MANAGEMENT LETTER
OF THE
NEBRASKA STATE COLLEGE SYSTEM

JULY 1, 2007 THROUGH JUNE 30, 2008

Issued on December 16, 2008

NEBRASKA AUDITOR OF PUBLIC ACCOUNTS

Mike Foley
State Auditor

Mike.Foley@apa.ne.gov
P.O. Box 98917
State Capitol, Suite 2303
Lincoln, Nebraska 68509
402-471-2111, FAX 402-471-3301
www.auditors.state.ne.us

December 9, 2008

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, 2008, and have issued our report thereon dated December 9, 2008. We have also audited the NSCS's compliance with requirements applicable to major federal award programs and have issued our report thereon dated December 9, 2008. In planning and performing our audit, 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 of Management and Budget (OMB) Circular A-133 and not to provide assurance on internal control. Internal control and compliance matters required by *Government Auditing Standards* and OMB Circular A-133 were reported in the above reports. The matters disclosed in this letter are not required to be reported in the above reports but are matters for NSCS's consideration. We have not considered internal control since the date of our reports.

As noted above, in connection with our audit, 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.

Also included in this letter is a listing of Governmental Accounting Standards Board (GASB) Statements which may have an effect on future financial statements of the NSCS. These GASB Statements are provided for the NSCS's future consideration.

1. Perkins Loan Grace Period Contacts – *Chadron State College and Wayne State College*

34 CFR Section 674.42 (c) regarding due diligence contacts with Perkins loan borrowers requires an exit interview contact with the borrower as well as a minimum of three separate contacts during a borrower's initial and post-deferment grace periods. Colleges must contact borrowers for the first time 90 days after the commencement of a grace period reminding them of their responsibility to comply with loan terms and provide information consisting of the total outstanding loan amount including principal and interest accruing over the remaining life of the loans well as the date and amount of the next required payment. Colleges must contact borrowers for the second time 150 days after the commencement of a grace period notifying borrowers of the date and amount of their first required payment. Colleges must contact borrowers for a third time 240 days after the commencement of the grace period informing them of the date and amount of the first required payment. Good internal control requires procedures be in place to ensure all required notifications are made in the timely manner outlined in Federal regulations.

Testing of defaulted Perkins loans noted the following:

- *Chadron State College:* Ten of 19 defaulted Perkins loans tested did not have a 90 day grace period contact made to the borrower.

- *Wayne State College:* Three of 26 defaulted Perkins loans tested did not have both 90 and 150 day grace period letters sent prior the start of loan repayment, 1 of 26 defaulted Perkins loans tested did not have a 90 day grace period letter sent prior to the start of loan repayment, and 1 of 26 defaulted Perkins loans tested did not have notification letters sent in an appropriate time period.

In most instances the borrowers had entered their grace period without the Colleges' prior knowledge and at the time the Colleges became aware of the borrower's withdrawal or failure to return, the timing of the 90 day, and in some instances the 150 day, notices had passed. At that time neither the Colleges nor their third party processors sent belated 90 and/or 150 day notices but did send all subsequently required notices.

Borrowers who are not being adequately notified during their grace period of the date and amount of their first required payment may not begin making payments in a timely manner which may translate into an increased risk of loan delinquency. In addition, lack of documented grace period contracts may lead borrowers to dispute their repayment start dates.

This issue was also previously reported in the prior audit report. Subsequent to that report the Colleges implemented procedures adequate to resolve this finding in future defaulted loans.

> We recommend the Colleges ensure compliance with Federal regulations which require three separate, distinct grace period contacts with Perkins loan borrowers during their initial and post-deferment grace periods.

NSCS's Response: As noted, the Colleges have implemented new procedures and will continue to work to come into compliance with the interpretation of the Federal financial aid regulations. In Chadron, a realignment of duties has been made with a new employee assigned to oversee the Perkins Loan program.

2. National SMART Grant Eligibility – *Chadron State College*

34 CFR 691.15 states "A student is eligible to receive a National SMART Grant for the third or fourth academic year of his or her eligible program." 34 CFR 691.62 states, "The maximum National SMART Grant Scheduled Award for an eligible student may be up to $4,000 for each of the third and fourth academic years of the student's eligible program." US Department of Education guidance (GEN-06-18) regarding implementation of "academic year" definition stated that for the 2007-2008 award year they would consider a student's fourth academic year to end when the student had completed the minimum number of credits required for completion of an academic program, as published in the institution's official academic publications.

Two of three students tested who received a SMART grant award during the 2007-2008 award year were ineligible for such awards based on their academic year status. In both instances, the students received $2,000 SMART awards despite having already completed their fourth academic year and having earned more hours than required for graduation. Subsequent to this finding the College reviewed 100% of 2007-2008 SMART grant awards and determined six awards, totaling $13,820, had been ineligible based on academic year completion.

When National SMART grants are not awarded in compliance with Federal grant requirements there is an increased risk of student ineligibility.

> We strongly recommend the College strictly enforce student financial aid eligibility criteria. We further recommend the College, particularly when implementing new student financial aid programs, have a second knowledgeable person double-check the completeness and accuracy of the packaged aid based on program requirements.

NSCS's Response: When this was brought to their attention, Chadron State College financial aid staff reviewed 100% of the 2007-08 grant awards. The noncompliant awards were brought into compliance. Financial Aid staff is implementing a new internal control system for the awarding of financial aid which will allow additional personnel to verify compliance.

3. <u>Federal Family Education Loan (FFEL) Refund Calculation – *Peru State College*</u>

34 CFR 668.22 states "When a recipient of Title IV grant or loan assistance withdraws from an institution during a payment period or period of enrollment in which the recipient began attendance, the institution must determine the amount of title IV grant or loan assistance that the student earned as of the student's withdrawal date…" The Student Financial Aid (SFA) Handbook also states "If a student earns a passing grade in one or more of his or her classes offered over an entire period, for that class, an institution may presume that the student completed the course and thus completed the period. If a student who began attendance and has not officially withdrawn fails to earn a passing grade in at least one course offered over an entire period, the institution must assume, for Title IV purposes, that the student has unofficially withdrawn, unless the institution can document that the student completed the period."

For one of fourteen SFA refunds tested, a refund calculation was completed despite the student having earned one "F" during the semester. As a result, a total of $947 in FFEL funds was incorrectly returned by the institution.

When SFA refunds are not calculated in accordance with Federal regulations there is an increased risk of unrequired returns of earned SFA.

> We recommend the College implement procedures to ensure that return of Title IV funds occurs only in cases in which a student has actually withdrawn or dropped out.

NSCS's Response: Peru State College will implement procedures to ensure that return of Title IV funds occurs only in cases in which a student has actually withdrawn or dropped out.

4. <u>Password Complexity – *Chadron State College, Peru State College, and Wayne State College*</u>

Best business practices include a minimum password length of eight characters, a password history rule that does not allow the use of the same password in a 12-month period, and a password expiration policy of 30-90 days depending on the criticality of the application.

During testing of password complexity we noted the following:

- *Chadron State College:* SIS users with update access were required to change their password every 180 days. Read-only users were never required to change their passwords.

- *Peru State College:* The minimum password length for SIS was set to five characters. SIS maintained a password history of two passwords, which was the system default established in 1995. SIS users were required to change their password every 90 days.

- *Wayne State College:* The minimum password length for SIS was set to six characters. The Director of Administrative Systems had full update access to SIS and was only required to change passwords every 90 days while all other users were required to change their passwords every 120 days.

Without strong password rules there is an increased risk usernames and passwords could be compromised and used to view or process unauthorized information.

> We recommend the Colleges establish a minimum password length of eight, consider changing the password expiration to 30-60 days, and increase password history so that a user cannot use the same password in a one-year period.

NSCS's Response: The current student information system is limited in this regard. The Colleges are implementing a new student information system. The new system will provide for more complex password schemes.

5. Backup Tapes – *Chadron State College and Peru State College*

Sound business continuity and disaster recovery practices include the safeguarding of critical application backups at an offsite location.

During our review of disaster recovery practices we noted the following:

- *Chadron State College:* Weekly backup tapes were stored on campus in the Library, approximately 100 yards from the datacenter.

- *Peru State College:* Daily backup tapes (Monday-Thursday) were stored on a table in the datacenter. The tapes were subject to environmental hazards such as fire and water. If the daily tapes were destroyed, the previous weekly tape, stored at a local bank, would be the most current backup available for restoration.

When backup tapes are not adequately protected, there is an increased risk of data loss which cannot be easily restored electronically.

> We recommend the Colleges implement procedures to safeguard backup tapes from environment threats to the datacenter.

NSCS's Response: At Chadron State, a new storage location is being investigated that will provide limited access. Peru State College took immediate action upon being notified of the issue in June. The College purchased a fireproof safe specifically designed for safekeeping of data tapes and began to use it for all daily backups. Peru State continues to store weekly backup at the local bank and update them regularly.

GASB Standards for the NSCS's Future Consideration

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, 2009:

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 issued GASB Statement No. 49, *Accounting and Reporting for Pollution Remediation Obligations,* effective for fiscal years beginning after December 15, 2007. This Statement will enhance comparability of financial statements among governments by requiring all governments to account for pollution remediation obligations in the same manner, including required reporting of pollution remediation obligations that previously may not have been reported.

The GASB has issued GASB Statement No. 51, *Accounting and Financial Reporting for Intangible Assets,* effective for fiscal years beginning after June 15, 2009, with provisions for this statement generally required to be applied retroactively. The objective of this Statement is to establish accounting and financial reporting requirements for intangible assets to reduce inconsistencies in the accounting and financial reporting of intangible assets among state and local governments, particularly in the areas of recognition, initial measurement, and amortization and thereby enhance the comparability of the accounting and financial reporting of intangible assets among state and local governments.

The GASB has issued GASB Statement No. 52, *Land and Other Real Estate Held as Investments by Endowments,* effective for fiscal years beginning after June 15, 2008, with provisions for this statement generally required to be applied retroactively. This Statement establishes consistent standards for the reporting of land and other real estate held as investments by essentially similar entities. It requires endowments to report their land and other real estate investments at fair value. Governments also are required to report the changes in fair value as investment income and to disclose the methods and significant assumptions employed to determine fair value, and other information that they currently present for other investments reported at fair value.

The GASB has also issued GASB Statement No. 53, *Accounting and Financial Reporting for Derivative Instruments*, effective for fiscal years beginning after June 15, 2009. This Statement addresses the recognition, measurement, and disclosure of information regarding derivative instruments entered into by state and local governments. A key provision in this Statement is that derivative instruments covered in its scope, with the exception of synthetic guaranteed investment contracts (SGICs) that are fully benefit-responsive, are reported at fair value. The changes in fair value of derivative instruments that are used for investment purposes or that are reported as investment derivative instruments because of ineffectiveness are reported within the investment revenue classification. Alternatively, the changes in fair value of derivative instruments that are classified as hedging derivative instruments are reported in the statement of net assets as deferrals.

This letter is intended solely for the information and use of management, the Board of Trustees, others within the Nebraska State College System, and the appropriate Federal and regulatory awarding agencies, and pass-through 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,

Signed Original on File

Don Dunlap
Assistant Deputy Auditor