

**Report 14-3
February 2014**

University of Wisconsin System Fiscal Year 2012-13

STATE OF WISCONSIN



Legislative Audit Bureau ■

**Report 14-3
February 2014**

**University of Wisconsin System
Fiscal Year 2012-13**

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Joe Chrisman
State Auditor

February 4, 2014

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

Dear Senator Cowles and Representative Kerkman:

As required by s. 13.94(1)(t), Wis. Stats., we have completed a financial audit of the University of Wisconsin (UW) System. This audit was completed in two phases. In the first phase, which was performed at the request of the Joint Legislative Audit Committee, we reviewed UW System's program revenue balances as of June 30, 2012, and issued report 13-17 in November 2013. In the second phase, we audited and provided an unmodified audit opinion on UW System's fiscal year (FY) 2012-13 and FY 2011-12 financial statements. These financial statements and our audit opinion are included in UW System's *2013 Annual Financial Report*.

UW System revenue increased from \$4.9 billion in FY 2011-12 to \$5.1 billion in FY 2012-13, or by 3.9 percent. UW System's largest revenue was student tuition and fees, which totaled nearly \$1.2 billion in FY 2012-13 and was 23.1 percent of its total revenue. UW System expenses increased from \$4.5 billion in FY 2011-12 to \$4.6 billion in FY 2012-13, or by 2.1 percent. UW System's largest expense was Salary and Fringe Benefits, which totaled nearly \$2.9 billion in FY 2012-13 and was nearly 63.0 percent of its total expenses.

UW System's net position, which is the difference between its assets and its liabilities, increased from \$5.8 billion as of June 30, 2012, to \$6.3 billion as of June 30, 2013. Unrestricted net position, which represents amounts available for future spending, increased from \$860.2 million as of June 30, 2012, to \$1.1 billion as of June 30, 2013. UW System's unrestricted net position has increased since June 30, 2004, largely due to growth in unspent balances from student tuition and fees.

In the Independent Auditor's Report on Internal Control over Financial Reporting and on Compliance and Other Matters, we again report a material weakness in internal control over the Human Resource System (HRS), which is used by UW System to process and record payroll for its employees. We recommend UW System report to the Joint Legislative Audit Committee on the status of its efforts to resolve internal control concerns over HRS security. In addition, our separate audit of the oversight of HRS and payroll and benefits processing is report 14-4.

We appreciate the courtesy and cooperation extended to us by staff of UW System during our audit. UW System's response follows the appendix.

Respectfully submitted,

Joe Chrisman
State Auditor

JC/CS/ss

Introduction ■

The University of Wisconsin (UW) System provides postsecondary academic education for approximately 181,000 students. The System includes 13 four-year universities, 13 two-year colleges, UW-Extension, and UW System Administration. Each of the 13 universities awards bachelor's and master's degrees, and several also confer doctoral degrees. UW Colleges are 13 two-year campuses that offer general education associate degrees and course credits that transfer to other degree-granting universities. UW-Extension, in cooperation with other UW institutions, provides continuing education courses in classrooms and via distance education, as well as public service programs to Wisconsin residents. UW System Administration consists of the UW System President's staff who assist the Board of Regents in establishing, reviewing, and monitoring systemwide policies; financial planning for the system; and maintaining fiscal control.

UW System Board and Staff

Under s. 15.91, Wis. Stats., the Board of Regents members include:

- 14 citizen members;
- 2 student members, one of whom is a nontraditional student;
- the State Superintendent of Public Instruction; and
- the President of the Wisconsin Technical College System Board, or his or her designee.

Citizen and student members are appointed by the Governor and confirmed by the Senate. The citizen members are appointed for staggered seven-year terms, and the student members are appointed for two-year terms. At least one citizen member must reside in each of the State's congressional districts.

The Board of Regents establishes policies to govern UW institutions.

The 18-member Board of Regents establishes policies to govern UW institutions. The Board is responsible for appointing the President of UW System, the chancellors of each of the 13 four-year universities and UW Extension and UW Colleges, and the deans who head each of the two-year colleges. The UW System President and the chancellors of each UW institution are responsible for implementing policies established by the Board of Regents. Each chancellor is responsible for the institution's operations, including financial administration. In December 2012, UW System employed approximately 38,000 faculty and staff, and 36,000 student employees.

Financial Information

We provided an unmodified audit opinion on UW System's financial statements for FY 2012-13 and FY 2011-12.

As required by s. 13.94(1)(t), Wis. Stats., we have completed a financial audit of UW System. We have audited UW System's financial statements for the years ended June 30, 2013, and June 30, 2012, and have provided our unmodified audit opinion to UW System for inclusion in its *2013 Annual Financial Report*, which is available on its website at www.uwsa.edu/fadmin/finrep/afr.htm. As a state agency, UW System's financial information is also included in the State's Comprehensive Annual Financial Report (CAFR).

UW System's financial statements are prepared using generally accepted accounting principles (GAAP) prescribed by the Governmental Accounting Standards Board (GASB), and include the financial activity of all UW institutions. Financial information related to UW Foundation, which is the official nonprofit fundraising corporation for UW-Madison and certain other UW institutions, is not included in the financial statements but is disclosed in Note 11 of UW System's *2013 Annual Financial Report*.

Revenue and Expenses

As shown in Table 1, UW System revenue increased from \$4.9 billion in FY 2011-12 to \$5.1 billion in FY 2012-13, or by 3.9 percent. From FY 2008-09 through FY 2012-13, total revenue increased by 12.0 percent.

Student Tuition and Fees accounted for 23.1 percent of UW System's \$5.1 billion in total revenue.

UW System's largest revenue is Student Tuition and Fees, which includes tuition and other academic student fees. From FY 2011-12 through FY 2012-13, revenue from Student Tuition and Fees increased by 6.3 percent. The nearly \$1.2 billion in Student Tuition and Fees UW System collected in FY 2012-13 was 23.1 percent of its total revenue.

Table 1

UW System Revenue¹
(in millions)

Financial Statement Account	FY 2012-13	FY 2011-12	Percentage Change
Student Tuition and Fees ²	\$1,174.7	\$1,105.1	6.3%
State Appropriations ³	893.6	855.1	4.5
Federal Grants and Contracts	871.8	859.3	1.5
State, Local, and Private Grants and Contracts	410.9	397.0	3.5
Sales and Services of Auxiliary Enterprises ²	389.0	362.8	7.2
Sales and Services of Educational Activities ⁴	343.8	335.8	2.4
Gifts	295.8	248.1	19.2
Other Operating Revenue ⁵	277.1	261.0	6.1
Capital Appropriations	200.1	251.7	(20.5)
Other Nonoperating Revenue ⁶	87.6	62.0	41.4
Sales and Services to UW Hospital Authority	66.8	59.7	12.0
Capital Contributions	65.1	88.6	(26.5)
Student Loan Interest Income and Fees	4.5	4.7	(4.9)
Total	\$5,080.8	\$4,890.9	3.9

¹ On the basis of generally accepted accounting principles (GAAP).

² Does not include scholarships and fellowships applied to student accounts.

³ Includes general purpose revenue (GPR) received by UW System, except for GPR used for debt service payments.

⁴ Includes revenue received from the sales of goods or services that are incidental to the primary function of UW System, such as public service programs.

⁵ Includes revenue from intercollegiate athletics, student health services, child care centers, and certain administrative services.

⁶ Includes revenue in Other Revenues (Expenses), Net; Investment Income; and Additions to Permanent Endowment.

State Appropriations totaled \$893.6 million, or 17.6 percent of total revenue.

State Appropriations is UW System's second-largest revenue. Except for general purpose revenue (GPR) appropriated to UW System for its debt service payments, all GPR UW System receives is reported on UW System's financial statements as State Appropriations. In FY 2012-13, State Appropriations totaled

\$893.6 million and accounted for 17.6 percent of total revenue. From FY 2011-12 through FY 2012-13, State Appropriations increased by \$38.5 million, or by 4.5 percent.

Federal Grants and Contracts totaled \$871.8 million in FY 2012-13 and accounted for 17.2 percent of UW System's total revenue. Other significant revenue for UW System in FY 2012-13 included:

- State, Local, and Private Grants and Contracts, which totaled \$410.9 million and includes grants and contracts received from other state agencies, Wisconsin municipalities, or other nonfederal entities;
- Sales and Services of Auxiliary Enterprises, which totaled \$389.0 million and includes revenue received for services such as student housing and food service;
- Sales and Services of Educational Activities, which totaled \$343.8 million and includes revenue received from the sales of goods or services that are incidental to the primary function of UW System, such as textbook rentals, laboratory fees, scientific and literary publications, and public service programs;
- Gifts, which totaled \$295.8 million and includes amounts received from donors;
- Other Operating Revenue, which totaled \$277.1 million and includes revenue from intercollegiate athletics, student health services, child care centers, and certain administrative services; and
- Capital Appropriations, which totaled \$200.1 million and represents the proceeds from the issuance of GPR-funded debt.

As shown in Table 2, UW System expenses totaled \$4.6 billion in FY 2012-13. Although expenses have remained relatively constant in recent years, expenses increased by 8.8 percent from FY 2008-09 through FY 2012-13.

Table 2
UW System Expenses¹
(in millions)

Financial Statement Account	FY 2012-13	FY 2011-12	Percentage Change
Salary and Fringe Benefits	\$2,871.6	\$2,804.3	2.4%
Supplies and Services	1,152.9	1,143.4	0.8
Depreciation	258.5	238.4	8.4
Scholarships and Fellowships	132.2	130.9	1.0
Transfer to State Agencies	65.9	74.2	(11.2)
Interest on Indebtedness	57.3	50.4	13.7
Other Operating Expenses	21.1	7.9	169.6
Loss on Disposal of Capital Assets	17.9	33.4	(46.5)
Total	\$4,577.4	\$4,482.9	2.1

¹ On the basis of generally accepted accounting principles (GAAP).

Salary and Fringe Benefits was UW System's largest expense and totaled nearly \$2.9 billion.

Salary and Fringe Benefits was the largest expense of UW System and totaled nearly \$2.9 billion, or nearly 63.0 percent of total expenses in FY 2012-13. Other significant expenses include those related to the purchase of supplies and services, depreciation on capital assets, and scholarships and fellowships.

Debt Service Costs

The State of Wisconsin issues debt on behalf of UW System, as well as other state agencies. The proceeds of this debt are used to acquire or build facilities and other capital assets. Debt on academic facilities is repaid by the State of Wisconsin using GPR. Debt on other facilities, such as residence halls, is repaid by UW System program revenue that is generated by payments from users of these facilities.

In FY 2012-13, GPR-funded debt service payments totaled \$201.2 million, while program revenue-funded debt service payments totaled \$111.7 million. As of June 30, 2013, outstanding GPR-funded debt totaled \$1.8 billion and outstanding program revenue-funded debt totaled \$1.6 billion.

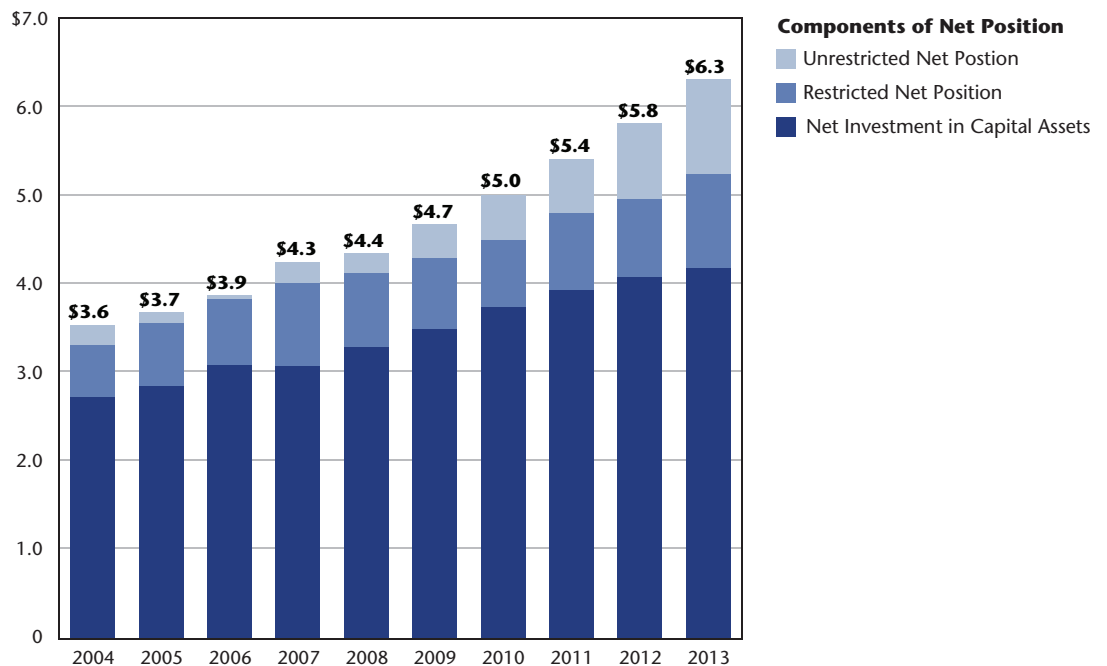
Net Position

Net position is the difference between UW System’s assets and liabilities.

In financial reporting terms, “net position” is the difference between an entity’s assets and its liabilities. UW System’s net position increased from \$5.8 billion as of June 30, 2012, to \$6.3 billion as of June 30, 2013, or by \$503.4 million. As shown in Figure 1, UW System has experienced a period of continued growth in its net position since June 30, 2004. Net position is presented in three components on UW System’s financial statements: Net Investment in Capital Assets, Restricted Net Position, and Unrestricted Net Position.

Figure 1

Net Position of UW System¹
As of June 30
(in billions)



¹ On the basis of generally accepted accounting principles (GAAP).

Net Investment in Capital Assets represents capital assets, such as buildings and equipment, less accumulated depreciation and less any related outstanding debt needed to purchase or construct these capital assets. Net Investment in Capital Assets is the largest component of UW System's net position and totaled \$4.2 billion as of June 30, 2013.

Restricted Net Position represents balances that have an external restriction on their use. The majority of UW System's Restricted Net Position relates to balances that are restricted for endowment funds, gifts and nonfederal grants and contracts, and federal student loans. Restricted Net Position totaled \$1.0 billion as of June 30, 2013.

Unrestricted Net Position, which represents balances available for future spending, totaled \$1.1 billion as of June 30, 2013.

Unrestricted Net Position represents any remaining balances not otherwise included in Net Investment in Capital Assets or Restricted Net Position. These balances are available to UW System for future spending. UW System has indicated that most of its Unrestricted Net Position will be used for academic and research programs and initiatives, and capital programs. Unrestricted Net Position increased from \$860.2 million as of June 30, 2012, to \$1.1 billion as of June 30, 2013.

Unspent balances from student tuition and fees are the largest component of Unrestricted Net Position and increased by 19.1 percent from June 30, 2012, to June 30, 2013.

UW System's Unrestricted Net Position has been increasing since June 30, 2004, as UW System has collected more revenue than it has used in its operations. This increase in Unrestricted Net Position is largely attributable to unspent balances from student tuition and fees. The portion of Unrestricted Net Position related to student tuition and fees increased from \$499.1 million as of June 30, 2012, to \$594.5 million as of June 30, 2013, or by 19.1 percent. Other components of Unrestricted Net Position include general operations receipts, non-student fee-funded auxiliary operations, and federal indirect cost reimbursement.

As noted, UW System's financial information is presented in the State's CAFR, which is prepared by the State Controller's Office in the Department of Administration. Certain reclassifications and adjustments, which are required by the State Controller's Office, result in differences between the net position reported in the UW System's *2013 Annual Financial Report* and the net position reported in the CAFR. For example, UW System reports an "Other Postemployment Benefit" liability of \$217.4 million as of June 30, 2013, in the CAFR. However, in its *2013 Annual Financial Report*, these amounts are disclosed in the notes to the financial statements and not in the statements themselves. As a result, UW System's net position as reported in its *2013 Annual Financial Report* is \$6.3 billion compared to \$6.1 billion as reported in the CAFR. These differences are discussed in Note 13 of the *2013 Annual Financial Report*.

Financial Management Issues ■

At the request of the Joint Legislative Audit Committee, the first phase of our FY 2012-13 financial audit of UW System included a review of the level of commitment for UW System's program revenue balances as of June 30, 2012. In the second phase of our audit, we reviewed UW System's progress in addressing security concerns related to the Human Resource System (HRS) that we had identified in prior financial audits.

Program Revenue Balances

On a budgetary basis, UW System's total program revenue balance increased to nearly \$1.3 billion as of June 30, 2013.

UW System receives program revenue from sources such as academic student fees, which includes tuition; auxiliary enterprises, such as fees charged for student housing and food service; federal revenue; and gifts. On a budgetary basis, and as shown in Table 3, UW System's total program revenue balance has increased since June 30, 2004, and reached nearly \$1.3 billion as of June 30, 2013.

Table 3

UW System Program Revenue Balances¹
As of June 30

Year	Total	Percentage Change
2004	\$ 232,267,000	–
2005	268,229,000	15.5
2006	315,240,000	17.5
2007	405,937,000	28.8
2008	443,557,000	9.3
2009	563,698,000	27.1
2010	649,615,000	15.2
2011	836,797,000	28.8
2012	1,045,023,000	24.9
2013	1,273,486,000	21.9

¹ On a budgetary basis.

In report 13-17, we reviewed the level of commitment for UW System’s program revenue balance as of June 30, 2012.

Concerns about UW System’s total program revenue balance prompted the Joint Legislative Audit Committee to direct the Legislative Audit Bureau to review the level of commitment for UW System’s program revenue balance. In November 2013, we issued a report on the level of commitment for UW System’s program revenue balance as of June 30, 2012 (report 13-17).

In report 13-17, we focused on \$755.4 million in June 30, 2012 balances from four program revenue sources that did not have a restricted use, including revenue generated from tuition and federal indirect cost reimbursement. Our review did not include program revenue from restricted sources, such as gifts, or from auxiliary enterprises because UW System currently reports annually on each UW institution’s student fee-funded auxiliary enterprises balances to the Joint Committee on Finance. We created five level-of-commitment categories for these balances based on available documentation, the flexibility of institutions to change an intended use, and whether any funding source requirements limited the use of a balance.

We found that \$458.9 million, or 60.8 percent of the June 30, 2012 program revenue balances we reviewed, had documentation to indicate that a plan or obligation was made for the expenditure of the funds. Although no institution had formal written reserve policies in FY 2011-12, 4.7 percent of the balances we reviewed had

documentation to indicate the amounts were held by institutions as reserves. We considered reserves to be amounts purposefully held for contingencies, such as an unexpected decline in enrollment. For 18.8 percent of the balances we reviewed, documentation of a plan for use was not provided, either because it was not available or because there was no plan.

2013 Wisconsin Act 20 required the Board of Regents to propose a methodology for the calculation of program revenue balances and reserves.

We also found that UW System did not have a policy to monitor program revenue balances, and the extent to which institutions monitored their program revenue balances varied. 2013 Wisconsin Act 20 required the Board of Regents to propose a methodology for the calculation of program revenue balances and reserves, expressed in both dollars and percentages of total annual expenses, and to submit it to the Joint Legislative Audit Committee. In November 2013, the Joint Legislative Audit Committee held a public hearing on report 13-17 and on the proposed methodology for the calculation of program revenue balances and reserves. Based on the hearing testimony, the Committee took no action on the proposed methodology and its co-chairpersons subsequently requested the Board of Regents revise its submissions.

Human Resource System

HRS is used by UW System to administer payroll and benefits for its employees.

Because payroll-related expenses are the largest expense of UW System, our financial audit includes a review of HRS, which is used by UW System to process and record the biweekly and monthly payroll for all staff and students employed by UW institutions. HRS is also used to track and maintain employee information, such as address, position, and benefit choices. HRS was developed to replace UW System's legacy, mainframe-based computer system, which had been operational for more than 35 years. HRS was largely implemented in April 2011.

The UW Service Center provides support to all UW institutions related to payroll, benefits, and other automated human resources processing. UW-Madison's Division of Information Technology (DoIT) provides HRS information technology support, such as programming and data security. Staff responsible for human resources and payroll functions at each UW institution enter employee-specific data into HRS that is needed to process employee payroll and benefits for their respective institutions.

Security Concerns

Access to HRS is controlled through the use of security roles. Each security role has specific permissions attached that allow a user to

perform a specific task or tasks. For example, certain security roles have permissions allowing the user to enter or change employee-related information. Further, a user's access can be limited to a department or an institution, or it can be granted systemwide to all UW institutions. Access at the institution level may allow a user to enter or change employee-related information for employees at the institution, whereas systemwide access allows a user this ability at any UW institution.

During our FY 2010-11 financial audit, we first identified incompatible access to HRS.

As noted, HRS was largely implemented in April 2011. As part of our audit of UW System's FY 2010-11 financial statements, we performed a limited review of HRS, including access granted to individual users and several separate system accounts. We identified concerns with incompatible or unnecessary access and sharing of passwords. For example, we identified several users with incompatible access, such as access that allowed individuals the ability to add a new employee, update direct deposit information, and process a payment.

We reported a significant deficiency in internal control over HRS for our FY 2010-11 audit.

In December 2011, we recommended UW System Administration review access to HRS, remove incompatible or unnecessary access, or implement compensating controls in order to reduce the risk that fictitious employees could be added to HRS or inappropriate payments could be processed through HRS. In response to our December 2011 recommendation, UW System Administration stated that it had developed a plan to complete a security role review, remove incompatible or unnecessary access, and develop compensating controls when staffing constraints would not allow for appropriate separation of duties. We considered this concern with HRS access to be a significant deficiency in internal control over HRS for our FY 2010-11 audit.

During our FY 2011-12 financial audit, we continued to identify incompatible access to HRS.

During our FY 2011-12 financial audit, we found UW System had reviewed and adjusted the unnecessary access granted to the system accounts. However, UW System had not completed the security role review nor had it removed the incompatible access or implemented compensating controls. UW System staff indicated that the security role review was planned for completion in summer 2012. However, due to competing priorities, the project was delayed. Had such a review been completed, it would have allowed UW System to identify and correct the incompatible access and better assess whether proper separation of duties was achieved. As part of our FY 2011-12 audit, we performed a limited review and again identified users with incompatible access. In December 2012, we recommended that UW System Administration give priority to completing a security role review, limiting or adjusting access as necessary, and implementing compensating controls when proper separation of duties cannot adequately be achieved. In response to our December 2012 recommendation, UW System indicated the security role review was to begin early in calendar year 2013.

In addition, during our FY 2011-12 financial audit, we reviewed the program change process established for HRS. This process is used to initiate, authorize, and document changes either to the HRS program code or to “configuration” information, such as various look-up tables used during payroll processing. 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. Controls over program changes, and the proper documentation of these changes, are necessary to ensure the integrity of the system and reduce the risk of inadvertent, erroneous, or unauthorized changes.

We first reported concerns with UW System’s program change control process in the early 1990s, prior to implementation of HRS, when UW System was using the legacy mainframe payroll system. Because of planned implementations of new payroll systems, UW System did not make improvements to the program change process for the legacy payroll system. As part of our review of HRS for our FY 2011-12 financial audit, we again 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, we identified one user, who was responsible for approving program changes before they were moved into production, also had full “update and correction” access to all functions in HRS. In December 2012, we recommended that UW System immediately correct the access concerns we identified that allow for the circumvention of the program change process. In response to our recommendation, UW System indicated some access changes were made and that they would evaluate job responsibilities related to the program change process.

We reported a material weakness in internal control over HRS for our FY 2011-12 financial audit.

When combined, we considered the concerns related to HRS access and the program change process to be a material weakness in internal control over HRS for our FY 2011-12 financial audit.

Status of Security Concerns

During our FY 2012-13 financial audit, we found that UW System Administration took some steps to address the concerns regarding HRS access and program change controls identified in our FY 2011-12 financial audit. For example:

- UW System began the HRS security role review, which also includes a review of roles and access to make configuration changes. At the time of our audit fieldwork in fall 2013, UW System staff indicated that the review of roles and access to make configuration changes was expected to be completed in December 2013.

- UW System removed some of the incompatible access granted to employees involved in the program change process.
- UW System implemented a new change management application, Phire, which if properly implemented requires all program changes to move through predetermined steps and approvals before migration to the HRS production environment.

However, we again identified incompatible access during our FY 2012-13 financial audit. We found that 18 of the 22 users we identified during our FY 2011-12 financial audit continued to have incompatible access that did not provide for proper separation of duties. The other four users either terminated employment from UW System since our last audit or had their access changed. We also identified one additional user who had incompatible access who did not have such access during our last audit. Further, we found that all 19 of these users had access on a systemwide level. Although it would be expected that users within the UW Service Center and a limited number of institution users would need access on a systemwide level, we found eight users at UW-Oshkosh who had such access.

In addition, we identified 46 users who have been granted access to one or more of at least 8 designated configuration roles and could, therefore, circumvent the established procedures for making configuration changes. For example, 11 users have access to a security role that is currently described as having the ability to set up benefit programs and plans and perform all related benefits configurations. We also identified several concerns with access granted through Phire security roles that allow programmers to circumvent the program code change process and move a program change to production without approval or testing.

We again report a material weakness in internal control over HRS for our FY 2012-13 financial audit.

We again consider the concerns related to HRS access and the program change process, when combined, to be a material weakness in internal control over HRS for our FY 2012-13 financial audit. In our Independent Auditor's Report on Internal Control over Financial Reporting and on Compliance and Other Matters, which is the appendix, we include recommendations for UW System related to HRS security. In response to these recommendations, UW System indicates corrective actions will be implemented by December 31, 2014.

The implementation of HRS was a large and complex project, and it may not have been unexpected during the early phases of implementation that some individual users and system accounts had access beyond what is required in a more mature or stable system.

It may also be expected that some employees may have been asked to temporarily perform duties beyond their typical jobs. However, after more than two years have elapsed since HRS implementation, and after we reported a material weakness in our FY 2011-12 financial audit, HRS security concerns remained largely unresolved by UW System.

Recommendation

We recommend the University of Wisconsin System Administration report to the Joint Legislative Audit Committee by July 1, 2014, on the status of its efforts to resolve the HRS security concerns.

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Appendix ■



STATE OF WISCONSIN
Legislative Audit Bureau

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Joe Chrisman
State Auditor

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

Senator Robert Cowles and
Representative Samantha Kerkman, Co-chairpersons
Joint Legislative Audit Committee

Members of the Board of Regents
University of Wisconsin System

We have audited the financial statements and the related notes of the University of Wisconsin (UW) System as of and for the years ended June 30, 2013, and June 30, 2012, and have issued our report thereon dated December 11, 2013. 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*, which is issued by the Comptroller General of the United States. The financial statements and related auditor's opinion have been included in UW System's 2013 *Annual Financial Report*.

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 of the financial statements, we considered UW System's internal control to determine the audit procedures that are appropriate in the circumstances for the purpose of expressing our opinion on the financial statements, but not for the purpose of expressing an opinion on the effectiveness of 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 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 UW System's 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. We consider the deficiencies described in the accompanying schedule of findings and responses as Findings 1 and 2, when combined, to be a material weakness.

In our fiscal year (FY) 2011-12 Independent Auditor's Report on Internal Control over Financial Reporting and on Compliance and Other Matters, dated December 13, 2012, we described four internal control deficiencies. Two of these deficiencies, when combined, were considered to be a material weakness and two were considered to be significant deficiencies for the fiscal year ended June 30, 2012. UW System has not fully addressed the material weakness, which related to Human Resource System (HRS) security. We continue to report these concerns as a material weakness, as described in Findings 1 and 2 in the accompanying schedule of findings and responses. Because UW System's financial activity is also included in the State of Wisconsin's Comprehensive Annual Financial Report, these internal control findings are 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.

UW System has taken corrective action to address the two significant deficiencies. First, UW System reviewed its procedures for preparation of the financial statements and implemented additional controls to reduce financial reporting errors. Second, UW System implemented procedures to reconcile state group health insurance payments, has continued to seek recoupment of the overpayment of health insurance premiums, and has implemented procedures to reconcile Wisconsin Retirement System contributions.

Our consideration of internal control was for the limited purpose described in the first paragraph of this section and was not designed to identify all deficiencies in internal control that might be material weaknesses or significant deficiencies. Therefore, material weaknesses or significant deficiencies may exist that were not identified. However, as described in the accompanying schedule of findings and responses, we identified certain deficiencies in internal control that we consider to be a material weakness.

Compliance and Other Matters

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

UW System Response to Findings

UW System's written responses to the findings identified in our audit are described in the accompanying schedule of findings and responses. UW System's 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

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

LEGISLATIVE AUDIT BUREAU



Joe Chrisman
State Auditor

December 11, 2013

SCHEDULE OF FINDINGS AND RESPONSES

Human Resource System Security

The Human Resource System (HRS), which was largely implemented in April 2011, is used by the University of Wisconsin (UW) System to track and maintain employee information, such as address, position, and benefit choices, and to process and record the biweekly and 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.

The UW Service Center provides support to all UW institutions related to payroll, benefits, and other automated human resources processing. UW-Madison's Division of Information Technology (DoIT) provides HRS information technology support, such as programming and data security.

Finding 1: Access Concerns with the University of Wisconsin System's Human Resource System

Criteria:

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 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.

Condition:

We reported concerns with access to HRS during both our FY 2010-11 and FY 2011-12 audits. We performed limited testing during our FY 2012-13 audit to determine if the incompatible access noted during our FY 2011-12 audit continued to exist. We found that 18 of the 22 users we identified during our FY 2011-12 audit continued to have access that allows the users to add either an employee or student help employee to HRS; enter, update, correct, and approve time worked or leave taken; update direct deposit information or generate paychecks; and process payroll or otherwise critically impact the payroll process. The other four users terminated employment from UW System since our last audit or had their access changed. We also identified one additional user who had incompatible access during FY 2012-13 who did not have incompatible access during FY 2011-12. Further, we found that all 19 of the users with incompatible access had access on a systemwide level.

Questioned Costs:

None

Context:

Payroll-related expense is the most significant expense of UW System, totaling nearly \$2.9 billion, or nearly 63.0 percent of UW System's total expenses for FY 2012-13.

Effect:

UW System is at increased risk that inadvertent, erroneous, or unauthorized payments could be processed through HRS.

Cause:

In response to our previous concerns over HRS security, UW System began a project to assess HRS security roles and the permissions that are attached to these roles so that necessary changes could be identified, including removing inappropriate access and developing compensating controls when staffing constraints would not allow for proper separation of duties. UW System has not completed its security role review and, therefore, it continues to be at risk that inadvertent, erroneous, or unauthorized payments could be processed through HRS. At the time of our fieldwork, UW System staff indicated that the security role review was expected to be completed in December 2013.

Recommendation:

We recommend UW System Administration review the specific concerns we communicated in more detail in our November 26, 2013 interim audit memorandum and complete its review of all HRS security roles, limit or adjust access as necessary, and implement compensating controls when proper separation of duties cannot adequately be achieved.

Response from University of Wisconsin System Administration:

UW System Administration has reviewed the findings and recommendations identified in the November 26, 2013 memorandum, and agrees with the findings listed in the memorandum.

UW System Administration and UW-Madison's DoIT are committed to addressing these findings during calendar year 2014 and completing the first part of the recommendation regarding the review of all HRS security roles by December 31, 2013. UW System Administration and DoIT will continue to adjust role configurations to address separation of duties and least privileges controls, and will identify and implement mitigating controls for instances where separation of duties or least privilege cannot be strictly enforced by December 31, 2014.

Finding 2: Program Change Controls over the University of Wisconsin System's Human Resource System

Criteria:

Procedures should be established to prevent users from making unauthorized changes to HRS program code or "configuration" information, such as various look-up tables used during payroll processing. The ability to perform program code or configuration changes 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 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 security roles is limited to that necessary for employees to complete their properly separated job duties.

Condition:

In response to our FY 2011-12 recommendations related to program change controls, UW System took some steps to address internal control concerns, including purchasing a separate change management application, Phire, which if properly implemented requires all program changes to move through predetermined steps and approvals before migration to the HRS production environment. However, we continued to identify 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 employee, who is responsible for moving program code changes into the production environment, also has access to the Phire Security Role that allows this employee to grant any access to any employee, including himself. This employee was granted access to the Phire Security Role even though this employee was not responsible for security.
- One employee, who is responsible for creating program code changes, also has access to the Phire Manager Role that allows this employee to bypass all required approvals and directly assign a program code change to be moved into the production environment.
- Four employees, who are responsible for moving program code changes into the production environment after all required approvals are applied, also have access to change Phire workflows and, thus, could bypass all required approvals before moving changes into production.
- Forty-six employees have been granted access to one or more of eight roles identified by UW System that provide the employees with the ability to make configuration changes directly in the HRS production environment. For example, eleven employees have access to a security role that is currently described as having the ability to set up benefit programs and plans and perform all related benefits configurations.

Finally, we found that the new Phire change management application could be circumvented because one employee continues to have access to an HRS security role that allows the user to move program code changes into the production environment.

Questioned Costs:

None

Context:

Payroll-related expense is the most significant expense of UW System, totaling nearly \$2.9 billion, or nearly 63.0 percent of UW System's total expenses for FY 2012-13.

Effect:

UW System is at increased risk that inadvertent, erroneous, or unauthorized changes could be made to HRS.

Cause:

UW System did not properly establish access to the Phire change management application. We found that there is currently no documentation, such as a role catalog, that describes the capabilities of each Phire security role and would help staff understand the permissions of each role to ensure that proper separation of duties is achieved.

Further, as noted during our FY 2011-12 audit, UW System was not aware of all HRS security roles that may provide the user with the ability to make configuration changes. UW System began a project to assess HRS security roles and the permissions that are attached to these roles so that necessary changes could be identified, including removing inappropriate access and developing compensating controls when staffing constraints would not allow for proper separation of duties. At the time of our fieldwork, UW System staff indicated that the security role review was expected to be completed in December 2013.

Recommendation:

We recommend UW System Administration:

- review the specific access concerns we communicated in more detail in our November 26, 2013 interim audit memorandum and adjust or remove access as appropriate;
- review all Phire security roles and the permissions attached to these roles, limit or adjust access as necessary, and implement compensating control when proper separation of duties cannot adequately be achieved; and
- complete the review of all HRS security roles with configuration access, limit or adjust access as necessary, and implement compensating controls when proper separation of duties cannot adequately be achieved.

Response from University of Wisconsin System Administration:

UW System Administration has reviewed the findings and recommendations identified in the November 26, 2013 memorandum, and agrees with the findings listed in the memo.

UW System Administration and UW-Madison's DoIT are committed to addressing these findings during calendar year 2014 by prioritizing the work and coordinating through the respective program management offices. These projects will be managed through discovery, implementation, and deployment phases. For program code changes, the goal is to complete the discovery phase by April 11, 2014, with an approved implementation and deployment plan by May 23, 2014. For configuration changes, the goal is to complete the discovery phase by June 30, 2014, with an approved implementation and deployment plan by July 31, 2014. Each project plan will identify the solution, the milestones, the implementation team, a communication plan, and a decision-making process. The project plans will also include a deployment schedule and the transition plan to the operational state.

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January 31, 2014

Mr. Joe Chrisman
State Auditor
Legislative Audit Bureau
22 E. Mifflin Street, Suite 500
Madison, WI 53703

Via Electronic Mail

Dear Mr. Chrisman:

Thank you for the opportunity to respond to the Legislative Audit Bureau's (LAB) audit of the University of Wisconsin System's 2013 financial statements and notes, which received an unmodified or "clean" audit opinion. UW appreciates the significant amount of time and effort that LAB staff invested in this audit.

UW System understands that a management review will now occur annually and be included with the audit opinion on UW System's annual financial statements. This year, the review was conducted somewhat concurrently to the Legislative Audit Bureau's evaluation of the Human Resource System (HRS) and shortly following a review of UW System's program revenue balances (report 13-17). Because several of the same issues pertaining to program revenue balances and HRS security were cited in those reports, several of UW's responses to this report will be similar as well.

Program Revenue Balances

Considerable attention to UW System's program revenue balances began in April 2013. Since then, UW System and the Board of Regents have worked hard to develop a methodology and policy to manage program revenue balances in the future. UW institutions are paying close attention to the use and management of program revenue balances and look forward to continued conversations with legislators and key stakeholders regarding the appropriate level of balances that should be maintained in a complex higher education system.

2013 Wisconsin Act 20 included a two-year freeze on tuition rates and required UW to provide \$114.1 million in funding for ongoing costs and base reductions. In addition, Act 20 required UW to provide \$88.5 million from its program revenue balances to fund several one-time initiatives and transfers. For these reasons, UW anticipates its fiscal year-end 2014 balances to decline from their year-end 2013 levels.

HRS Security

UW acknowledges the HRS security issues discussed in the report. HRS is a complex system that provides comprehensive processing of all UW employee appointment, payroll, and benefits data for approximately 75,000 faculty, staff, and student employees across 26 campuses, UW-Extension, and UW System Administration.

UW has been using a risk-based approach to our priorities throughout the HRS implementation and post-implementation support timeframe, and understands there are both internal and external risks associated with the information/data the Service Center processes. Due to the visibility of the UW System, much of the early emphasis focused on external risks, as external risks with data such as social security numbers and bank accounts is the greatest concern. UW agrees that there is work yet to do in FY14 to fully address the internal risks raised by LAB. UW's plans and progress on this work are summarized below.

UW agrees that Separation of Duties (SOD) is an integral component of maintaining adequate financial controls. UW also acknowledges that additional work is needed in the area of SOD. Since LAB initially identified a concern, UW has taken a systematic approach to develop compensating controls to ensure that this need is addressed in a manner that does not adversely impact the institutional need to support ongoing business operations.

Current projects in progress: SOD matrix created, conflicting access identified, and fraud overview materials developed. We are pursuing the following implementation steps and horizons:

- Refine the compensating controls for each conflict with Service Center (Current-February 2014)
- Communicate fraud overview, SOD matrix, compensating controls to campus HR leadership (March 2014)
- Implement SOD preventative and compensating control (April 2014)
- Review SOD conflict through user access certification process (Yearly: March & September)

Further, UW agrees that security is a critically important piece of our HRS implementation. Our challenge is to manage security in an environment with 2,000 users distributed over 15 institutions with a significant degree of turnover. UW has taken many steps to continually improve our security from both external and internal risks.

Completed Projects: UW has completed the following to address items previously raised by LAB:

- Deprovisioning: 177 users have had complete access removed since summer 2013.
- Reduced HRS Access: Review user access twice per year to determine appropriate access is assigned and aligned with least privilege. In September 2013, there were 269 people who had access reduced. This reduction included removing 1,350 roles/privileges.

- Second Factor Authentication: Implemented multi-factor authentication so that all of our 2,000 core users use a password and a dynamic authentication code each time they log-in. This step aligns us with access methods typically used in financial and auditing institutions.
- Program Change Implementation: Eliminated access so that compensation-related program changes could not be moved to production by the team that also makes those changes.

Future: UW is now ready to redesign access to address the ability to make configuration changes in production, in addition to the aforementioned SOD.

Thank you again for the opportunity to comment on the Legislative Audit Bureau's report, as well as for the professionalism of your staff throughout the audit process.

Sincerely,



Richard J. Telfer
Interim President