

Illinois Auditor General Frank Mautino



State Internal Audit Advisory Board

October 2016

Financial/Compliance Division

- **Statewide Financial Audit**
- **OAG Audit Guide Update**
- **Matters of Emphasis for FY16 Engagements**
- **GASB Statements**
- **Risk-Based Auditing**

Statewide Financial Audit

- **First audit was in 1981**
- **FY16 is the 36th Audit**
- **Goal to complete audit and issue opinion by December 31st each year**
- **Last time we were able to meet the goal was FY99**
- **It only takes a problem at one major State agency to impact completion of audit, and we have had this situation with one or more agencies for the past 16 years**

Independent Auditors' Report

- **Emphasis of Matter Section**
- **Included when:**
 - **Required by GAAS, or**
 - **Included at Auditors' Discretion**

Emphasis of Matters for FY15 Audit

- **Item No. 1:** “As discussed in Note 2 to the financial statements, the financial statements have been **restated** as of July 1, 2014 **for** prior year errors **and** the implementation of GASB statement number 68, Accounting and Financial Reporting for Pensions, an amendment to GASB statement number 27. Our opinion is not modified with respect to this matter.”

Emphasis of Matter

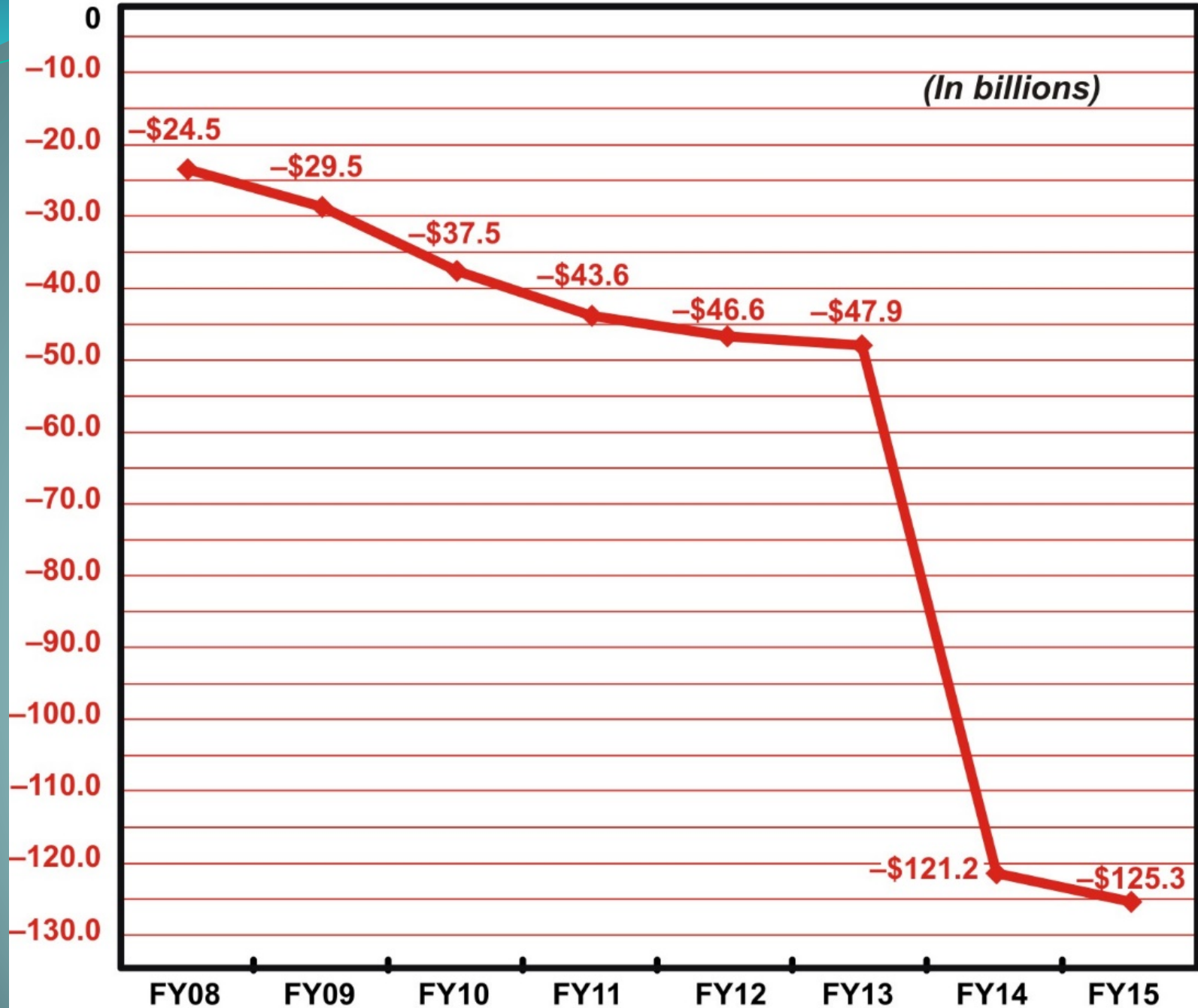
- **Item No. 2:** “The deficit for net position of governmental activities in fiscal year 2015 continued to increase by \$4,095,908,000 at June 30, 2014, from \$121,211,269,000 at June 30, 2014, as restated, to \$125,307,177,000 at June 30, 2015. This **deficit**, which is presented on an **accrual basis**, is the **excess** of total liabilities and deferred resources **over** total assets and deferred outflows of resources **and represents a deferral of current and prior year costs to future periods.** Our opinion is not modified with respect to this matter.”

Past 10 years

- **During the past 10 years the Net Position of Governmental Activities has gone from a deficit of \$18.3 billion in FY06 to \$125.3 billion in FY15.**
- **Approximately \$72 billion of the reported deficit is attributed to the implementation of GASB Statement No. 68 in FY15.**

DEFICITS FOR NET POSITION OF GOVERNMENTAL ACTIVITIES

(In billions)

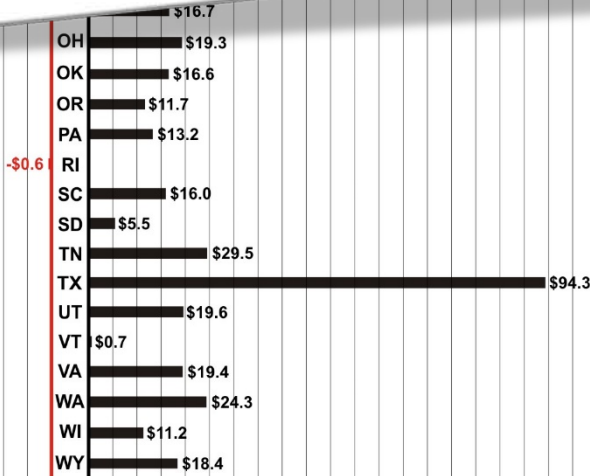
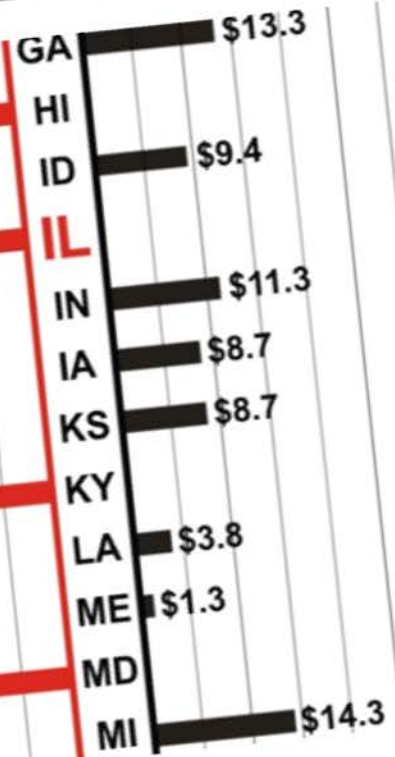


STATE COMPARISON OF NET POSITION OF GOVERNMENTAL ACTIVITIES FOR FY15

-\$125.3

AK

-\$3.1



-\$130 -\$120 -\$110 -\$100 -\$90 -\$80 -\$70 -\$60 -\$50 -\$40 -\$30 -\$20 -\$10 \$0 \$0 \$10 \$20 \$30 \$40 \$50 \$60 \$70 \$80 \$90 \$100 \$110 \$120
 (DEFICIT) SURPLUS

Credit Ratings at June 30, 2015

General Obligation Bonds

- **Moody's Investor Services: A3 with a Negative Outlook**
- **Standard and Poor's: A- with a Negative Outlook**
- **Fitch: A- with a Negative Outlook**

Credit Ratings in June 2016

General Obligation Bonds

- **Moody's Investor Services: down to Baa2**
- **Standards and Poor's: down to BBB+**
- **Fitch: remained at A- with a Negative Outlook**

Summary of Findings in FY 15 Statewide Financial Audit

- **Inadequate Financial Reporting Process (Material Weakness), first reported in FY07**
- **Financial Reporting Weaknesses (Material Weakness), first reported in FY02**
- **Late Payment of Statutorily Mandated Transfers (Noncompliance), first reported in FY09**
- **Debt Covenant Violations (Noncompliance), first reported in FY09**
- **Finances Increase Risks (Material Weakness), first reported in FY10**

OAG Audit Guide Update

- **Not many changes in 2016**
- **Chapter 6 contained some significant new questions that were added to our Preliminary Survey and Audit Planning checklist in January**
- **In summary, the three questions added were 10, 11 and 12. Each pertained to situations where there was not an enacted appropriation for the fiscal year that was under audit.**
- **All three questions were very important to us since we were starting most of our FY16 engagements in the Spring of 2016, and the General Assembly and the Office of the Governor had not come together on a complete budget and appropriation for FY16.**
- **If you have not seen these questions, we would encourage you to take a close look at them in the OAG Audit Guide**

Sharing of OAG Audit Guide

- **Upon request, we will share the OAG Audit Guide**
- **We have been doing this for many years**
- **We continue to believe this is a beneficial and cooperative process between the OAG and Internal Auditors**
- **Just send an e-mail to the OAG manager you are working with to obtain a copy**

Prior to June 30, 2016 Summary

- **State agencies did not have an appropriation or did not have an appropriation to cover the entire operations**
- **Many State agencies had court orders and consent decrees**
- **Some had continuing appropriations**
- **Some operated from locally held funds**
- **Etc.**

Issues and Concerns Prior to June 30, 2016

- **Did agencies enter into contracts with vendors wherein the contract clearly stated that it was subject to the availability of appropriations, however, the agency **did NOT** have an appropriation?**

Questions

- **Is the contract effective? If so, when? Void? Voidable?**
- **Did the agency allow the contractor to work and send in periodic billings even though the agency had no legal authorization without an appropriation?**
- **Was the agency in a position where it could not forward a voucher to the Office of the State Comptroller for payment because the Comptroller could not make a payment without an appropriation?**

Questions

- **Were our auditors in a position where they could not test expenditures since a voucher has not been processed by the Office of the State Comptroller and a warrant had not been issued?**
- **If an appropriation did not exist, were the contracts that had been entered into an actual legal liability of the State of Illinois?**

Questions

- **What are the legal ramifications for the agency personnel and the State?**
- **What guidance would the Office of the State Comptroller provide to State agencies for financial reporting?**
- **What position would the Office of the Attorney General take?**

Questions

- **What position would the courts take if the matters were litigated by the vendors who did not get paid?**
- **What position would the auditors take?**
- **Would the OAG be in a position to issue auditor reports that did not have a “DISCLAIMER OF OPINION” or a “MODIFIED OPINION”?**

What happened on June 30, 2016

- **General Assembly and the Governor took action on the budget and appropriation matters related to both FY16 & FY17.**
- **A bill was signed into law. Public Act No. 099-0524.**
- **Certain Articles pertained to FY16**
- **Certain Articles pertained to FY17**
- **Some Articles pertained only the first 6 months of FY17**
- **While the State law pertaining to appropriations did not supersede Court Orders, it did allow for FY17 appropriations to be used for prior year obligations.**

Questions and Answers from the OAG Perspective

- Was the OAG Relieved? – **YES**
- Did all the problems go away? – **NO**
- Could the OAG move forward on the FY16 audit engagements – **YES**
- Did the State Law include specific language or lay out provisions which would begin to address the **DETERIORATING FINANCIAL CONDITION** of the State of Illinois? - **NO**

Questions and Answers from the OAG Perspective

- **Did the Public Act provide State agencies and the Office of the Comptroller a way to move forward with both FY16 and FY17? – YES**
- **Is this the first time the OAG has ever seen anything like this? – YES**
- **Is the OAG still concerned? – YES**
What problems might we run into as we work to complete the FY16 engagements? What will take place after December 31, 2016?

Positives

- **Are there any positives? – YES**
 - 1) **We believe the policy makers understand the State cannot continue to operate the way it has from a fiscal/financial perspective.**
 - 2) **That is, we believe the decision makers will make some structural changes because they understand the current mode of operation cannot continue in perpetuity.**
 - 3) **When might this happen and what changes will occur? We don't know.**
 - 4) **Key is understanding that the problem exists and must be addressed.**

Issues we are focusing upon

- **Appropriation Schedules (different scenarios with different language and note disclosures)**
- **Alternative Financing Arrangements (IFA, CMS with VPP & VSI program)**
- **Interest Costs to State because of continuing cash flow problems**
- **FY16 costs being paid from FY17 appropriations**
- **Fund Deficits and Cash Flow Problems**

Footnote 18 of FY15 CAFR Excerpts

- The State's General Fund, from which a significant portion of day to day operating expenditures are paid, has a **GAAP deficit aggregating \$6.853 billion** at June 30, 2015.
- This deficit results **from spending in excess of revenues recognized.**
- With respect to "Cash Flow Deficits": As of June 30, 2015, transactions totaling \$4.646 billion that had been approved for payment by the State **remained unpaid** at year end **due to** the State's **cash flow difficulties.**
- Of this total, \$167.422 million related to intra-governmental transactions and \$1.747 billion related to statutorily mandated transfers, the latter of which represent **noncompliance with State law.** The **majority** of these transactions **were payable** from the General Revenue Fund.

Single Audit Matters

- **One of the problems on some of the component unit audits (i.e. University audits) is the issuance of Management Decision Letters from federal agencies within 6 months of the issuance of the Single Audit Report.**
- **This is frustrating for the Universities and it also impacts the audit process.**
- **Sometimes the letter(s) are received by the auditee; however, they are not then given to the auditors in a timely fashion.**
- **Today, I am asking for your assistance in helping ensure that once the University receives the MDL to help see that the OAG auditors get the letter in a timely fashion.**

New GASB Statements FY 16

- **No. 72: Fair Value Measurement and Application**
- **No. 76: Hierarchy of GAAP for State and Local Government**

GASB Statements FY17

- **No. 73: Accounting and Financial Reporting for Pensions and Related Assets that are not within the scope of Statement No. 68, along with amendments to certain provisions of Statements No. 67 and 68.**
- **No. 74: Financial Reporting for Postemployment Benefit Plans Other than Pension Plans**

GASB Statements FY18

- **No. 75: Accounting and Financial Reporting for Postemployment Benefits Other than Pensions.**
This statement will have a very large dollar impact on the amount that will be reported on the face of the financial statements.
- **Current GAAP requires only note disclosure.**
- **The actuarial liability amount that was disclosed in the FY15 financial statement note No. 17 was \$33.1 billion with no assets. Thus, the unfunded actuarial liability was \$33.1 billion.**

Risk-Based Auditing

- **Some of you have asked the OAG about Risk-Based Auditing.**
- **Our response has been consistent and we do not have a problem with risk-based auditing.**
- **The OAG uses risk-based auditing in planning and performing audit work.**
- **The OAG understands your professional Internal Auditing Standards address this topic.**
- **The OAG understands the requirements set forth in the State Fiscal Control and Internal Auditing Act.**

Information Systems Audits Division

- **DoIT**
- **ERP**
- **Protecting Personal Information**
- **Cloud Computing**





- Effective July 1, 2016 – DoIT was created.
- 50+ agencies, boards, and commissions are included in the consolidation.
- DoIT Responsibilities:
 - Consolidate all functions (infrastructure, systems, applications, data, and personnel) at all agencies under the Governor’s jurisdiction.
 - Modernization – drive efficiency and service delivery
 - Develop and implement data security and interoperability policies and procedures that protect data that are confidential, sensitive, or protected from disclosure.

Cybersecurity Assessments

- For agencies in the Executive branch, the assessments will consist of three phases:



- Phase 1 – Completion of vulnerability scans of your technical environment to identify vulnerability which could be exploited by attackers and the development of remediation plans to address any vulnerabilities;
- Phase 2 – Completion of Information Security Risk Assessments to more fully assess the information security risks faced by your agencies and develop risk reduction plans;
- Phase 3 – Conduct Business Impact Analyses to identify your most critical information technology applications and services and develop resiliency, security incident response and disaster recovery requirements.



ERP System

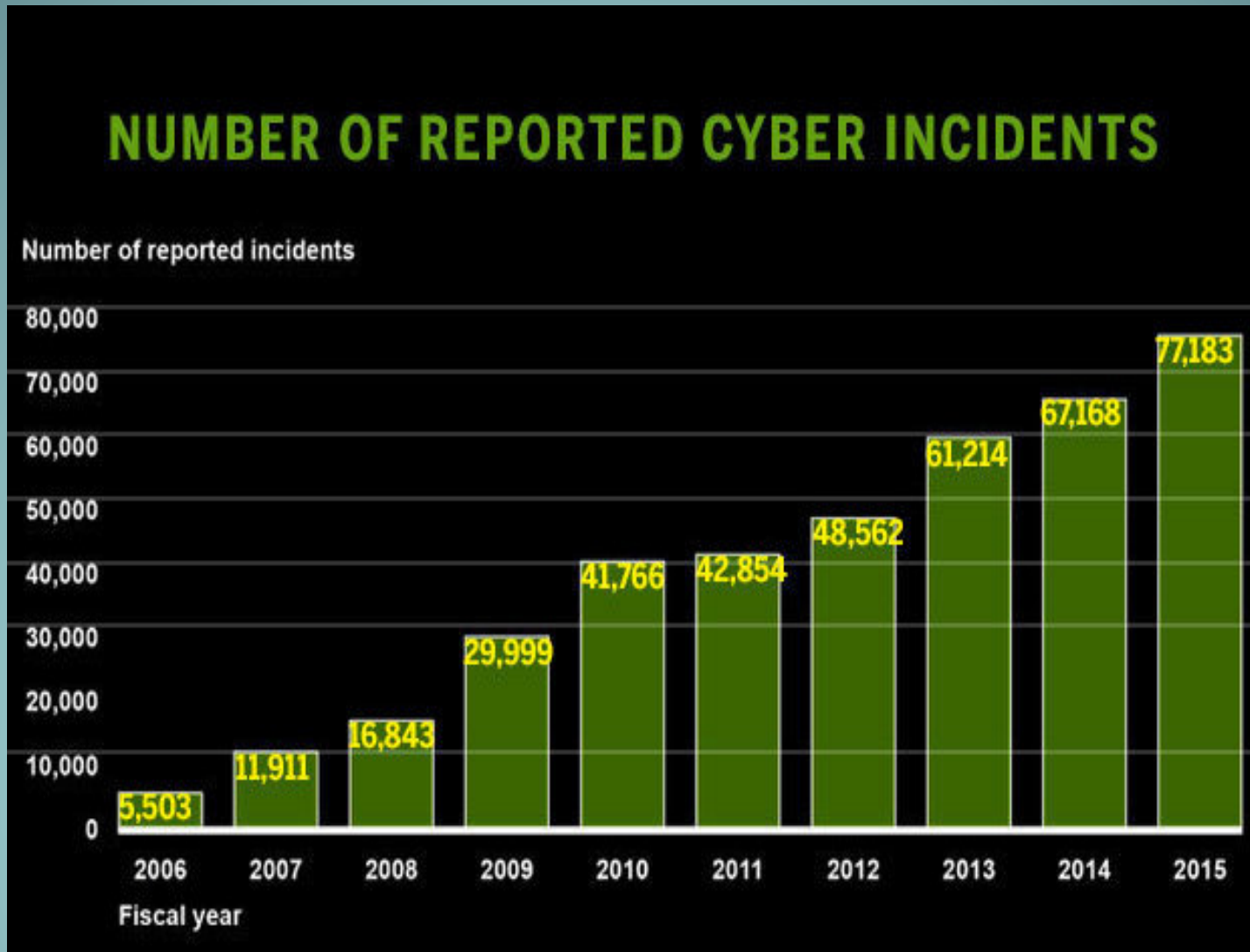


- *Background and objectives - Implementation of a single, Statewide ERP Software Package that will enable greater financial transparency and compliance with applicable laws and regulations.*
- *The ERP effort will deliver a modern, integrated IT platform for the State of Illinois that:*
 - *Consistently delivers financial statements in a timely manner*
 - *Enables Statewide transparency, access to information, and swift decision-making*
 - *Enables State operations to receive a clean audit from the Auditor General*
 - *Is a catalyst for the Statewide transformation of administrative services*
- *The project is continuing to move forward and some financial modules (General Ledger, AR, AP) went into production for pilot agencies (IOC, DES, EPA, and DVA) in October.*
- *The new projected cost is \$282 million over a 6 year period.*
- *Agencies will need to ensure access rights are appropriate and controls are available to promote data integrity, availability, and security.*

- **Who is accountable for addressing audit findings?**
- The accountability for addressing audit findings will not change. Agencies are currently responsible for their respective IT audit and any resulting findings. DoIT will have accountability for its IT audit and any resulting findings.



Since 2006 cyber incidents involving the Federal Government have grown 1,300%



State Board of Elections Breach

- 80,000+ records viewed from the IL Voter Registration System (IVRS)

System Enhancements

- Introduced enhanced password complexity requirements.
- Mandated two-factor token login for all users.
- Added password encryption to IVRS.
- Added code to encrypt URL transmissions.
- Daily review of web server and firewall logs.



Protecting Personal Information

Requirements to protect personal information are outlined in laws such as the Personal Information Protection Act (815 ILCS 530), Identity Protection Act (5 ILCS 179), and the federal Health Insurance Portability and Accountability Act (HIPAA).

Additionally, due to the increasing threat of identity theft, we all have the obligation and responsibility to safeguard confidential data that has been entrusted to us.



Findings

- Using email to send confidential Personally Identifiable Information (PII) such as Social Security Numbers (SSN) or Protected Health Information (PHI) over the Internet in clear text.
- Transporting confidential information on laptops or storage devices without utilizing encryption.
- Improper storage or disposal of documents containing confidential information.
- Not ensuring drives are properly wiped and ensuring compliance with the Data Security on State Computers Act (20 ILCS 450)

Recommendations



- Perform a Comprehensive Risk Assessment
- Encrypt
 - Attachments
 - Laptops
 - Jump Drives
- Control and shred confidential documents
- Ensure drives are properly wiped and documented.



Revised - CMS State Surplus Electronics Receiving and Processing Procedures

Data Storage Devices - Data Wiping Data Destruction Procedures

Please note: With exception of state universities, all state entities are required to comply with Illinois Public Act 93-0306 and Public Act 97-0390. These “Acts” compel state agencies to create their own data wiping policies in accordance with the acts. P.A. 97-0390 provides that agencies shall perform data wiping with a minimum of three (3) passes and certify the process.

Data wiping must be done **before** a PC or other data collection devices are transferred, donated, or otherwise **leaves custody of the original agency.**

Cloud Computing

- DoIT is promoting a Cloud First strategy
- 2016
 - 3% of workload in the cloud
- 2019
 - Fully implemented cloud strategy
 - 70% of workload in the cloud



Recommendations

- As data owners, an agency entering into the cloud computing arena should ensure an adequate service level agreement is in place. The agreement should include financial terms and address key system attributes such as:
 - Security - the environment is protected against both physical and logical unauthorized access.
 - Availability - the environment is available for operation and use as committed or agreed.
 - Processing integrity - system processing is complete, accurate, timely, and authorized.
 - Confidentiality - information designated as confidential is adequately protected.
- Agencies should also obtain or perform independent reviews of internal controls associated with outsourced environments at least annually. Any exceptions resulting from the independent internal controls review should be reviewed and assessed for risk.



Performance Audit Division

Performance Auditing

1. Introduction
2. Yellow Book
3. 2016 Audits
4. Audit Resolution
5. Resolution Development
6. Audit Scope
7. Audit Process
8. Report
9. Internal Review
10. Agency Review
11. Time
12. Follow up

Performance Audits

1. INTRODUCTION. How are Performance Audits conducted?

You know about financial, compliance, and IS audits so I will talk about special audits that the OAG does -- called performance audits.

- 5 to 7 performance audits are done in a year.
- Performance audits review how a program (or function) is managed.
- These audits focus on one program/agency and review it in **detail** – i.e., management's responsibilities (e.g., planning, operations, controlling).

Performance Audits

2. **YELLOW BOOK.** These audits are done in accordance with the GAO's **Government Auditing Standards** which direct auditors to review certain areas:
 - Purpose and **goals** of the program, function, or area
 - **Laws** and regulations
 - Internal **controls**
 - Program **operations**, including program monitoring

Performance Audits

3. **2016 AUDITS** – audits released in **2016** include:

1. The ALL KIDS insurance program (1 for FY14, and 1 for FY15).
2. State grants for violence prevention.
3. Procedures for transporting forensic patients.
4. Placement of children who are wards of the State.
5. Operations of the College of DuPage.

Later this year we will release reviews of CTA pensions & State pensions.

- Performance audits also look at **multiple agencies**, such as:
 - Operations of State vehicles at all agencies.
 - Operation of mass transit agencies in Chicago (RTA, CTA, Metra, Pace).
 - Tuition and fee waivers given by all 9 State Universities.
- Now we are in a Twitter world – attention span is shorter.

Performance Audits

4. AUDIT RESOLUTION. How do performance audits start?

- **Requested by the General Assembly** to answer questions they may have.
- Mainly the audit resolution comes from the:
 - House of Representatives/Senate
 - **Legislative Audit Commission**

Performance Audits

5. RESOLUTION DEVELOPMENT. Who writes the audit resolution?

- Primarily resolution is written by **legislative staff**.
- Sometimes we may review -- only for factual questions: i.e., will the audit address the General Assembly's issues?
- We maintain a **neutral** position on all legislative bills or audit resolutions.

Performance Audits

6. **AUDIT SCOPE. What is examined by a performance audit?**

- The audit resolution frames the main questions to answer.
- Some typical areas include:
 - Program planning: goals, objectives
 - Compliance with all legal requirements
 - Internal controls (e.g., policies, procedures), and
 - Program monitoring.

Performance Audits

7. **AUDIT PROCESS.** 3 Phases of a performance audit. Each takes about 1/3 of the audit time (also, designate a contact person to work with us)

1) Survey Phase: Learn about the program being audited.

- 1) Hold **entrance** conference
- 2) Collect **background** information (how it works, organized, reports prepared)
- 3) **Audit plan** (can be 50 pages): identifies issues, tasks, methodology, DCI
- 4) Interview program staff
- 5) Determine **available data** (reports)
- 6) Identify **legal requirements** and review **internal controls**.

2) Fieldwork Phase: Conduct detailed testing.

- 1) Test applicable laws, rules, procedures, internal controls
- 2) Sample case files – often 100 cases

3) Reporting Phase: Draft report

- ✓ Extensive internal review, hold exit review (3 weeks), etc.

Performance Audits

8. REPORT. How are the results presented?

- A full audit contains a synopsis, digest, chapters, and appendix.
- Chapter on each audit area.
 - Chapter 1 begins with “Report Conclusions” that **summarize results**.
 - Other chapters detail the areas examined/tested.
 - The **appendix** contains the audit **resolution, methodology, and agency response**.
 - Released **audit is public** – goes to General Assembly, Governor, and anyone who requested it (is on our web page).
 - **LAC** may hold a hearing to discuss the results of the audit.

Performance Audits

9. INTERNAL REVIEW. Review of audit evidence collected:

- All performance audits go through many levels of internal reviews:
 1. **Team reviews** by the audit supervisor and manager.
 2. **Referencing** – review by a 2nd team of auditors called “referencers”.
 3. **Quality Assurance meeting** – with Auditor General.
 4. **“Face validity”** of full report – checking the report for internal consistency, along with punctuation, grammar, etc. before printing.
 5. **Quality Inspection** – performed after audit is released with results reported to the Auditor General.
- Audits are subject to peer review by other state’s auditors; we also participate and send auditors to other states.

Performance Audits

10. AGENCY REVIEW. Does the agency get to review the draft findings?

- Yes, **draft findings are provided to the agency.**
- Agency has 3 weeks to review and provide written comments.
- During the audit, auditors discuss any missing information with the agency.

Performance Audits

11. TIME. How long does it take to complete a performance audit?

- Typically takes more than **6 months** and involves many steps:
 - Requesting background information
 - Developing an audit plan and getting it approved by OAG management
 - Interviewing program staff
 - Testing internal controls + case files
 - Determining compliance with statutes, rules, policies/procedures
 - Reviewing operations.
- During the audit, all information is confidential.
 - But our workpapers become public information upon release – **tell us any information that needs to be kept confidential** after audit release.

Performance Audits

12. FOLLOW-UP. Does OAG follow up on recommendations in performance audits?

- **Yes**, recommendations are followed up after the audit.
- Results of the follow up are provided to the agency for review and comment, like in a regular audit.
- Status of recommendations is reported to the General Assembly.

Thanks For Your Time

