taken limited steps to improve controls, payroll and accounting data remained at risk during FY 2006-07.

Questioned Costs:
None

Context:
The State's central accounting system maintains the State's official accounting records. The system processes financial data for all state agencies and is the main source of information for financial schedules and statements, including the State of Wisconsin's financial statements. The State's central payroll system processes the biweekly payroll for most state employees. Both of these systems generate checks.

Effect:
Programmers with access to and extensive knowledge of the computer programs in the systems could make unauthorized changes to data and conceal those changes. This risk is increased because these programmers also have access to the production programs for these systems.

Cause:
DOA requires computer programmers to perform production and data control duties and does not believe the benefits of separating these duties outweigh the related costs. As of the end of FY 2006-07, DOA has not implemented compensating controls in this area but believes it would be difficult for a programmer to conceal inappropriate transactions without detection. However, DOA plans to continue moving forward to limit programmers' access.

Recommendation:
We recommend DOA continue to implement changes to limit programmers' access to production data and programs to reduce the risk of unauthorized transactions.

Management's Response:
DOA agrees with the tenor of the recommendation to limit programmer access to data. DOA has begun to expand the number of datasets and files that programmers have controlled access to in both the payroll system and WiSMART. In addition, DOA has started a preliminary procedure for the security officer for the two systems to notify the data owner in the State Controller's Office any time a programmer finds it necessary to access a file to complete a processing cycle.

Finding WI-07-04: Programmer Access to Critical Production Programs and Data at the Department of Transportation*

Criteria:
To provide proper internal control, computer programmers should not have the ability to access or update production data and programs.

Condition:
Computer programmers at DOT have access to programs in production, and some are allowed to move programs from the test environment to production. In addition, some computer programmers have access to production data through access to the Control-M job scheduling program.

Questioned Costs:
None

Context:
DOT maintains accounting and other systems critical to agency operations. These systems enable DOT to collect and expend $2 billion annually; to issue driver licenses and vehicle titles and registrations; to track drivers' records and traffic violations; and to oversee the State's construction of roads and bridges.

Effect:
Programmers with extensive knowledge of the computer programs and data sets could make unauthorized changes to the programs or data and conceal those changes, resulting in undetected erroneous or fraudulent changes.

Cause:
DOT believes it can more efficiently complete program changes and job scheduling by allowing programmers access to the production environment and to Control-M. To control production system security, it uses a combination of Changeman staging controls, user verification procedures, periodic access reviews, and supervisory oversight. However, we believe these controls would not prevent or detect unauthorized changes.

Recommendation:
In prior audits, we have expressed our concerns regarding programmers' ability to access or update production data and programs and have recommended removal of programmers' access to critical production programs and to the Control-M job scheduling program. We continue to believe programmers should not have access to production data and programs. DOT is aware of our concerns but accepts the risks in this area. Therefore, we do not repeat our recommendation.

Management's Response:
DOT recognizes the risk of allowing computer programmer access to production programs and data and has implemented numerous processes and checkpoints to reduce this risk. In the absence of other workable alternatives, DOT believes this risk is minor and manageable given its operational business requirements and needs. DOT further believes a greater overall risk is created if authorized IT staff are not provided access to systems and data necessary to develop, maintain, and support IT systems, applications, data, and infrastructure.

Finding WI-07-05: Program Change Controls at the University of Wisconsin*

Criteria:
To provide proper internal control, procedures should be established to prevent computer programs from being altered and/or put into production without proper oversight, review, and documentation.

Condition:
While UW-Madison has made some improvements in its procedures for making computer program changes, an independent review of program changes is not performed to assess the reasonableness of the changes for some applications. Further, for some applications, programmers have the ability to move programs into production. Thus, even if such reviews were performed, programmers could circumvent these procedures and make changes without oversight, review, or documentation.

Questioned Costs:
None

Context:
UW-Madison maintains critical financial systems, including the UW System accounting and payroll systems.

Effect:
Programmers with extensive knowledge of the computer programs could make unauthorized changes to the programs and conceal those changes, resulting in undetected erroneous or fraudulent information.

Cause:
Controls were not originally developed to ensure proper oversight before programs are moved to production. Limited resources are available to change the current procedures for the mainframe programs because the UW System is moving its critical financial applications from the mainframe computers to computer servers. For those that have been moved to the server environment, UW-Madison is reviewing its procedures and making improvements.

Recommendation:
We recommend UW-Madison continue to improve its internal controls related to changes to production programs to ensure only authorized programs changes are made and implemented.

Agency Response:
UW-Madison notes that several improvements have been implemented and additional procedures are being considered.

Finding WI-07-06: Integrity of the Injured Patients and Families Compensation Fund Provider System*

Criteria:
The Injured Patients and Families Compensation Fund should ensure that its provider system, which is used to bill health care providers who participate in the Fund and to maintain the Fund's medical malpractice claims history, is able to accurately and efficiently process information. Further, this system should be properly secured to ensure data stored and processed by the system are protected from accidental or intentional misuse or destruction.

Condition:
The provider system was developed in the early 1990s and has not been able to easily accommodate changes that have occurred over time, which has resulted in errors occurring within the system. Fund staff estimate approximately 15 to 20 hours per week have been needed to address the problems that have developed. Further, these system issues have limited the Fund's ability to address system access control weaknesses.

Questioned Costs:
None

Context:
During our prior audit, we provided a separate audit communication to the Office of the Commissioner of Insurance identifying in detail our concerns related to the integrity of the provider system and various system access control weaknesses that could compromise data integrity. The Fund is focusing its efforts on developing a new system rather than making major changes to the current system. Therefore, the conditions noted during the prior audit remained concerns throughout FY 2006-07. Additional funding to complete work on the new provider system was approved as part of the State's 2007-09 biennial budget.

Effect:
The aging provider system presents an increased risk to the integrity of the Fund's financial operations. Access control weaknesses increase the risk that unauthorized or erroneous changes could be made to provider system data without being detected. In addition, increased time spent to correct processing problems that arise with the current provider system results in less time available for more productive tasks for the Fund.

Cause:
The Fund was delayed in developing a new provider system because of past denials of its requests for budget authority. As a result, additional time was needed to implement an increased number of program changes to fix problems that arose with the old system. Further, because of the difficulties in making program changes in the old system, the Fund opted not to address access control weaknesses with the old system, but instead to address them as part of the new system.

Recommendation:
We recommend that the Fund continue its efforts to develop a new provider system that appropriately processes and secures system data.

Management Response:
The Office of the Commissioner of Insurance will continue to focus its efforts on developing a new system that will appropriately address the system data integrity and control concerns noted. Significant planning for the improved provider system has already occurred and, with the approval of the additional budget authority in the 2007-09 biennial budget, the Office of the Commissioner of Insurance expects to complete the new system by November 2008.

Finding WI-07-07: Lack of Adequate Planning for New Accounting Standard by the Department of Employee Trust Funds

Criteria:
The Department of Employee Trust Funds' (ETF's) management is responsible for ensuring that it adequately plans for the appropriate and timely implementation of new accounting standards. It is also responsible for ensuring that ETF's financial statements included in the State's basic financial statements are fairly presented and that misstatements are prevented or detected in a timely manner.

Condition:
ETF did not adequately plan for the implementation of the Government Accounting Standards Board (GASB) Statement 43, *Financial Reporting for Postemployment Benefit Plans Other Than Pension Plans*, issued in April 2004, and it had not fully understood or considered the implications of the new standard on its programs.

Questioned Costs:
None

Context:
GASB Statement 43 was implemented in April 2004 to establish financial reporting requirements for other postemployment benefit plans (OPEBs) that are comparable to pension plan reporting. It was required to be implemented for periods beginning after December 31, 2005, which should have provided sufficient time for ETF to plan and implement the new standard.

Effect:
ETF was late in submitting its financial information for the State's financial statements. We also identified several audit adjustments that were necessary to make ETF's OPEB statements acceptable. Further, we identified errors in the financial statements for other programs because of the workload and time pressures resulting from the delays in planning for the implementation of the new standard.

Cause:
ETF had not placed sufficient priority in planning for the timely implementation of the new standard. ETF also experienced staffing absences during a critical stage of the implementation of the standard but did not have back-up procedures to proceed until the key accounting staff person returned to work.

Recommendation:
We recommend that ETF take steps to resolve outstanding issues associated with financial reporting under GASB Statement 43 and recognize the importance of adequately planning for future accounting standards to implement them in a timely manner and minimize the extent of audit adjustments needed.

Management's Response:
We agree with the recommendation and will implement steps to resolve outstanding issues associated with implementing GASB Statement 43 and will improve our planning process for implementing future accounting standard changes. Among other things, in the future the Secretary's Office and Division management will be engaged from the outset in planning for and providing oversight of the implementation of new accounting standards and in working with Legislative Audit Bureau staff early in the process to make sure we meet our obligations. We are committed to pursuing and providing the necessary personnel, resources, and training to appropriately implement current and future accounting standards. Further, we will work to improve our interactions with Legislative Audit Bureau staff to ensure that expectations and understandings of new accounting standards are clearly, timely, and professionally communicated. Finally, we will continue to assess how we can make further improvements to meet our financial reporting obligations, now and in the future.

Finding WI-07-08: Cash Reconciliations at the Department of Employee Trust Funds*

Criteria:
As required under s. 16.41, Wis. Stats., ETF is responsible for ensuring its information on the State's central accounting system is complete and accurate. Regular reconciliations between the State's central accounting system and ETF's internal system are an important step to help ensure that information reported is complete and accurate on both systems.

Condition:
ETF has not fully reconciled its cash balances between the State's central accounting system and ETF's internal system.

Questioned Costs:
None

Context:
The State's central accounting system maintains the State's official accounting records, while ETF uses its internal system for developing its separately issued financial report. Although ETF has made some attempts to reconcile cash balances, varying amounts of unreconciled differences exist at the end of each year.

Effect:
The cash balances could be misstated on the State's central accounting system and/or ETF's internal system, which could also result in misstatements in the financial reports.

Cause:
Cash balances were not properly allocated at the program level when the State's central accounting system was implemented. Further, ETF has not identified all reconciling items that should be considered in the reconciliation process.

Recommendation:
We recommend ETF develop a plan to fully reconcile the cash balances for each program and take steps to correct any inaccuracies identified in the beginning cash balances on the State's central accounting system or ETF's internal system through the reconciliation process.

Management's Response:
We agree with your recommendation and share your concern regarding the incorrect cash balances on the State's central accounting system. We intend to assist the State Controller's Office in correcting these balances as part of the Integrated Business Information System implementation plan.

Finding WI-07-09: Business Resumption Planning*

Criteria:
To minimize disruption that may occur in an emergency, the State of Wisconsin should have effective business resumption plans in place.

Condition:
DOA is coordinating a project to develop a statewide business resumption plan. However, although state agencies have made progress, some do not have complete and tested business resumption plans and, therefore, a statewide plan is not available.

Questioned Costs:
None

Context:
The State provides a variety of critical services to citizens, local governments, and others in Wisconsin.

Effect:
Without effective business resumption plans in place, an emergency could disrupt the State's ability to provide critical services.

Cause:
Because of budget restrictions and the limited availability of staff, the State has not been able to devote sufficient resources to complete development of its business resumption plans and to test its ability to use the plans.

Recommendation:
We recommend the State continue to move forward to complete and test its business resumption plan.

Management's Response:
The Continuity of Government project, led by the DOA, has made substantial progress in developing and testing Continuity of Operations (COOP) plans for state agencies with time-sensitive business services. Twenty-eight agencies have completed COOP plans covering a total of 235 time-sensitive business services. Since mid-2006, agencies have held 26 agency command center exercises and 208 service plan COOP exercises. DOA will continue to work with agencies toward the goal of testing all state agency COOP plans on an annual basis.

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