MANAGEMENT LETTER
OF THE
NEBRASKA STATE COLLEGE SYSTEM

JULY 1, 2005 THROUGH JUNE 30, 2006

Issued on December 12, 2006

STATE OF NEBRASKA
AUDITOR OF PUBLIC ACCOUNTS

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December 12, 2006

Mr. Stanley Carpenter, Chancellor
Nebraska State College System
Board of Trustees
P.O. Box 94605
Lincoln, NE 68509-4605

Dear Mr. Carpenter:

We have audited the basic financial statements of the Nebraska State College System (NSCS) for the fiscal year ending June 30, 2006, and have issued our report thereon dated November 20, 2006. We have also audited the NSCS's compliance with requirements applicable to major federal award programs and have issued our report thereon dated November 20, 2006. In planning and performing our audits, we considered the NSCS's internal controls in order to determine our auditing procedures for the purpose of expressing our opinions on the basic financial statements of the NSCS and to report on internal control in accordance with Office Management and Budget (OMB) Circular A-133 and not to provide assurance on internal control. We have not considered internal control since the date of our report.

In connection with our audits described above, we noted certain matters involving the internal control over financial reporting and other operational matters which are presented below for your consideration. These comments and recommendations, which have been discussed with appropriate individuals at the NSCS Office, Chadron State College (CSC), Peru State College (PSC), and Wayne State College (WSC), are intended to improve the internal control over financial reporting, ensure compliance, or result in increased operational efficiencies.

Our consideration of internal controls and compliance included a review of prior year comments and recommendations. To the extent the situations which prompted the recommendations in the prior year still exist, they have been incorporated into the comments presented for the current year. All other prior year comments and recommendations have been satisfactorily resolved.

More detailed information on our comments and recommendations is provided hereafter. It should be noted this letter is critical in nature since it contains only our comments and recommendations on the areas noted for improvement.

1. Live Data Access

Good internal control includes a proper segregation of functions so no one individual is capable of accessing production files, making modifications to the production files, and placing it back into production.

As part of each programmer's assigned duties for providing technical end-user support, programmers at all three Colleges have update access to live production files of the Student Information System.

Without the proper controls to ensure only valid changes are made, there is an increased risk unauthorized production file changes would occur and go undetected.

This was a prior audit comment in NSCS's past three management letters.

> We continue to recommend NSCS examine its programmer responsibilities in an effort to provide a proper segregation of duties. If the Colleges decide programmers will continue to have access to live data, strong compensating controls should be developed, documented, put in place and monitored to help ensure the completeness and accuracy of the data processed by the College's computer systems. As always, we recognize the cost of providing a segregation of functions must be balanced with the benefits gained.

NSCS's Response: Programmers at CSC and PSC do have access to production files; however, we believe there are compensating controls that help to mitigate internal control issues. The staff in the offices responsible for the functions supported by computer center all receive and review reports, view information on-line, and create reports from the system, thus providing a check of the accuracy of the data. Wayne State College limited live data access to the Director and Assistant Director of Administrative Systems during fiscal 2005-06. Live data access at Wayne State has now been limited to only the Director. The cost of fully implementing the suggested segregation of duties is prohibitive for the NSCS at this time. We will continue to review alternatives we might consider to help address this concern.

2. Bids – Contracts for Consulting Services (Chadron State)

Board Policy 7010 (Purchases; Bids; Public Lettings) states that all purchases of and contracts for services, materials, supplies, or equipment, and all leases of property are to be made "… by a competitive formal sealed bidding process in all cases in which the purchases are of estimated value in the amount of $10,000 or more ...."

Board Policy 7016 (Contracts; Consulting Services) states "… contracts where the fee is estimated to be between $10,000 and $25,000, such contracts shall be approved by the Executive Director and signed by the President and Executive Director. All consulting contracts exceeding $25,000 that are covered under this policy shall be approved by the Board and signed by the President and Executive Director."

One of ten $10,000+ expenditures tested did not go through a competitive, formal sealed bid process and was not signed by the System Office Executive Director. The College had entered into a contract not to exceed $30,500 for the design and production of two 30 second television spots ($10,000) as well as planning, placement, and evaluation of approved television spots with television stations in a broad geographic area ($20,500). The contractor served as a "placement agency" on behalf of the College for ad placement. Payments of $30,006 were made directly to the contactor ($10,000 for their planning, placement, and evaluation and $20,006 for actual billed commercial airtime). The contractor was responsible for then paying the media outlets for their airtime.

When bids are not obtained in accordance with Board policy there is an increased risk the College will not have received the most competitive bid and there is a higher risk of scrutiny from potential competing vendors.

> We recommend the College review current Board purchasing and contracting policies and discuss with the System Office any particular concerns related to contracting for, in particular, media advertising creation and placement in order to ensure future compliance with Board policy, both in fact and appearance.

NSCS's Response: The College had interpreted the purchasing policy different from the auditor's office interpretation. The policy on bidding for consulting services is currently being reviewed by the Vice Presidents for Administration and Finance and by System Office staff for clarification. A proposal will be brought forward to the Board of Trustees for consideration.

3. Donated Library Books (Chadron State, Wayne State)

Board Policy 7002 states, "All library holdings, including books, bound periodicals, microfilms, microfiche, and other items shall be reported at acquisition cost or, if donated, at fair market value at the date of donation."

The Colleges do not account for donated library books in accordance with board policy. Most donated books come from either professors as they retire or from text book company donations. These book donations have not historically been recorded by the Colleges on their financial statements. At Wayne State College over 17,000 donated books have been cataloged since the College library implemented an automated tracking system in 1991.

When donated books are not reported in accordance with Board policy assets reported on the College's financial statements are understated.

> We recommend the College account for all donated library books in accordance with Board policy. We further recommend the Colleges collectively work together to arrive at a reasonable policy for calculating fair market value.

NSCS's Response: The value of donated library books is difficult to determine and immaterial to the financial statements. Some donations are left anonymously at the library and include such items as old textbooks with little or no value. The capitalization policy is currently being reviewed by the Vice Presidents for Administration and Finance and by System Office staff. A proposal will be brought forward to the Board of Trustees to clarify and provide consistency in capitalizing donated library books.

4. <u>Audit Preparedness (Chadron State)</u>

Sound financial reporting requires financial statements be complete, accurate, and prepared in a timely manner.

The College did not have its financial statements and other client prepared workpapers submitted by the September 22, 2006, deadline as agreed upon by the College and the auditors. Several deadline extensions were granted to the College; however, at the start of audit fieldwork on October 23, 2006, numerous audit workpapers had not been completed by the College. Additionally, during audit fieldwork, numerous journal entries were made to the College's financial statements due to oversights in preparation; for example, account payable and prepaid assets had not been accurately recorded, Sparks Building Construction-In-Progress had been omitted, and a bank account had not been recorded as a balance sheet asset.

At each of the Colleges one individual assumes primary responsibility for financial statement preparation. As such, those individuals are extremely vital to the College's financial reporting. We acknowledge that in June 2006 the College had a personnel change in the position responsible for the preparation of the College's financial statements. This change may have been a factor in the College's inability to have their financial statements prepared in a timely and accurate manner; however, it appears the College did not adequately consider and plan for this staffing change.

When financial statements are not prepared in a timely and accurate manner, there is an increased risk of statement errors and/or omissions as well as delays and/or interruptions to audit fieldwork and report issuance.

> We recommend the College implement procedures to ensure that its financial statements, accompanying schedules and supporting workpapers, and all other "prepared by client" workpaper requests be complete, accurate, and delivered to the auditors in a timely manner.

NSCS's Response: Chadron State College experienced turnover in the comptroller position just prior to audit. This provides a significant challenge in not only learning the accounting systems, but in then preparing for audit. We understand the need to have financial statements prepared in a timely manner. The Colleges have been working at developing detailed lists of source documents for accounting/audit work-papers to provide a starting point should someone else need to take over the responsibility for financial statement preparation. Chadron State indicates future years should go more smoothly.

5. <u>Board Approved Fees (Chadron State)</u>

Good internal control requires adequate procedures be in place to ensure rates charged are in agreement with those established and authorized by the appropriate governing bodies.

The College did not charge its capital improvement fee at the Board approved rate for the 2005/2006 academic school year.

When the College submitted its 2005/2006 fee proposal to the Board, a capital improvement fee of $5 per credit hour was requested. On June 9, 2005, the Board unanimously approved a fee schedule setting the College's capital improvement fee at $6 per credit hour. College personnel indicated they were initially unaware that the Board had approved a capital improvement fee rate different from their $5 request. The College charged its 2005/2006 capital improvement fee at $5 per credit hour.

As a result of the College having charged its students $5 per credit hour rather than the $6 per credit hour established by the Board, the College collected approximately $61,493 less in capital improvement fee revenue based on total student credit hours for 2005/2006.

> We recommend the College implement procedures, including a timely review of Board approved rates/fees, in order to ensure all rates/fees are charged in accordance with Board authorization.

NSCS's Response: As noted in the comment, the Chadron State College 2005-06 fee proposal was submitted to the board with a $5 per credit hour capital improvement fee. The Board approved a capital improvement fee of $6 per credit hour. Staff at the College implemented the $5 per credit hour capital improvement fee without realizing the Board had made the change. The impact of the lost revenue was in funding availability to Chadron State for projects. There was no impact on the ability to provide debt service on outstanding obligations. In the future, the College will pull approved rates from the approved Board materials as opposed to relying on the internal documents.

6. <u>Contract Signatures (Peru State)</u>

Good internal control and sound business practice require maintenance of adequate supporting documentation for all expenses, including signed contractual agreements.

The College had a contractual agreement with the College's Foundation for repayment of a loan made by the Foundation to the College for remodeling of the cafeteria area of the Student Union. Although a copy of the contractual agreement was available for review, the contract had not been signed by either the College or the Foundation.

When a contractual agreement is not signed, there is an increased risk that if a dispute were to arise between the parties resolution could be difficult.

> We recommend the College implement procedures to ensure all contractual agreements are signed by all parties and maintained on file for review and inspection.

NSCS's Response: A contract addendum has since been signed by all parties. The contract and the addendum are on file for review and inspection. The APA has reviewed the materials and agree that the addendum has satisfied the issue.

7. Bidding Requirements (Wayne State)

Board Policy 7010 states, "All purchases of and contracts for services, materials, or equipment, and all leases of property shall be made in the following manner, except in emergencies approved by the Board of Trustees Executive Director. 1) By a competitive formal sealed bidding process in all cases in which the purchases are of estimated value in the amount of $10,000 or more; Competitive formal sealed bids are price quotations secured from vendors by means of Quotation Request form. Goods or services for which formal sealed bids are requested are advertised for a minimum of fifteen calendar days. Bids are opened publicly at the time and date specified in the Quotation Request. Facsimile quotes are not allowed during the process."

One of twelve $10,000+ expenditures tested did not go through a competitive formal sealed bidding process. On June 3, 2005, the College entered into a $19,987 written purchase contract with a local car dealer for the purchase of a used 2001 Dodge pickup truck with no evidence of any bids having been obtained prior to the purchase contract. Subsequent to the purchase agreement on June 6, 2005, the College documented two prices (one for a vehicle in Wisconsin and the other in Washington state) from www.AutoTrader.com, an internet website that can be used to research and compare new and used car listings throughout the United States in an effort to have those prices serve as after-the-fact "bids" for compliance purposes.

When bids are not obtained in accordance with Board policy there is an increased risk of scrutiny, including that of potential competing vendors.

> We recommend the college implement procedures to ensure that all purchases are made in accordance with Nebraska State College System Board Policy. Furthermore, bids must be obtained prior to purchase rather than after-the-fact.

NSCS's Response: The College did secure comparable price comparisons but did not initiate formal competitive bidding. The bidding of a used vehicle provides significant challenges to assure the quality of the vehicle purchased and the availability of service and support for the vehicle, once purchased. The NSCS purchasing policies are currently being reviewed to better address this type of purchase. A proposal will be brought forward to the Board of Trustees for consideration.

8. <u>Reconciliation of Bank Records to Nebraska Information System</u>

During the audit of the Comprehensive Annual Financial Report (CAFR) of the State of Nebraska, we noted the absence of a completed reconciliation between the State Treasurer's bank statements and the accounting records on the Nebraska Information System (NIS). This has been an issue for the Department of Administrative Services Accounting Division (State Accounting) for many years. Our previous comments noted monthly reconciliations were not completed in a timely manner and showed significant unknown variances with bank records short compared to accounting records. Although State Accounting continues to work on the reconciliation of bank records to NIS accounting records, we continue to note areas where improvement is needed in the reconciliation process to ensure NIS integrity and operational efficiency.

As of October 31, 2006, State Accounting has developed a very detailed process of analyzing bank activity compared to activity recorded on NIS to identify reconciling items, but continued progress is needed. State Accounting continues to work on reconciliations for the months of June 2005 through June 2006 to determine the reasons for the continuing unknown variances. We have reviewed the reconciliations and noted the month of June 2006 shows an unknown variance of $2,657,411. Again, the reconciliations show bank records short compared to accounting records.

Good internal control requires a plan of organization, procedures, and records designed to safeguard assets and provide reliable financial information. Without a timely and complete reconciliation of bank records to NIS accounting records, there is a greater risk for fraud or errors to occur and to remain undetected.

> We recommend State Accounting continue the reconciliation process to ensure all financial information is correct on NIS. We also recommend, when a consistent cash variance between bank records and accounting records is obtained, State Accounting should submit the shortage amount to the Governor and the Legislature. The Governor and the Legislature should then develop a plan to correct NIS accounting records and resolve the shortage noted.

This issue is the responsibility of State Accounting; however, as the variance has not been identified by fund or agency, this issue directly affects all Nebraska State agencies' financial information and must be disclosed in this report.

NSCS's Response: The reconciliation of the State Treasurer's bank records to the Nebraska Information System (NIS) accounting records is outside of the responsibilities of the Nebraska State College System. We are only able to balance the records within the Nebraska State College System.

Future GASB Standards

The NSCS should review and determine the applicability of the following GASB Statements which may have an effect on the financial statements of the NSCS for the year ending June 30, 2007.

GASB has issued Statement No. 43, *Financial Reporting for Postemployment Benefit Plans Other Than Pension Plans,* effective for fiscal years beginning after December 15, 2006. This Statement establishes uniform financial reporting standards for OPEB plans and supersedes the interim guidance included in Statement No. 26, *Financial Reporting for Postemployment Healthcare Plans Administered by Defined Benefit Pension Plans.* The approach followed in this Statement generally is consistent with the approach adopted in Statement No. 25, *Financial Reporting for Defined Benefit Pension Plans and Note Disclosures for Defined Contribution Plans,* with modifications to reflect differences between pension plans and OPEB plans.

GASB has issued Statement No. 45, *Accounting and Financial Reporting by Employers for Postemployment Benefits Other Than Pensions,* effective for fiscal years beginning after December 15, 2007. This statement provides standards for the measurement, recognition, and display of other postemployment benefit expenditures, assets, and liabilities, including applicable note disclosures and required supplementary information.

The GASB has also issued GASB Statement No. 48, *Sales and Pledges of Receivables and Future Revenues and Intra-Entity Transfers of Assets and Future Revenues*, effective for fiscal years beginning after December 15, 2006. This statement establishes criteria that governments will use to ascertain whether the proceeds received should be reported as revenue or as a liability. The criteria should be used to determine the extent to which a transferor government either retains or relinquishes control over the receivables or future revenues through its continuing involvement with those receivables or future revenues.

This letter is intended solely for the information and use of the Nebraska State College System, management, and Federal awarding agencies and pass-through entities and is not intended to be and should not be used by anyone other than these specified parties.

We appreciate and thank all of the Nebraska State College System employees for the cooperation and courtesy extended to us during the course of the audit.

Sincerely,

Don Dunlap CPA

Don Dunlap
Assistant State Auditor