



**STATE OF WISCONSIN**  
**Legislative Audit Bureau**

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Joe Chrisman  
State Auditor

January 30, 2013

Mr. Brent Smith, 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 Smith and President Reilly:

We have completed our audit of the financial statements of the University of Wisconsin (UW) System as of and for the years ended June 30, 2012, and June 30, 2011. The financial statements for those years and the related unqualified auditor's report are included in UW System's 2012 Annual Financial Report.

As provided for in *Government Auditing Standards*, we are furnishing you with the Independent Auditor's Report on Internal Control over Financial Reporting and on Compliance and Other Matters. In this report, we describe four internal control findings at UW System: Human Resource System (HRS) Security, HRS Program Change Controls, Overpayment of State Group Health Insurance Premiums and Wisconsin Retirement System Contributions, and Financial Reporting Errors. 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.

Because UW System's financial activity is reported in the State of Wisconsin's Comprehensive Annual Financial Report, these internal control findings were also included in the Independent Auditor's Report on Internal Control over Financial Reporting and on Compliance and Other Matters related to our audit of the State of Wisconsin's financial statements, which was released on January 10, 2013.

Sincerely,

Joe Chrisman  
State Auditor

JC/CS/sm

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, 2012, and June 30, 2011, and have issued our report thereon dated December 13, 2012. The financial statements and related auditor's opinion have been included in UW System's 2012 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 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**

Management of UW System is responsible for establishing and maintaining effective internal control over financial reporting (internal control). In planning and performing our audits, we considered UW System's 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.

Our consideration of internal control was for the limited purpose described in the preceding paragraph and was not designed to identify all deficiencies in internal control that might be significant deficiencies or material weaknesses, and therefore there can be no assurance that all deficiencies, significant deficiencies, or material weaknesses have been identified. However, as discussed in the following paragraphs, we identified certain deficiencies in internal control that we consider to be material weaknesses, and other deficiencies that we consider to be significant deficiencies.

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. We identified two deficiencies related to the Human Resource System (HRS), which is UW System's payroll and personnel system. When combined, we consider these deficiencies to be a material weakness in internal control.

*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 identified one internal control deficiency related to overpayments of health insurance and retirement fringe benefits and another internal control deficiency related to financial reporting errors, both of which we consider to be significant deficiencies.

In our fiscal year (FY) 2010-11 internal control and compliance report, dated December 21, 2011, we described three deficiencies in internal control that we considered to be significant deficiencies for the fiscal year ended June 30, 2011. UW System has taken corrective action to address one deficiency in business resumption planning. In addition, we no longer report mainframe computer program change control concerns related to the legacy payroll system because the legacy payroll system was replaced by HRS in April 2011. However, we continue to report concerns related to HRS security.

### ***Human Resource System Security***

HRS is used by UW System to track and maintain employee information, such as address, position, and benefit choices, and to process and record the biweekly or monthly payroll for all staff and students employed by the UW institutions, including the 13 four-year campuses, 13 two-year colleges, UW-Extension, and UW System Administration. Payroll-related expense is the most significant expense of UW System, totaling more than \$2.8 billion, or nearly 65.0 percent of UW System's total expenses for FY 2011-12. UW System Administration is responsible for the overall strategic direction and oversight of HRS. The UW Service Center within UW-Madison's Office of Human Resources manages the day-to-day operations of HRS. UW-Madison's Division of Information Technology (DoIT) provides many information technology services for HRS, including programming and data security functions.

#### *Access to the Human Resource System*

In order to ensure that information is properly safeguarded and to limit the risk that inadvertent, erroneous, or unauthorized changes could be made, UW System should ensure that access to HRS is limited to that necessary for individual users to complete their properly separated job duties, and that access to system accounts is also properly limited. The ability to perform the various functions within HRS is controlled through the use of security roles. Each security role has specific permissions attached that allow the user to perform a specific task or tasks.

In response to our FY 2010-11 concerns over HRS security, UW System Administration reported in December 2011 that it had developed a plan to review overall HRS security, remove inappropriate access, and develop compensating controls when separation of duties could not be achieved. UW System indicated that this review was planned for completion in summer 2012. However, UW System has not completed its planned security role review, and it is not aware of all permissions attached to each security role. The planned security role review is a necessary step in assessing the HRS security roles and permissions that are attached to these roles, and in determining changes that are necessary.

Because the security role review was not completed, we performed a limited review of access granted to HRS users at three UW institutions. We identified 22 users with incompatible access that does not provide for proper separation of duties. Further, 21 of these users have these capabilities on a system-wide level, which allows them to make changes at any of the UW institutions.

In addition, we reviewed access granted to several separate system accounts. We continued to find excessive access granted to system accounts for the majority of FY 2011-12. UW System did remove this access in April 2012, but the risks with this access were present for most of FY 2011-12.

We recommend UW System Administration review the specific concerns we communicated in more detail in our October 31, 2012 interim memorandum and give priority to reviewing all HRS security roles and the permissions attached to these roles, limiting or adjusting access as necessary, and implementing compensating controls when separation of duties cannot adequately be achieved.

Management's Response: UW System agrees with the recommendations regarding HRS security. FY 2011-12 was a period of stabilization for HRS. It is common practice during the stabilization phase of a large, complex system for users to have access not specifically needed to perform their job duties. Access evolved as UW System became more familiar with the system and new business processes, and as UW System staff responsibilities became more defined.

With this enhanced knowledge of the system and processes, the UW Service Center and DoIT will finalize and execute existing plans to closely review all available HRS security roles and permissions in order to facilitate refined privileges and separation of duties controls for HRS end users. Resources to implement the plan will be identified and work prioritized to begin early in calendar year 2013.

#### *Human Resource System Program Change Controls*

In order to ensure that information is properly safeguarded and to limit the risk that inadvertent, erroneous, or unauthorized changes could be made, UW System should establish procedures to prevent users from making unauthorized changes to HRS program code or "configuration" information, such as various look-up tables used during payroll processing. Because the ability to perform program code or configuration changes is controlled through the use of security roles, access to security roles should be limited to that necessary for employees to complete their properly separated job duties.

We reviewed the program change process and identified concerns with access that allows users to circumvent the established program change process and could allow an inadvertent, erroneous, or unauthorized program code or configuration change. For example:

- One user, who is also responsible for approving program changes before they are moved into production, has full "update and correction" access to all functions in HRS.
- Three of the four users responsible for moving program code changes into the production environment have access that allows them to make program changes directly in the HRS production environment. Further, all four of these users have access that allows them to develop changes in the HRS development environment and move these changes into production.

- Fifty-one users have been granted access to one or more of eleven security roles that provide the users with the ability to make configuration changes directly in the HRS production environment.

Because UW System has delayed its planned security role review, it is not aware of all permissions attached to each security role. The planned security role review is a necessary step in assessing the HRS security roles and permissions that are attached to these roles, and in determining changes that are necessary.

We recommend UW System Administration review the specific access concerns we communicated in more detail in our October 22, 2012 interim memorandum and adjust or remove access as appropriate. Further, we recommend UW System Administration give priority to reviewing all HRS security roles and the permissions attached to the roles, limiting or adjusting access as necessary, and implementing compensating controls when separation of duties cannot adequately be achieved.

Management's Response: UW System agrees with the recommendations regarding the HRS program change process. To mitigate potential risks surrounding the HRS program change process, UW System has removed the full functional update and correction access for the one user. This access was necessary during HRS implementation and system stabilization. Because the need for this user to back up key support staff remains, the ongoing necessity for such access will be re-evaluated in May 2013.

The UW Service Center and DoIT are currently evaluating the impact of removing employees' ability to make program changes and move changes into production. This evaluation process includes identifying specific requirements related to job responsibilities and the change management process. Once identified, mitigating solutions will be presented to executive management at UW System Administration, the UW Service Center, and DoIT for review. All required resources will be identified and implementation work will be prioritized to begin early in calendar year 2013.

Finally, the UW Service Center and DoIT will finalize and execute existing plans to closely review all available HRS security roles and permissions in order to facilitate refined privileges and separation of duties controls for HRS end users. Resources to implement the plan will be identified and work prioritized to begin early in calendar year 2013.

### ***Overpayment of State Group Health Insurance Premiums and Wisconsin Retirement System Contributions***

UW System offers its employees a number of fringe benefit choices and options, including the State Group Health Insurance Program and the Wisconsin Retirement System (WRS), which are both administered by the Department of Employee Trust Funds (ETF). UW System is responsible for ensuring that the employee and employer share of payments for fringe benefit programs are appropriately collected and paid to ETF. Due to the implementation of HRS, UW System did not provide adequate oversight and monitoring over the fringe benefit processes, resulting in overpayments for State Group Health Insurance and the WRS.

For the State Group Health Insurance Program, UW System is responsible for updating the ETF health insurance database for changes in an employee's enrollment or coverage in the program, based upon changes made in HRS. We found that after the implementation of HRS, UW System had not established adequate procedures for reconciling the health insurance premiums collected from employees and employing UW institutions with coverage information maintained in the ETF database. As a result, we found that UW System did not identify in a timely manner that it overpaid health insurance premiums. It does not appear that any employee or employing UW institution was charged for the premium overpayments.

UW System continues to assess the causes of the overpayments, and it estimates that it overpaid health insurance premiums by \$15.4 million from May 2011 through September 2012.

UW System has identified that \$8.0 million of the \$15.4 million in overpayments were for health insurance premiums paid for 924 terminated employees during the period May 2011 through September 2012.

Through October 2012, UW System has been able to recover \$228,000 of the overpayments. However, the provisions in the contracts between the State and the health insurance providers may limit UW System's ability to recover the entire amount of the overpayments. If UW System is unable to collect the health insurance overpayments from the health insurance providers, UW System will need to identify another funding source to cover these overpayments.

In addition, UW System made errors when manually calculating the WRS contributions due to ETF for the months of April 2011, May 2011, and July 2011. This resulted in overpayments of \$17.5 million to the WRS for calendar year 2011 retirement contributions. ETF identified the overpayment through its annual contributions review. In September 2012, ETF credited UW System for the \$17.5 million in overpayments.

We recommend UW System Administration:

- continue to implement procedures to promptly reconcile HRS information with ETF's database of employees enrolled in the State Group Health Insurance Program and keep the database updated for any changes in enrollment or coverage, including the timely removal of all terminated employees;
- work with ETF to assess whether the health insurance premium overpayments can be recovered and, if not, determine an appropriate source of funding for these overpayments; and
- review procedures for all other employee benefit programs, including the WRS, to ensure proper reconciliations and other necessary procedures are in place.

Management's Response: UW System generally agrees with the assessment and subsequent recommendations. In October 2012, the UW Service Center implemented procedures to reconcile HRS information with ETF's database of employees enrolled in the State Group Health Insurance Program. Therefore, the State Group Health reconciliation is current and as such, the overpayment issue is contained and not growing. The next steps are:

1. The UW Service Center is in the process of completing an employee-specific review of historical transactions in order to identify the total amount that UW System could recoup through ETF. This step, which will be completed by June 30, 2013, must be completed in order to make the strongest possible case for recouping the overpayments.
2. The UW Service Center has requested credits for known overpayments and will request credits for the remaining portion when validated.
3. The UW Service Center will review procedures for all other employee benefit programs to ensure proper reconciliation procedures are in place.

### ***Financial Reporting Errors***

UW System's financial statements are included in UW System's separately issued financial report and are used by the Department of Administration's State Controller's Office when compiling the State of Wisconsin's financial statements. UW System Administration is responsible for maintaining effective internal controls to ensure the financial statements of UW System are fairly presented and prepared in accordance with generally accepted accounting principles. Financial reporting for UW System is complicated by its size and decentralized nature, as well as by its complex accounting structure.

To prepare the financial statements, UW System Administration financial reporting staff accumulate transactions recorded in the accounting system and request information from each campus to make necessary adjustments to reflect the financial information in accordance with generally accepted accounting principles. UW System Administration has established several internal controls over the financial reporting process. However, we identified errors in the FY 2011-12 financial statements that occurred either because financial reporting staff did not identify an adjustment was necessary or because some steps needed to appropriately calculate the amount of an adjustment were not completed. For example, we identified:

- \$59.7 million reported as "Sales and Services of Educational Activities" revenue that should have been reported as other nonoperating revenue;
- \$25.2 million reported as "State, Local, and Private Grants and Contracts" that should have been reported as "Capital Contributions"; and
- \$23.4 million overstatement of "Accounts Receivable," \$21.8 million overstatement of "State, Local, and Private Grants and Contracts," and \$1.6 million overstatement of "Federal Grants and Contracts."

We discussed these errors with UW System financial reporting staff, who made the necessary corrections to the financial statements. UW System Administration's Financial Reporting Unit experienced turnover in key accounting staff, which added to delays in preparing the financial statements and contributed to the errors identified.

We recommend UW System Administration take steps to ensure that in future years all necessary financial statement adjustments are made and all steps needed to appropriately calculate adjustment amounts are completed.

Management's Response: UW System agrees with the recommendation. As noted, staff turnover contributed to this issue, as the person with primary knowledge of the financial statements retired after nearly 30 years. Two of the three identified errors were reclassifications between financial statement accounts and did not affect the overall increase in net assets. Nevertheless, UW System will undertake a review of material accounting entries to ensure accuracy and efficiency in compilation. This review will be completed by August 31, 2013.

### **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 audits 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 are described in the preceding narrative. We did not audit the responses and, accordingly, express no opinion on them.

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

December 13, 2012

by



Carolyn Stittleburg  
Audit Director