

**Report 18-2  
February 2018**

# **University of Wisconsin System Fiscal Year 2016-17**

STATE OF WISCONSIN



Legislative Audit Bureau ■



# **University of Wisconsin System Fiscal Year 2016-17**

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## OPINION PUBLISHED SEPARATELY

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The financial statements and our unmodified opinion on them are included in the University of Wisconsin System's *2017 Annual Financial Report*





# STATE OF WISCONSIN | Legislative Audit Bureau

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

Joe Chrisman  
State Auditor

February 6, 2018

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. We have provided an unmodified opinion on UW System's fiscal year (FY) 2016-17 and FY 2015-16 financial statements. These financial statements and our audit opinion on them are included in UW System's *2017 Annual Financial Report*, which is available on its website.

On the basis of generally accepted accounting principles (GAAP), UW System's net position was \$6.6 billion as of June 30, 2017. UW System revenues were \$5.1 billion in FY 2016-17, including \$1.3 billion in revenue from student tuition and fees. UW System expenses totaled \$5.1 billion in FY 2016-17. UW System's largest expense is payroll, which was \$3.3 billion for FY 2016-17.

We reviewed UW System's FY 2016-17 *Report on Program Revenue Balances by Institution and Level of Commitment*, which was approved by the Board of Regents in October 2017. On a budgetary basis, UW System's total program revenue balance as of June 30, 2017, was \$1.2 billion. Of this amount, \$851.6 million was from unrestricted sources, such as tuition and auxiliary operations. Board of Regents policy requires UW institutions to categorize unrestricted program revenue balances into five commitment categories: obligated, planned, designated, reserves, and undocumented. Balances categorized as planned totaled \$435.8 million, or 51.2 percent of total unrestricted program revenue balances.

We have reported concerns related to information technology (IT) security policies, procedures, and controls at UW System since the early 1990s. Although we found that UW System worked to address concerns related to IT security policies, procedures, and controls that we identified in reports 16-3 and 17-6, UW System Administration has not taken significant steps to develop IT security policies and procedures to cover all critical IT areas and comply with Board of Regents policy. We again report a significant deficiency in internal control in our Independent Auditor's Report on Internal Control and on Compliance and Other Matters, which begins on page 27. Given the continuing nature of these concerns, we recommend that UW System Administration report the status of its efforts to the Joint Legislative Audit Committee by August 31, 2018.

We appreciate the courtesy and cooperation extended to us by staff of UW System during the audit. A response from the UW System President follows the Appendix.

Respectfully submitted,

  
Joe Chrisman  
State Auditor

JC/ES/ss



## Introduction ■

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The University of Wisconsin (UW) System provides postsecondary academic education for approximately 176,000 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 the 13 two-year colleges, which 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 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. Citizen members are appointed for staggered seven-year terms, and 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, the chancellor of UW-Extension and Colleges, and the deans 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.

## **Financial Condition**

***We provided an unmodified audit opinion on UW System's financial statements for FY 2016-17 and FY 2015-16.***

As required by s. 13.94 (1) (t), Wis. Stats., we completed a financial audit of UW System. We audited UW System's financial statements for the years ended June 30, 2017, and June 30, 2016, and provided our unmodified audit opinion to UW System for inclusion in its *2017 Annual Financial Report*, which is available on its website. UW System's financial statements were prepared using generally accepted accounting principles (GAAP) prescribed by the Governmental Accounting Standards Board (GASB) and include the financial activity of all UW institutions. Because UW System Administration has determined UW Foundation to be a component unit of UW System, UW Foundation's financial statements are presented in UW System's *2017 Annual Financial Report*.

2017 Wisconsin Act 59, the 2017-19 Biennial Budget Act, requires UW System to hire an external auditor that is not the Legislative Audit Bureau to conduct a financial statement audit of UW System for fiscal year (FY) 2017-18 and FY 2018-19. For these fiscal years, and in compliance with s. 13.94 (1) (t), Wis. Stats., the Legislative Audit Bureau will continue to conduct annual financial audit work with the purpose of assessing selected aspects of UW System's financial management and financial operations. However, we will not render an opinion on UW System's financial statements.

As a state agency, UW System's financial information will be included in the State's FY 2016-17 Comprehensive Annual Financial Report (CAFR), which will be available on the Department of Administration's website.

## Revenue and Expenses

**Student Tuition and Fees accounted for 24.8 percent of UW System's total revenue in FY 2016-17.**

As shown in Table 1, UW System revenue increased from \$4.9 billion in FY 2015-16 to \$5.1 billion in FY 2016-17, or by 4.1 percent. During FY 2016-17, UW System's largest revenue was Student Tuition and Fees, which includes tuition and other academic student fees. The \$1.3 billion in Student Tuition and Fees collected by UW System in FY 2016-17 was 24.8 percent of its total revenue. From FY 2015-16 through FY 2016-17, revenue from Student Tuition and Fees reported in UW System's financial statements increased by 2.1 percent. This increase was largely the result of increases in tuition for nonresident and graduate students.

Table 1

### UW System Revenue<sup>1</sup> (in millions)

Financial Statement Account	FY 2016-17	FY 2015-16	Percentage Change
Student Tuition and Fees <sup>2</sup>	\$1,258.2	\$1,231.8	2.1%
State Appropriations <sup>3</sup>	808.2	802.7	0.7
Federal Grants and Contracts	761.3	779.9	(2.4)
State, Local, and Private Grants and Contracts	439.8	414.6	6.1
Sales and Services of Auxiliary Enterprises <sup>2</sup>	429.5	418.1	2.7
Other Operating Revenue	404.9	394.7	2.6
Gifts	378.1	303.1	24.7
Sales and Services of Educational Activities	335.6	317.1	5.8
Capital Appropriations	103.3	89.1	15.9
Other Nonoperating Revenue	69.4	16.1	331.7
Sales and Services to UW Hospital Authority	69.2	66.9	3.4
Capital Contributions	20.8	43.9	(52.6)
Student Loan Interest Income and Fees	4.2	6.1	(31.1)
<b>Total</b>	<b>\$5,082.5</b>	<b>\$4,884.1</b>	<b>4.1</b>

<sup>1</sup> On the basis of generally accepted accounting principles (GAAP).

<sup>2</sup> Excludes scholarships and fellowships applied to student accounts.

<sup>3</sup> Excludes GPR appropriated to UW System for debt service payments.

State Appropriations was UW System's second-largest revenue during FY 2016-17. Except for general purpose revenue (GPR) appropriated to UW System for its debt service payments, GPR that UW System received was reported on UW System's financial statements as State Appropriations. In FY 2016-17, State Appropriations totaled \$808.2 million and accounted for 15.9 percent of total revenue. From FY 2015-16 through FY 2016-17, State Appropriations increased by \$5.5 million, or by 0.7 percent.

Federal Grants and Contracts totaled \$761.3 million in FY 2016-17 and accounted for 15.0 percent of UW System's total revenue. From FY 2015-16 through FY 2016-17, Federal Grants and Contracts decreased by \$18.6 million, or by 2.4 percent.

Other significant revenue for UW System in FY 2016-17 included:

- State, Local, and Private Grants and Contracts, which totaled \$439.8 million and included grants and contracts received from other state agencies, Wisconsin municipalities, and other non-federal entities;
- Sales and Services of Auxiliary Enterprises, which totaled \$429.5 million and included revenue received for services such as student housing and food service;
- Other Operating Revenue, which totaled \$404.9 million and included revenue from intercollegiate athletics, student health services, child care centers, and certain administrative services;
- Gifts, which totaled \$378.1 million and included amounts received from donors; and
- Sales and Services of Educational Activities, which totaled \$335.6 million and included revenue received from the sales of goods or services that were incidental to the primary function of UW System, such as textbook rentals, laboratory fees, scientific and literary publications, and public service programs.

As shown in Table 2, UW System expenses increased from \$5.0 billion in FY 2015-16 to \$5.1 billion in FY 2016-17, or by 1.4 percent.

Table 2

**UW System Expenses<sup>1</sup>**  
(in millions)

Financial Statement Account	FY 2016-17	FY 2015-16	Percentage Change
Salary and Fringe Benefits	\$3,256.8	\$3,194.1	2.0%
Supplies and Services	1,228.6	1,194.9	2.8
Depreciation	292.4	303.9	(3.8)
Scholarships and Fellowships	145.2	149.7	(3.0)
Transfer to State Agencies	76.8	78.6	(2.3)
Interest on Indebtedness	53.4	61.0	(12.5)
Other Operating Expenses	24.9	6.0	315.0
Loss on Disposal of Capital Assets	24.8	46.7	(46.9)
<b>Total</b>	<b>\$5,102.9</b>	<b>\$5,034.9</b>	<b>1.4</b>

<sup>1</sup> On the basis of generally accepted accounting principles (GAAP).

***Salary and Fringe Benefits was UW System's largest expense and totaled \$3.3 billion in FY 2016-17.***

Salary and Fringe Benefits was UW System's largest expense and totaled \$3.3 billion, or 63.8 percent of its total expenses in FY 2016-17. From FY 2015-16 through FY 2016-17, Salary and Fringe Benefits expense increased by 2.0 percent because, as of June 30, 2017, a net pension liability was reported, which increased UW System's pension expense and is reflected as part of Salary and Fringe Benefits. As a participating employer in the Wisconsin Retirement System (WRS), UW System is required to report its proportionate share of the net pension liability (or asset) for all employees participating in the WRS. The net pension liability of the WRS was discussed in report 17-16. Other significant expenses included 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 it does for 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 using GPR appropriated to UW System for that purpose. Debt on other facilities, such as residence halls, is repaid using program revenue that is generated by payments from users of these facilities.

In FY 2016-17, GPR-funded debt service payments totaled \$222.3 million and program revenue-funded debt service payments totaled \$209.4 million. As of June 30, 2017, outstanding GPR-funded debt totaled \$1.6 billion, and outstanding program revenue-funded debt totaled \$1.6 billion.

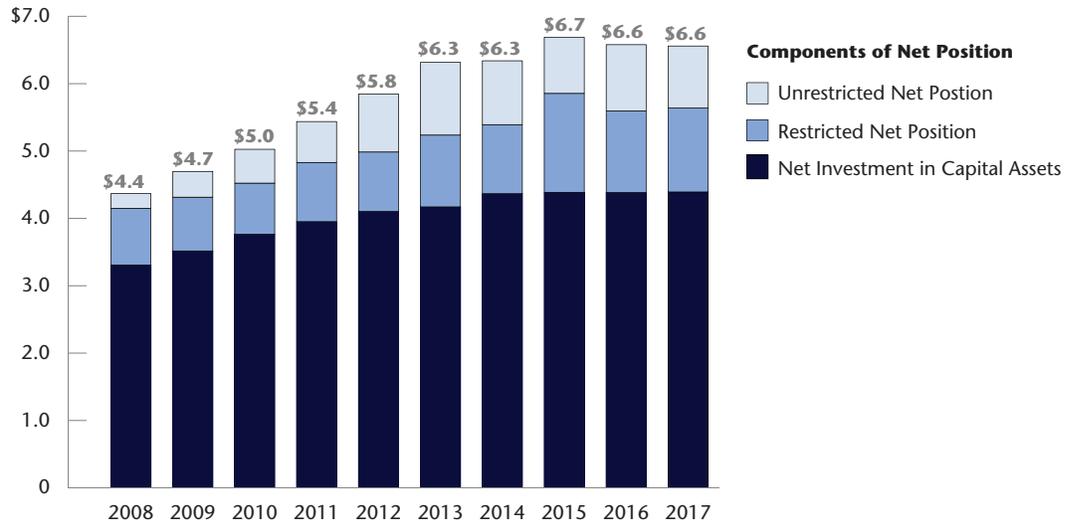
**Net Position**

***UW System’s net position was \$6.6 billion as of June 30, 2017.***

Net position provides a measure of overall financial condition. On a GAAP basis, UW System’s net position was \$6.6 billion as of both June 30, 2016, and June 30, 2017, as shown in Figure 1. On UW System’s financial statements, net position was presented in three components: Net Investment in Capital Assets, Restricted Net Position, and Unrestricted Net Position.

Figure 1

**Net Position of UW System<sup>1</sup>**  
As of June 30  
(in billions)



<sup>1</sup> 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 program revenue-funded debt needed to purchase or construct these capital assets. Net Investment in Capital Assets was the largest component of UW System’s net position and totaled \$4.4 billion as of both June 30, 2017, and June 30, 2016.

Restricted Net Position represents amounts that have an external restriction on their use. The majority of UW System's Restricted Net Position relates to amounts that were restricted for endowment funds, gifts, non-federal grants and contracts, and federal student loans. Restricted Net Position totaled \$1.2 billion as of both June 30, 2017, and June 30, 2016.

***On a GAAP basis,  
UW System's Unrestricted  
Net Position was  
\$920.7 million as of  
June 30, 2017.***

Unrestricted Net Position represents any remaining amounts not otherwise included in Net Investment in Capital Assets or Restricted Net Position. UW System Administration indicated that most of the Unrestricted Net Position will be used for academic and research programs and initiatives, and capital programs. Unrestricted Net Position decreased from \$984.1 million as of June 30, 2016, to \$920.7 million as of June 30, 2017, or by \$63.4 million.

## **Planned Merger**

In November 2017, the Board of Regents approved a plan to merge UW Colleges, which are UW System's 13 two-year colleges, with certain four-year universities. This plan also merges certain UW-Extension divisions with UW-Madison and the others with UW System Administration. UW System has developed the Restructuring Project Steering Committee to oversee the planning and implementation of the restructuring of UW Colleges and UW-Extension. The committee includes representatives from UW System Administration; UW Colleges and UW-Extension; each of the other UW institutions; and faculty, staff, and student governance representatives. The committee met in November 2017 and December 2017. The merger is effective July 1, 2018, and will be first represented in the financial reports for FY 2018-19.

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## Program Revenue Balances Reporting ■

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UW System receives program revenue from sources such as tuition; auxiliary operations, which include fees charged for student housing and food service; federal revenue; and gifts. Board of Regents policy requires that UW System Administration report fiscal year-end program revenue balances to the Board of Regents annually at its October meeting. We performed a limited review of the FY 2016-17 program revenue balances report, which was approved by the Board of Regents in October 2017.

### **Program Revenue Balances as of June 30, 2017**

***On a budgetary basis,  
UW System's total  
program revenue balance  
was \$1.2 billion, as of  
June 30, 2017.***

UW System reports program revenue balances to the Board of Regents in its *Report on Program Revenue Balances by Institution and Level of Commitment* (program revenue balances report). Program revenue balances are reported for five program revenue sources that do not have restrictions on their use (unrestricted), including tuition; auxiliary operations; general operations; federal indirect cost reimbursement; and other unrestricted program revenue sources. Program revenue balances are also reported for four restricted program revenue sources, including gifts; nonfederal grants and contracts; federal grants and contracts; and other restricted program revenue sources. On a budgetary basis, and as shown in Table 3, UW System's total program revenue balance as of June 30, 2017, was \$1.2 billion.

Table 3

**UW System Total Program Revenue Balance<sup>1</sup>**  
 As of June 30  
 (in millions)

Year	Total	Percentage Change
2007	\$406.0	–
2008	443.6	9.3%
2009	563.7	27.1
2010	649.6	15.2
2011	836.8	28.8
2012	1,045.0	24.9
2013	1,273.5	21.9
2014	1,185.6	(6.9)
2015	1,182.4	(0.3)
2016	1,188.5	0.5
2017	1,223.4	2.9

<sup>1</sup> On a budgetary basis.

According to the program revenue balances report for FY 2016-17, the increase in total program revenue balances is largely attributable to restricted program revenue balances, which increased from \$305.2 million as of June 30, 2016, to \$371.8 million as of June 30, 2017, or by 21.8 percent. The increase in restricted program revenue balances primarily related to gifts and nonfederal grants and contracts.

***On a budgetary basis, the unrestricted program revenue balance was \$851.6 million as of June 30, 2017.***

As shown in Table 4, on a budgetary basis, unrestricted program revenue balances decreased \$31.7 million, from \$883.3 million as of June 30, 2016, to \$851.6 million as of June 30, 2017, or by 3.6 percent. UW institution unrestricted program revenue balances ranged from \$7.4 million at UW-Superior to \$336.7 million at UW-Madison.

Table 4

**Unrestricted Program Revenue Balances, by Institution<sup>1, 2</sup>**  
As of June 30<sup>3</sup>  
(in millions)

Institution	2017	2016	Difference Amount	Difference Percentage
Madison	\$336.7	\$369.4	\$(32.7)	(8.9)%
Milwaukee	88.4	81.9	6.5	7.9
Systemwide <sup>4</sup>	78.5	59.6	18.9	31.7
Eau Claire	48.1	43.0	5.1	11.9
Whitewater	41.0	46.1	(5.1)	(11.1)
Platteville	32.2	32.3	(0.1)	(0.3)
La Crosse	29.4	30.7	(1.3)	(4.2)
Oshkosh	28.2	38.8	(10.6)	(27.3)
Stout	25.4	20.4	5.0	24.5
Colleges	22.9	26.1	(3.2)	(12.3)
Stevens Point	22.9	37.6	(14.7)	(39.1)
Extension	22.5	24.5	(2.0)	(8.2)
River Falls	21.7	19.5	2.2	11.3
Green Bay	20.6	20.7	(0.1)	(0.5)
Parkside	14.2	14.9	(0.7)	(4.7)
System Administration	11.5	10.1	1.4	13.9
Superior	7.4	7.7	(0.3)	(3.9)
<b>Total</b>	<b>\$851.6</b>	<b>\$883.3</b>	<b>\$(31.7)</b>	<b>(3.6)</b>

<sup>1</sup> On a budgetary basis.

<sup>2</sup> Includes balances from tuition, including academic student fees and UW-Extension student fees; auxiliary operations; general operations; federal indirect cost reimbursement; and other unrestricted program revenue.

<sup>3</sup> As adjusted by allocations to UW institutions from UW Systemwide accounts.

<sup>4</sup> Accounts maintained by UW System Administration for the benefit of all UW institutions.

Unrestricted program revenue balances decreased at 11 institutions, including by \$32.7 million at UW-Madison. Unrestricted program revenue balances increased at six institutions, including by \$18.9 million for UW Systemwide, which are accounts maintained by UW System Administration for the benefit of all UW institutions. According to the FY 2016-17 program revenue balances report, the increase in UW Systemwide balances is attributed to increases in tuition and general operations balances.

With the exception of auxiliary operations, unrestricted program revenue balances decreased by \$38.2 million since June 30, 2016. The program revenue balance for auxiliary operations increased by \$6.5 million, or 2.6 percent, since June 30, 2016. According to the FY 2016-17 program revenue balances report, the increase in auxiliary operations is attributed to delayed capital projects, which included anticipated expenses that were not incurred when originally planned.

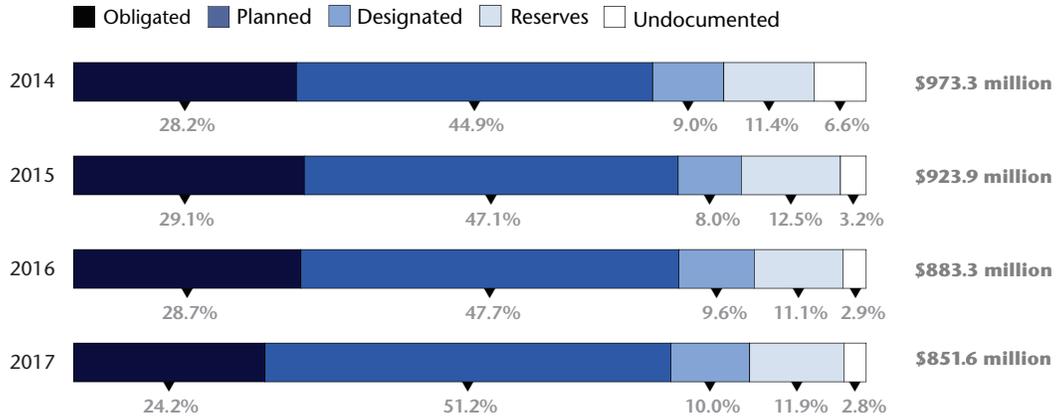
### **Levels of Commitment for Program Revenue Balances**

Board of Regents policy requires that reported year-end unrestricted balances be categorized according to the level of commitment for which funds are to be used. “Obligated” balances are firm commitments that cannot be easily redistributed, such as encumbrances or signed contracts. “Planned” balances are less committed than obligated balances and are held for a specific purpose as authorized by a chancellor or designee, such as planned financial aid that has not yet been awarded. “Designated” balances are held for purposes related to the original funding source for which there is no documentation or plan, such as funds for general operations that often accumulate in advance of known expenses for future years, such as study abroad and athletic camps. “Reserves” are amounts approved by a memo from the chancellor or authorized authority to be held for contingencies, such as unexpected enrollment declines, and are based on a dollar value or percentage of revenue. “Undocumented” balances do not have an obligation or plan and may be used for any purpose because there are no funding source requirements.

While the overall total of unrestricted program revenue balances decreased, the percentage of the balance in each category to the overall unrestricted program revenue balance has remained consistent since UW System Administration prepared the first program revenue balances report for FY 2013-14. As shown in Figure 2, in each of the past four years, the majority of unrestricted program revenue balances was categorized as planned or obligated. Of the total unrestricted program revenue balance as of June 30, 2017, planned commitments totaled \$435.8 million (51.2 percent) and obligated commitments totaled \$205.8 million (24.2 percent). The appendix shows each UW institution’s program revenue balance by level of commitment as of June 30, 2017.

Figure 2

Unrestricted Program Revenue Balances, by Level of Commitment<sup>1, 2</sup>



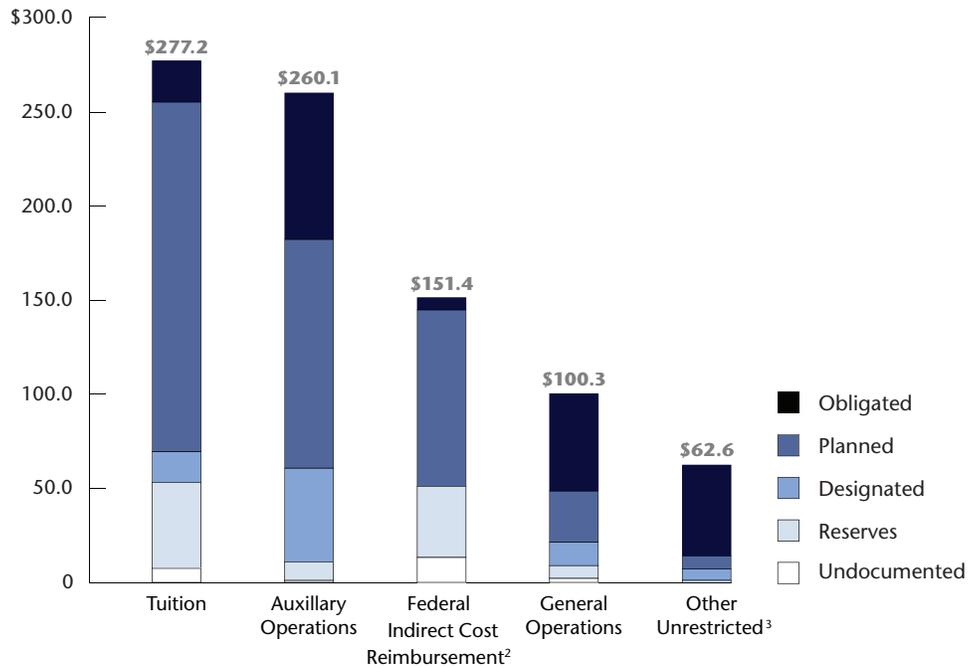
<sup>1</sup> As reported in UW System’s reports on program revenue balances by institution and level of commitment.

<sup>2</sup> Includes balances from tuition, including academic student fees and UW-Extension student fees; auxiliary operations; general operations; federal indirect cost reimbursement; and other unrestricted program revenue.

Unrestricted program revenue balance commitments varied by fund. As shown in Figure 3, a majority of the tuition, auxiliary operations, and federal indirect cost reimbursement program revenue balance commitments was categorized as planned. However, most of the general operations and other unrestricted balances were categorized as obligated. All funds included balances categorized as reserves, the majority of which was related to tuition and federal indirect cost reimbursement program revenue balances.

Figure 3

**Program Revenue Commitments, by Fund Type<sup>1</sup>**  
 As of June 30, 2017  
 (in millions)



<sup>1</sup> As reported in UW System’s FY 2016-17 Report on Program Revenue Balances by Institution and Level of Commitment.

<sup>2</sup> No federal indirect cost reimbursement balances were categorized as designated.

<sup>3</sup> \$1.3 million in reserves and \$34,513 in other unrestricted program revenue balances categorized as undocumented are not shown.

Examples of commitments reported by institutions in the FY 2016-17 program revenue balances report included the following:

- UW-Milwaukee reported a \$3.0 million obligated commitment in the auxiliary fund for debt service for student affairs and transportation services in FY 2017-18;
- UW Colleges reported a \$162,000 obligated commitment in the general operations fund for Registrar’s Office salary and fringe benefits in FY 2017-18;
- UW-Platteville reported a \$1.5 million planned commitment in the tuition fund for offsetting a portion of an estimated tuition shortfall in FY 2017-18;

- UW-Superior reported a \$73,000 planned commitment in the general operations fund for distance learning program marketing and staff development in FY 2017-18; and
- UW-La Crosse reported a \$1.7 million obligated commitment for equipment for the Wittich Hall project in FY 2017-18.

## **UW Institution Spending and Savings Plans**

Board of Regents policy requires that institutions with positive balances in excess of 12.0 percent of unrestricted fund fiscal year expenditures, with the exception of federal indirect cost reimbursement, provide a detailed spending plan and additional information for those balances. These detailed spending plans must include, for example, the total dollar amounts held, the total amounts set aside for specific upcoming projects in terms of their level of commitment, and the time frame for spending completion. These spending plans are included in the program revenue balances report.

Each UW institution submitted a detailed spending plan for at least two unrestricted program revenue sources. As shown in Table 5, the FY 2016-17 program revenue balance report included 44 detailed spending plans for unrestricted balances that exceeded the 12.0 percent limit. This was two fewer spending plans than were submitted in the FY 2015-16 program revenue balances report.

Table 5

**Required Spending Plans, by Institution**  
FY 2015-16 to FY 2016-17

■ Spending Plan required.<sup>1</sup>    ■ No Spending Plan required.

Institution	Tuition		Auxiliary Operations		General Operations		Other Unrestricted Program Revenue	
	2017 <sup>2</sup>	2016 <sup>3</sup>	2017 <sup>2</sup>	2016 <sup>3</sup>	2017 <sup>2</sup>	2016 <sup>3</sup>	2017 <sup>2</sup>	2016 <sup>3</sup>
Colleges	■	■	■	■	■	■	■	■
Eau Claire	■	■	■	■	■	■	■	■
Extension	■	■	■	■	■	■	■	■
Green Bay	■	■	■	■	■	■	■	■
La Crosse	■	■	■	■	■	■	■	■
Madison	■	■	■	■	■	■	■	■
Milwaukee	■	■	■	■	■	■	■	■
Oshkosh	■	■	■	■	■	■	■	■
Parkside	■	■	■	■	■	■	■	■
Platteville	■	■	■	■	■	■	■	■
River Falls	■	■	■	■	■	■	■	■
Stevens Point	■	■	■	■	■	■	■	■
Stout	■	■	■	■	■	■	■	■
Superior	■	■	■	■	■	■	■	■
System Administration	■	■	■	■	■	■	■	■
Systemwide <sup>4</sup>	■	■	■	■	■	■	■	■
Whitewater	■	■	■	■	■	■	■	■

<sup>1</sup> Required when the ratio of the balance to total expenditures exceeds 12.0 percent.

<sup>2</sup> As reported in UW System's FY 2016-17 *Report on Program Revenue Balances by Institution and Level of Commitment*.

<sup>3</sup> As reported in UW System's FY 2015-16 *Report on Program Revenue Balances by Institution and Level of Commitment*.

<sup>4</sup> Accounts maintained by UW System Administration for the benefit of all UW Institutions.

Board of Regents policy also requires that institutions with negative balances in their tuition or auxiliary operations funds submit a savings plan on how and when they will eliminate the negative balance. No UW institutions met the requirement to submit a savings plan for FY 2016-17. The two institutions—UW-Parkside and UW-Superior—that were required to submit savings plans for negative auxiliary operations balances as of June 30, 2016, had positive tuition and auxiliary operations balances as of June 30, 2017.

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## Status of Prior Audit Findings ■

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We followed up on the status of UW System Administration's efforts to address recommendations from prior audits. We found that UW System Administration has taken steps to address our recommendations related to oversight and investment of trust funds and to special course fees. Although UW System Administration has worked to address our recommendations related to repeated information technology (IT) security concerns, we continue to identify concerns in this area.

### Office of Trust Funds

***At its November 2017 meeting, the Board of Regents approved the negotiation of a contract with the State of Wisconsin Investment Board for investment management services.***

In report 16-3, we evaluated the role of UW System Administration's Office of Trust Funds in overseeing investments of gifts, grants, and bequests made to the Board of Regents or individual UW institutions, and we made recommendations to improve oversight and administration of investments. In report 17-6, we reported that UW System Administration took steps to address our concerns. For example, the Board of Regents created a subcommittee on investments within its Business and Finance Committee. At its November 2017 meeting, the Board of Regents approved the negotiation of a contract with the State of Wisconsin Investment Board (SWIB) for investment management services. The Board of Regents is allowed under s. 36.11 (11m), Wis. Stats., to contract with SWIB to manage investments of gifts, grants, and bequests, and s. 25.17 (9m), Wis. Stats., allows SWIB to invest these funds. At its December 2017 meeting, SWIB approved a motion to begin contract discussions with UW System Administration.

## Special Course Fees

In report 17-6, we reviewed compliance by UW institutions with policies related to nontraditional student fees and special course fees. We found UW institutions did not have a process in place for conducting regular audits of special course fees as required by UW System Administration policy. We also found instances in which fees were inaccurately categorized in the statutorily required tuition and fee report UW System provided to the Legislature. We made recommendations for UW System Administration to ensure that required audits are conducted and to ensure the accuracy of the tuition and fee report.

***UW System Administration has taken some steps to address our prior audit recommendations related to special course fees.***

During our FY 2016-17 audit, UW System Administration indicated it has taken some steps to address our recommendations. For example, UW System Administration communicated with institution budget officers and controllers about reviewing and managing special course fee balances according to UW System Administration policy, which requires an audit. In addition, to improve the accuracy of the 2017-18 tuition and fee report, UW System Administration assigned two analysts to verify tuition and fee data submitted by institutions, remove duplicate entries, and compare reported tuition and segregated fee rates with those approved by the Board of Regents.

## Information Technology Findings

***We have reported concerns with IT security policies, procedures, and controls for various systems at UW System since at least the early 1990s.***

Weaknesses in IT security policies, procedures, and controls increase the risk that unauthorized or erroneous transactions could be processed; accounting, payroll, and student data could be changed; or personally identifiable information could be accidentally or maliciously exposed. We have reported concerns with IT security policies, procedures, and controls for various systems at UW System since at least the early 1990s. For many years, we reported a significant deficiency in internal control related to the process for making changes to UW System's legacy payroll systems, which operated on a mainframe computer. During that time, UW System's process for making changes to the legacy payroll systems did not include an independent review of program changes to assess reasonableness or compliance with users' requests. In addition, programmers had the ability to move program changes into the mainframe computer production environment. UW System replaced the legacy payroll systems with the Human Resource System (HRS) in April 2011. HRS is used by UW System to process and record the biweekly and monthly payroll for all staff and students employed by UW institutions.

For our FY 2010-11 audit, we performed a limited review of HRS access granted to certain UW employees and identified several concerns with incompatible or excessive access and sharing of

passwords. We reported this concern as a significant deficiency in internal control over HRS for our FY 2010-11 audit. During our FY 2011-12, FY 2012-13 (report 14-3), and FY 2013-14 (report 15-1) audits, we reported concerns related to excessive user access and the program change process that, when combined, represented a material weakness in internal control over HRS.

During the FY 2014-15 audit (report 16-3), we found that UW System completed its corrective actions to address our specific HRS concerns. However, beginning with our FY 2014-15 audit, we identified weaknesses in IT security policies, procedures, and controls at several UW institutions. We made recommendations to the individual institutions and we recommended UW System develop systemwide IT security policies and procedures. We reported this concern as a significant deficiency in internal control for FY 2014-15.

In December 2015, the UW System Board of Regents approved a high-level policy on information security that required UW System to develop and maintain a comprehensive IT security program. However, during our FY 2015-16 audit (report 17-6), we continued to identify weaknesses in IT security policies, procedures, and controls at several institutions, and again reported a significant deficiency in internal control for our FY 2015-16 audit.

***UW System Administration has developed five systemwide IT policies, but it has not developed a comprehensive IT security program.***

During our FY 2016-17 audit, we followed up on UW System Administration's progress in implementing our prior recommendations. Five systemwide IT policies in the areas of authentication, data classification, security awareness, incident response, and acceptable use were established in September 2016 through the UW Information Assurance Council. The Council, which is made up of IT, legal, and audit staff representing different institutions, including UW System Administration, was established to identify and analyze risks related to IT security, develop policies to address these risks, and review the performance of the UW System IT security program. However, we found UW System Administration has not taken significant steps to develop IT policies and procedures to cover other critical areas and comply with the Board of Regents policy to develop a comprehensive IT security program.

In response to our institution-specific recommendations from prior years, we found UW institutions were working to address the concerns we noted in our prior audits in several areas. For example, UW institutions were implementing password controls in an effort to comply with the new UW System Administration policies and procedures. However, many of these corrective actions were completed late in FY 2016-17. We also identified new areas of concern, which we determined were too sensitive to communicate

publicly. Therefore, we communicated our concerns to the institutions involved through confidential interim memoranda.

***We again report a significant deficiency in internal control related to weaknesses in IT security policies, procedures, and controls at UW System.***

We again report a significant deficiency in internal control related to weaknesses in IT security policies, procedures, and controls at UW System in our Independent Auditor’s Report on Internal Control and on Compliance and Other Matters, which begins on page 27. In its response, UW System Administration indicated it agreed with the recommendations and set forth a timeline for developing a comprehensive IT security program, including policies and procedures. In addition, UW System Administration indicated that it plans to have an information security assessment completed by a third-party vendor. Given that we have reported concerns with IT security policies, procedures, and controls for a number of years and continue to identify such concerns, it is important for UW System Administration to report to the Joint Legislative Audit Committee on the status of its efforts to address these issues.

**Recommendation**

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*We recommend the University of Wisconsin System Administration report to the Joint Legislative Audit Committee by August 31, 2018, on the status of the development of a comprehensive IT security program, including policies and standards established, and a summary of steps it has taken to address high-risk areas identified by the third-party vendor.*

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## **Auditor's Report ■**

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Report 18-2

## 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 University of Wisconsin Board of Regents, and  
Dr. Raymond Cross, President  
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, 2017, and June 30, 2016, and have issued our report thereon dated January 31, 2018. 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 *2017 Annual Financial Report*. Our report includes a reference to other auditors who audited the financial statements of the UW Foundation, as described in our report 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* and accordingly this report does not include reporting on internal control over financial reporting or instances of reportable noncompliance associated with the UW Foundation.

### 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.

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 and, therefore, material weaknesses or significant deficiencies may exist that were not identified. Given these limitations, we did not identify any deficiencies in internal control that we consider to be material weaknesses. We did identify certain deficiencies in internal control, described in the accompanying Finding and Response Schedule, that we consider to be a significant deficiency. These deficiencies were also considered to be a significant deficiency in the FY 2015-16 Independent Auditor's Report on Internal Control over Financial Reporting and on Compliance and Other Matters, dated March 30, 2017 (report 17-6).

Because UW System's financial activity is also included in the State of Wisconsin's Comprehensive Annual Financial Report, this significant deficiency will also be 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 FY 2016-17 financial statements.

### **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's Response to Finding**

UW System's written response to the finding identified in our audit is described in the accompanying Finding and Response Schedule. UW System's response and its corrective action plan were not subjected to the auditing procedures applied in the audit of the financial statements and, accordingly, we express no opinion on them.

### **Purpose of This Report**

This report is an integral part of an audit performed in accordance with *Government Auditing Standards* and should be used when considering UW System's internal control and compliance. The purpose of this report is solely to describe the scope of our testing of internal control and compliance and the result of that testing, and not to provide an opinion on the effectiveness of

UW System's internal control or on compliance. Accordingly, this report is not suitable for any other purpose.

LEGISLATIVE AUDIT BUREAU

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

Joe Chrisman  
State Auditor

January 31, 2018



## FINDING AND RESPONSE SCHEDULE

### **Finding 2017-001: Information Technology Controls at the University of Wisconsin System**

*Criteria:*

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

In developing systemwide IT security policies and procedures, UW System Administration consulted policies and procedures from UW institutions and other educational institutions, as well as using the National Institute of Standards and Technology (NIST) *Special Publication 800-63* and *Special Publication 800-171*. NIST publications provide a framework for establishing a well-controlled IT environment and are most effective when implemented for all critical IT areas. The UW Information Assurance Council, which is made up of IT, legal, and audit staff representing different institutions, including UW System Administration, was established to identify and analyze risks related to IT security, develop policies to address these risks, and review the performance of the UW System IT security program. Chancellors and chief information officers at each institution are responsible for ensuring compliance with the new policies.

*Condition:*

We have reported weaknesses in UW System's IT security policies, procedures, and controls during our fiscal year (FY) 2014-15 and FY 2015-16 audits. We made recommendations for UW System Administration to develop systemwide IT security policies and procedures, assist UW institutions in implementing timely corrective actions related to our institution-specific concerns, and develop procedures for assessing the level of protection provided for UW systems and data.

In response to our prior-year recommendations, the UW System Board of Regents approved, in December 2015, a high-level policy on information security that required UW System to develop and maintain a comprehensive IT security program. Further, five systemwide IT policies were established in September 2016 through the UW Information Assurance Council. These policies covered the following areas: authentication, data classification, security awareness, incident response, and acceptable use. However, UW System Administration has

not taken significant steps to develop IT policies and procedures to cover other critical areas under the NIST framework and to meet the requirements of the Board of Regents policy to develop a comprehensive IT security program.

In response to our institution-specific recommendations from prior years, we found institutions were working to address the concerns we noted in our prior audits in several areas. For example, institutions were implementing password controls in an effort to comply with UW System Administration policies and procedures. However, many of these corrective actions were completed late during FY 2016-17, and we also identified new areas of concern. We determined that the detailed results of our review were too sensitive to communicate publicly. Therefore, we communicated these results in confidential interim memoranda to the institutions involved.

In addition, UW System Administration staff indicated that UW System Administration's Office of Internal Audit is in the process of performing IT audits at each UW institution to test compliance with UW System Administration IT security policies and procedures. Finally, UW System Administration indicated that it is in the process of developing procedures to assess the overall level of protection provided for UW systems and data. UW System Administration indicated that procedures will be implemented by December 2017.

***Questioned Costs:***

None.

***Context:***

We reviewed UW System's new IT security policies and procedures and assessed them in comparison to NIST standards. We interviewed the Vice President for Administration, the Chief Information Officer, and the Chief Information Security Officer for UW System Administration. We tested various IT controls at several UW institutions. We did not audit the IT security policies and procedures at all UW institutions or the IT controls over all computer applications used by the institutions. However, we believe there is a potential that similar weaknesses may exist at those institutions or in those applications that we did not review.

***Effect:***

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

Weaknesses in IT security policies, procedures, and controls increase the risk that unauthorized or erroneous transactions could be processed or changes could be made to accounting, payroll, and student data. In addition, failure to provide an appropriate level of protection for UW systems and data increases the risk that personally identifiable information could be accidentally or maliciously exposed. Finally, ineffective or inconsistent general IT controls may lead to increased risks of cyberattacks and loss of data or intellectual property, which could lead to a significant financial loss.

**Cause:**

UW System Administration, working with the UW Information Assurance Council, has not agreed on the next areas of systemwide IT security policy and procedure development. The resources and time needed by the institutions to implement the current IT security policies and procedures were noted as reasons for delays in the further development of systemwide IT security policies and procedures.

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

**☑ Recommendation**

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*In addition to recommendations we made to individual University of Wisconsin institutions, we recommend UW System Administration continue to work with the UW Information Assurance Council and individual institutions to:*

- *continue development and maintenance of a comprehensive IT security program, including developing systemwide IT security policies and procedures across the remaining critical IT areas as recommended by National Institute of Standards and Technology publications;*
- *provide guidance and training to the institutions regarding information technology security policies and procedures, as needed;*
- *assist the institutions in implementing timely corrective actions related to our institution-specific recommendations; and*
- *complete development of and implement procedures for assessing the level of protection provided for UW systems and data.*

**Response from the University of Wisconsin System:** UW System Administration agrees with the recommendations.

**Corrective Action Plan from the University of Wisconsin System:** UW System Administration agrees with the assessment that additional steps should continue to be taken to develop IT policies and procedures to cover other critical areas under the NIST framework and to meet the requirements of the Board of Regents policy to develop and maintain a comprehensive information security program. UW System Administration will work with the UW Information Assurance Council to address the recommendations as follows:

Action Item	Anticipated Date
Continue development and maintenance of a comprehensive IT security program including developing systemwide IT security policies and procedures across the remaining critical IT areas as recommended by National Institutes of Standards and Technology publications	
Develop a UW System Information Security Program document, accompanied by a 12-month work plan.	April 30, 2018
Create additional systemwide, NIST-based information security policies to support the Information Security Program. Include in the 12-month work plan the next set of policies to be developed.	Based on Information Security Program schedule
Provide guidance and training to the institutions regarding information technology security policies and procedures, as needed	
Develop documentation which provides comprehensive guidance to all UW institutions on suggested methods to implement information security policies and procedures.	April 30, 2018
Conduct monthly reviews, during which UW System institutions will share best practices, identify ways to most effectively use available resources, as well as receive guidance from UW System on resources which can be used to implement policies.	January 30, 2018 (start date)
Assist the institutions in implementing timely corrective actions related to our institution-specific recommendations	
Engage monthly with the UW System institutions, advising them of potential ways to address audit recommendations and confirming progress as planned. Lead in aligning resources with institution priorities to address audit recommendations.	January 30, 2018 (start date)
Complete development of and implement procedures for assessing the level of protection provided for UW systems and data	
Complete external UW System Information Security Assessment to establish a baseline for assessing the level of protection provided for systems and data.	March 30, 2018
Use results of external Information Security Assessment to establish an order of priority in which to address deficiencies of data and systems protection, across UW System institutions and consistent with the Information Security Program.	April 30, 2018
Provide an advanced General Data Protection Regulation readiness assessment to assist UW System institutions with awareness of the regulations; actions to comply with the regulations; and assessments to monitor progress.	June 30, 2018
Establish an ongoing program to assess the level of protection provided for UW systems and data.	June 30, 2018



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## **Appendix ■**

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Appendix

**Summary of UW System Unrestricted Program Revenue Balances  
by Level of Commitment**

FY 2016-17 Ending Program Revenue Balance

Institution	Obligated	Planned	Designated	Reserves	Undocumented (Discretionary)	Total
Madison	\$ 89,653,512	\$ 189,454,524	\$ 19,302,650	\$ 38,320,085	\$ -	\$ 336,730,771
Milwaukee	13,557,376	46,237,505	24,065,797	4,500,000	-	88,360,678
Eau Claire	6,906,849	26,202,779	9,157,207	4,517,888	1,356,928	48,141,651
Green Bay	520,130	7,043,815	6,939,994	5,859,616	244,800	20,608,355
La Crosse	7,162,094	14,435,776	7,093,992	635,673	78,010	29,405,545
Oshkosh	10,515,421	13,519,442	988,632	3,157,735	-	28,181,230
Parkside	1,519,425	9,170,070	1,419,295	-	2,070,575	14,179,365
Platteville	11,138,229	15,535,087	2,477,654	3,000,000	59,899	32,210,869
River Falls	8,163,888	12,280,451	153,554	942,751	192,088	21,732,732
Stevens Point	8,578,315	8,065,661	2,173,581	2,419,493	1,656,978	22,894,028
Stout	8,654,293	7,832,290	783,879	7,058,720	1,079,434	25,408,616
Superior	501,163	4,429,094	102,742	948,269	1,386,271	7,367,539
Whitewater	1,015,065	27,271,130	4,111,563	6,000,000	2,635,561	41,033,319
Colleges	1,800,442	19,897,880	558,472	632,220	-	22,889,014
Extension	4,471,880	9,662,471	5,050,816	3,286,592	4,408	22,476,167
System Administration	182,804	-	324,276	-	10,991,155	11,498,235
Systemwide	31,469,939	24,766,838	131,766	20,078,399	2,016,456	78,463,398
<b>Total</b>	<b>\$205,810,825</b>	<b>\$435,804,813</b>	<b>\$84,835,869</b>	<b>\$101,357,441</b>	<b>\$23,772,563</b>	<b>\$851,581,512</b>
	24%	51%	10%	12%	3%	100%

Source: Appendix 7 of UW System's FY 2016-17 Report on Program Revenue Balances by Institution and Level of Commitment



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## **Response ■**

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January 30, 2018

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

Dear Mr. Chrisman,

Thank you for the opportunity to review and comment on the Legislative Audit Bureau's 2016-17 financial audit of the University of Wisconsin (UW) System. In particular, we appreciate the opportunity to comment on fiscal year 2016-17 findings, as well as your most recent information technology audit.

The UW System continues to report a stable financial position, as your report confirms. For the second consecutive year, Total Net Position for the UW has declined. Included in the Total Net Position is an overall decline of \$63.4 million, or a 6.5% reduction, in the UW's Unrestricted Net Position (resources not restricted by the federal government, donors, or other external source). These resources continue to be critical resources in supporting the ongoing initiatives as detailed in 2020FWD, the UW System's strategic framework.

Likewise, the UW System is committed to being responsible stewards of its information technology systems and data. In 2017, the UW System approved and focused on continued implementation of detailed information security policies and procedures that address authentication, security awareness, data classification, incident response, and acceptable use. The UW System has developed a plan for achieving the objectives and requirements within these policies, and looks forward to sharing our progress with the Joint Legislative Audit Committee by August 31, 2018.

Thank you again for the opportunity to respond and for the time and effort provided by the audit team.

Sincerely,

A handwritten signature in black ink that reads "Ray Cross".

Ray Cross  
President

cc: Sean Nelson, UW System Vice President for Finance