NEBRASKA AUDITOR OF PUBLIC ACCOUNTS

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December 9, 2008

The Board of Regents
University of Nebraska

Ladies and Gentlemen:

We have audited the financial statements of the University of Nebraska (the University) for the year ended June 30, 2008, and have issued our report thereon dated December 9, 2008. In planning and performing our audit of the financial statements of the University of Nebraska, in accordance with auditing standards generally accepted in the United States of America, we considered the University's internal control over financial reporting (internal control) as a basis for designing our auditing procedures for the purpose of expressing our opinion on the financial statements but not for the purpose of expressing an opinion on the effectiveness of the University's internal control. Accordingly, we do not express an opinion on the effectiveness of the University's internal control.

During our audit, we noted certain matters involving internal control and other operational matters that are presented for your consideration. These comments and recommendations have been discussed with the appropriate members of management and their formal responses have been incorporated into this report from the attached letter. These comments and recommendations are intended to improve internal control or result in other operating efficiencies and are summarized as follows:

## 1. University Internal Audit Organization

Generally Accepted Government Auditing Standards (GAGAS) paragraph 3.16 states "Certain federal, state, or local government entities employ auditors to work for management of the audited entities. These auditors may be subject to administrative direction from persons involved in the entity management process…Under GAGAS, a government internal audit function can be presumed to be free from organizational impairments to independence for reporting internally if the head of the audit organization meets all of the following criteria:

a. is accountable to the head or deputy head of the government entity or those charged with governance;
b. reports the audit results both to the head or deputy head of the government entity and to those charged with governance;

c. is located organizationally outside the staff or line-management function of the unit under audit;
d. has access to those charged with governance; and:
e. is sufficiently removed from political pressures to conduct audits and report findings, opinions, and conclusions objectively without fear of political reprisal."

GAGAS paragraph 3.17 also states "The internal audit organization should report regularly to those charged with governance."

GAGAS paragraph 3.19 also states "The internal audit organization should document the conditions that allow it to be considered free of organizational impairments to independence for internal reporting…"

University of Nebraska employees performing an internal audit function are not part of a single internal audit organization and are not free from organizational impairments.

The Director of Internal Audit is part of the University of Nebraska—Central Administration's Office of the Vice President for Business and Finance. The Director of Internal Audit reports directly to the Vice President for Business and Finance, not the Board of Regents. The APA believes this structure limits the independence of the director of Internal Audit and may influence the nature and type of work performed.

University management agrees with the change in reporting structure and has proposed a new organizational structure that will be presented to the Board's Audit Committee at their regularly scheduled meeting in January 2009. If recommended by the Audit Committee, the full Board would likely consider approval of the new organizational structure at their regularly scheduled meeting in March 2009. This revised organizational structure removes the Director of Internal Audit from Central Administration's Office of the Vice President for Business and Finance and makes the position responsible for reporting directly to the Board. We understand this restructuring would give the Director of Internal Audit the continued authority to perform audit work at any of the University's campuses.

The University's individual campuses also have employees who perform an internal audit function for their specific campus. Generally these individuals report to a member of the campus' Vice Chancellors for Business and Finance office and would not be considered free from organizational impairment. Under the proposed organizational structure noted above, their work would also be separate from the work performed by the Director of Internal Audit.

We believe there may be a benefit to the University to organize their internal audit function into a single, centralized internal audit organization reporting directly to the Board of Regents. We believe the single organization would be able to more effectively utilize University resources, coordinate projects, and ensure no duplication or overlap of work by the individual employees performing internal audit work.

When University of Nebraska employees performing internal audit functions are not independent there is a greater risk internal audit staff may be subject to pressures limiting the nature or type of work they perform.

> We recommend that the University of Nebraska Board of Regents consider restructuring those individuals performing an internal audit function into a single internal audit organization. We also recommend the internal audit organization be free from organizational impairments by meeting the criteria in GAGAS and reporting directly to the Board of Regents. Further, we recommend that the internal audit organization document the conditions allowing it to be considered free of organizational impairments.

*University's Response: The University's response to the internal audit function recommendation is printed below. The response was provided after the internal audit comment was subsequently added to a draft copy of the management letter.*

*The University agrees with the proposed change in reporting structure Central Administration Director of Internal Audit as it formalizes the informal structure that has existed for a period of time. The internal auditor, as well as internal audit on the campuses, has long enjoyed unrestricted access to the audit committee. In fact, when the Board of Regents started its separate audit committee at the advent of Sarbanes Oxley in 2002-2003, Audit Committee chairman McClurg, stated the following in a memo dated November 3, 2003 which was sent to all of the internal audit/operations analysis professionals at the University.*

> *"Any changes in employment or responsibilities of University of Nebraska internal auditors will be approved by the Chairperson of the Audit Committee prior to the action being taken."*

> *"If at any time, you feel your professional judgment is being compromised or should you feel the need to obtain outside feedback on an issue, do not hesitate to contact any of us. The committee members and their phone numbers and mailing addresses are as follows….."*

*In addition to the statements above, in each audit committee meeting, there are separate executive sessions with internal and external auditors, without management present, to help ensure that the auditors are being given unrestricted access to information to allow them to discharge their responsibilities.*

*With regard to the comment on changes in reporting for campus-based auditors, we agree with the comment that seeks to formalize reporting to the Chancellors of the campuses and to the audit committee. Again, the 2003 memo cited above was designed to make clear that the campus-based auditors/operations analysis groups enjoyed access to the audit committee and should report any instances where they felt their independence was being compromised to the committee. The University also agrees that greater coordination and of efforts and collaboration between the central administration Director of Internal Audit and the campus-based units would increase efficiencies and take maximum advantage of those resources.*

## 2. <u>Journal Entry Processing</u>

All campuses of the University of Nebraska have a large number of individuals with the ability to prepare and post journal entries on SAP, the University's accounting system, without a review or approval by anyone else. During fiscal year ended June 30, 2008 the University had 569 individuals who prepared and posted over 41,000 journal entries in the amount of $14.5 Billion. The University as a whole has 946 individuals who have access to prepare and post journal entries. Of those 946 individuals, 377 individuals did not post any journal entries during the fiscal year, and 159 individuals posted 9 or less journal entries throughout the fiscal year. Per discussion with University Management, most individual who prepare and post journal entries are accounting clerks within the various Departments. University Management believes these individuals need the ability to perform this function. In addition, University Management indicated an after the fact review of journal entries is made at various levels, however, this review is generally not required or documented.

Good internal control requires a documented review and approval of journal entries before they are posted to the General Ledger. Good internal control also requires the access to process journal entries be given only to those individuals who routinely need to post journal entries.

When a large number of individuals can prepare and post journal entries without a documented review and approval there is a greater risk erroneous or inappropriate journal entries could be made and go undetected.

> We recommend the University establish a policy that all journal entries be reviewed and approved by someone other than the person preparing the journal entry prior to it being posted in SAP. This approval should be done by an individual with the knowledge to understand the journal entry, to ensure it is properly supported, and to determine it is a proper journal entry for the University. We also recommend the University review the need for 946 individuals having access to process journal entries on SAP.

*University's Response: The University will examine the number of users authorized to enter journal entries to ensure those who require access have the ability to enter journal entries.*

*While the University understands the auditors comment and will examine the number of users, the volume statistics cited may mistakenly lead the reader to believe the system is not functioning properly. In addition, there are other controls in the internal control structure which mitigate the condition cited. The following paragraphs are designed to give additional background to the observation forepart of the recommendation.*

*Part of the reason there are a large number of users and entries is because, unlike traditional or less robust accounting systems, SAP is a decentralized system that gathers data at a granular level and pushes information to the fingertips of the ultimate user. Our number of users may appear outsized at first blush, but the utility of the system is diluted if the ultimate user, say a Dean or Director who normally or infrequently would make entries, cannot fully access the system and examine his/her accounts and make corrections.*

*Secondly, while 41,000 entries and $14.5 billion of journal entries may seem large to the uninitiated, the complexity of the enterprise and the different "cuts" at the same information required as part of everyday activities drive a substantial amount of this volume. A couple of examples may help. Many of the entries relate to year end closings and reversals which are confined to a relatively few persons. Other entries relate to cost accounting wherein costs are reallocated to departments and projects, which is critical as the department and project level is the point where budgetary controls exist. The University wants these allocations and resultant journal entries to be done in SAP versus creating additional shadow systems. Another driver is that accounting information, often the same information, must be broken out two or three ways so separate accountings can be provided to Federal, State and other organizations. Within this as background, the volume becomes more understandable.*

*Lastly, the controls offered by project and departmental budgets are a strong detective control that partially offsets the preventive control contained in the observation. In addition, the on-line review of transactions by end users, including deans and directors, helps to ensure costs are properly posted. If improper costs are posted to a cost center or project, they should be detected on a monthly or even real time basis.*

**APA Response: We understand that SAP is a decentralized system and concur that there should not be any additional shadow systems created to process journal entries. Our two main concerns and recommendations relate to the number of users and review of journal entries.**

**First, there are a significant number of individuals with the ability to process journal entries that do not appear to do so on a regular basis. Specifically, there were 159 individuals that processed nine or fewer transactions, and 377 individuals who posted no journal entries. We recommend access for these low volume individuals be reviewed to ensure only those who are required to perform journal entries on a regular basis have access to do so.**

**Last, we believe the University's current detective or reactive control model could be strengthened to a proactive model with a real-time, work-flow review and approval process prior to journal entries being posted in SAP. A proactive control is more likely to detect an erroneous or irregular journal entry than a detective control.**

**3. Timesheets**

By University policy, monthly salaried employees are not required to complete timesheets.

Neb. Rev. Stat. § 84-1001(1) (Reissue 1999) states, "All state officers and heads of departments and their deputies, assistants, and employees, except permanent part-time employees, temporary employees, and members of any board or commission not required to render full-time service, shall render not less than forty hours of labor each week except any week in which a paid holiday may occur." In addition, sound business practices, as well as good internal control, requires hours actually worked be adequately documented, for example, via timesheets, time logs, etc., and such documentation be kept on file to provide evidence of compliance with the requirements of § 84-1001(1). Furthermore, good internal control also requires that whenever employees accrue vacation and sick leave, adequate documentation should be maintained to support the employees' having "earned" the amounts recorded in the leave records by documenting not less than forty hours of work each week.

> We recommend employees that do not maintain timesheets document their compliance with § 84-1001 by signing and dating the following certification, and having their immediate supervisor approve the certification.
>
> "I certify that I have worked or been on approved leave for at least 40 hours each week of this pay period or in accordance with a separate employment contract and/or agreement".
>
> This language would apply to all faculty, professional, and support staff. Hourly employees using timecards or timesheets would not have this language as actual hours are reported and paid accordingly.

*University's Response: The University understands the auditors observation. There is also substantial Federal law in this area, much of which may have been promulgated since the State law cited. We need to make sure that in following the state regulation, we are not in violation of Federal law should we, as suggested, have salaried personnel start keeping track of hours. We will examine our options in navigating between potentially conflicting laws in this area with counsel during the coming year.*

**APA Response: We understand the University's concern related to Federal labor law. Our recommendation to document compliance with State statute is not to have salaried staff maintain timesheets, but to have them sign and date the language recommended above each pay period, either manually or electronically.**

**4. <u>Payroll Process</u>**

In our review of the University payroll process at each of the campuses we noted some variation in the payroll processes but generally the University's payroll process is best described as a negative reporting system. This means employees will be paid the same amount each pay period unless the Human Resource (HR) department receives information from the department head to change an employee's payroll. University departments generally do not document their review and approval that payroll is ready to be processed by Central Administration or their review of the "Payroll Expense Distribution Report by Cost Object" report after payroll has been processed on SAP, the University's accounting system. There is an after the fact payroll report sent to some departments for their review which reports individual employees' payroll information. However, there is no requirement for the department to respond back to the HR department that the payroll processed was accurate and complete.

Given the fact timesheets are not kept by many employees and no documentation that payroll was actually reviewed by the employees' supervisor, there is a greater risk of errors or irregularities occurring in the payroll process and going undetected.

> We recommend a payroll report be sent to all departments and that this report be reviewed and approved by appropriate department management/supervisors having knowledge of the completeness and accuracy of the department's payroll before payroll is processed and that these supervisors be required to respond to HR with their documented approval of the payroll.

*University's Response: The University understands the auditors observation, but believes other controls present in the system provide many of the features sought in the recommendation. In addition, while the procedure suggested has merit, we believe it would require additional personnel and recordkeeping without providing a commensurate increase in controls.*

**APA Response: We understand and appreciate the University's response, and maintain that a proactive instead of a detective or reactive control is more likely to detect erroneous or irregular activity.**

**5. Capital Assets**

In our review of the capital asset records at the various campuses of the University we noted the following:

1. The University does not have a University-wide policy to account for property that cannot be located. The University of Nebraska at Kearney (UNK), University of Nebraska Omaha (UNO), and University of Nebraska Medical Center (UNMC) do not have policies to account for property that cannot be located. The University of Nebraska at Lincoln (UNL) has a policy but it is not being followed. UNL's policy requires staff to account for property that cannot be located in one of three ways:

   - Produce a copy of a signed "Request for pick-up" form, showing the item was returned to inventory.

   - Produce a copy of an "Incident Report", from the University Police Department, showing the item was reported as stolen.

   - Obtain a letter from the department head citing the item cannot be located and noting specific and valid reasons why the item should be deleted.

   Our review of University capital asset records noted UNK had no items they could not locate. In our review of UNL, UNO, and UNMC capital asset records, we noted each campus removed capital assets from their records that they could not locate. For fiscal year ended June 30, 2008, UNO removed 42 capital assets with an original cost of nearly $500,000 from their capital asset records; UNMC and UNL removed capital assets from their records but the number and dollar amount of the assets removed was not readily available from their capital asset records. We also noted that disposal documents were prepared by staff responsible for the capital asset records. We generally noted no documentation to support why the capital assets were not located. In addition to the general lack of documentation to support the reason the capital assets could not be located and the action taken to locate the item, the disposal documents generally did not have management level approval for the removal of the capital assets from their records.

2. The University does not require equipment costing less than $5,000 to be marked as "Property of the State of Nebraska". Neb. Rev. Stat. § 81-1118.02(3) (Reissue 1999) states, "Each such executive, department, commission, or other state agency shall indelibly tag, mark, or stamp all such property belonging to the State of Nebraska, with the following: Property of the State of Nebraska. In the inventory required by subsection (1) of this section, each such executive, department, commission, or other state agency shall state positively that each item of such property has been so tagged, marked, or stamped."

3. The University does not have University-wide procedures to control access to certain types of equipment under $5,000—such as laptop computers, cameras, and other electronic equipment. Good internal control requires procedures to ensure certain types of equipment are monitored to help ensure the equipment is not lost or misappropriated.

4. The University's policy is to take an inventory of their capital assets every two years. However, State statute requires an inventory be taken annually. Neb. Rev. Stat. § 81-1118.02(1) (Reissue 1999) states, "Each executive, department, commission, or other state agency, including the Supreme Court, the Board of Regents of the University of Nebraska, the State Board of Community Colleges, and the Board of Trustees of the Nebraska State Colleges, shall annually make or cause to be made an inventory of all property, including furniture and equipment, belonging to the State of Nebraska and in the possession, custody, or control of any executive, department, commission or other state agency. The inventory shall include property in the possession, custody, or control of each executive, department, commission, or other state agency as of June 30 and shall be completed and filed with the materiel administrator by August 31 of each year."

When strong controls and procedures are not in place to account for items that cannot be located or when there is a lack of accountability over certain equipment that is susceptible to misuse or theft, there is greater risk of loss or misappropriation of University assets will occur. In addition, when statutory accountability requirements are not being followed, the University assumes additional risk assets will be misused or stolen.

We recommend the following:

1. The University develop written procedures to be followed when capital assets cannot be located. Procedures should include steps to ensure all reasonable efforts have been made to locate the asset, including the possibility the asset was misappropriated, and to require appropriate level management approval for the removal of an asset from the capital asset records.

2. Property belonging to the State of Nebraska be marked "Property of the State of Nebraska" as required by State statute.

3. The University consider establishing University-wide policies and procedures establishing accountability over items more susceptible to theft. Those controls might include requiring a listing of such items, which indentifies the item and to whom it is assigned.

4. The University take an annual inventory as required by State statute.

*University's Response: The University agrees documentation should be bolstered relating to items that cannot be located during inventories and will formalize its procedures in that area.*

*The University understands the auditors recommendations on capitalization, but, like many of our peers, has adopted guidelines set forth in Federal Office of Management and Budget Circular A-21 so as to not have a number of different capitalization thresholds. A-21 defines capital equipment as being "personal property having a useful life of more than one year and acquisition cost which equals or exceeds the lesser of the capitalization level established by the organization for financial statement purposes, or $5,000." The University's policy capitalizes equipment with a useful life of one year or more and a cost greater than $5,000. Items costing less than $5,000 are charged to expense.*

*Departments are responsible for the protection and maintenance of equipment available to them. Certain items susceptible to theft in various departments are tracked by them outside of SAP fixed assets but are not included as capital assets on the balance sheet.*

*Capital equipment is inventoried every two years, which is congruent with Federal guidelines. The University went to biennial inventories as it was more cost effective. We would hope that state regulations could be brought into agreement with the Federal policies which would also allow us to continue to realize the savings captured by moving to biennial inventories.*

**APA Response: Auditor's recommendation #2 is not related to the University capitalization threshold. This recommendation relates to compliance with State statute requiring all property belonging to the State of Nebraska, including those not capitalized, be marked as "Property of the State of Nebraska".**

**We understand the University's response to recommendation #4 and continue to recommend the University comply with <u>all</u> State and Federal inventory requirements and conduct an inventory annually as is required by State statute, even if not required by Federal regulations.**

**6. <u>Accounting for Investment in Joint Venture and Related Equity in Earnings of Joint Venture</u>**

In 1997 the University of Nebraska (University) and Clarkson Regional Health Services, Inc. (Clarkson) entered into a Joint Operating Agreement forming the Nebraska Medical Center (NMC). A Board of Directors comprised of six members appointed by Clarkson and six members appointed by the Board of Regents govern NMC. Upon dissolution of NMC, the University and Clarkson will share equally in the remaining net assets. The University has chosen to account for its investment in joint venture using the equity method.

Our review of University's accounting for this investment in joint venture and the related equity in earnings of joint venture noted the following:

- University is not following all provisions of the generally accepted accounting principles associated with the equity method of valuing its investment in joint venture and the related equity in earnings of joint venture.

- University and Clarkson are using different methods of valuing their investment in joint venture and the related equity in earnings of joint venture.

Accounting Principles Board Opinion 18—The Equity Method of Accounting for Investments in Common Stock states "An investor initially records an investment in the stock of an investee at cost, and adjusts the carrying amount of the investment to recognize the investor's share of the earnings or losses of the investee after the date of acquisition. The amount of the adjustment is included in the determination of net income by the investor, and such amount reflects adjustments similar to those made in preparing consolidated statements including adjustments to eliminate intercompany gains and losses, and to amortize, if appropriate, any difference between investor cost and underlying equity in net assets of the investee at the date of investment. The investment of an investor is also adjusted to reflect the investor's share of changes in the investee's capital. Dividends received from an investee reduce the carrying amount of the investment."

Good business practices also require communication between co-sponsors of a joint venture, ensuring that their individual valuations of their investment in joint venture and the related equity in earnings of joint venture are consistent and comparable.

Because the University has an ongoing financial interest in NMC, it is using the equity method to account for its investment in joint venture and the related equity in earnings of joint venture, but omits certain provisions. Clarkson is also using the equity method, however, they are also following provisions that the University has chosen to omit.

We have discussed these differences with the University's management. They have provided us documentation supporting their application of the equity method which we considered in developing this comment and recommendation.

The University's investment in joint venture and equity in earnings of joint venture may not comply with all generally accepted accounting principles related to the equity method and the joint venture co-sponsors methods of accounting for their investment in joint venture and the related equity in earnings of joint venture are not consistent and comparable.

> We recommend the University review generally accepted accounting principles and consider following all provisions of the equity method of accounting for investment in joint venture. We also recommend the University communicate with their co-sponsor in the joint venture and create a dialog regarding both sponsors method of determining their investment in joint venture and adopt comparable methods.

*University's Response: The University recognizes the need to communicate with our venture partner and believe that communication has improved greatly, but, as with any partnership, improved communications should be a year-in and year-out goal.*

*We have communicated with the auditor in a separate memo on this subject. The auditor has asserted that our investment in joint venture and net assets be increased by approximately $20 million dollars. We maintain that the amount in our financial statements is conservatively stated as it agrees to our ownership percentage interest in the equity balances displayed in the separately audited financial statements of the venture.*

**7. Accounts Receivable Write-off Procedures**

In our review of the University's account receivables write-off procedures, we noted each campus of the University performs its own write-off of accounts receivable. Although procedures at each campus varies, each campus follows collection procedures which include preparation of late notice letters and submission to collection agencies. If these procedures prove unsuccessful, the amounts are written-off from the University's records after two years. Our review also noted certain procedures were not being followed at the various campuses, that if followed, would improve the controls over write-off of accounts receivables of the University.

At all campuses, we noted no formal approval of the write-off of receivables by the Vice Chancellor or Assistant Vice Chancellor for Business and Finance and no procedures to submit write-offs to the State Claims Board in accordance with Neb. Rev. Stat. § 81-8,297 (Reissue 1999). We also noted the University of Nebraska at Omaha (UNO) campus had a lack of segregation of duties in their process. The staff in the cashiering department who receipt money also had the ability to write-off accounts in the University's receivables system.

Records of the University show for fiscal year ended June 30, 2008, UNO wrote off over $500,000 in tuition and fees, University of Nebraska at Lincoln (UNL) wrote off $911,000, University of Nebraska at Kearney (UNK) wrote off $168,000, and the University Nebraska Medical Center wrote off $16,000.

Neb. Rev. Stat. § 81-8,297 (Reissue 2003) states, in part, "The State Claims Board shall have the power and authority to receive, investigate, and otherwise carry out its duties with regard to ... all requests on behalf of any department, board, or commission of the state for waiver or cancellation of money or charges when necessary for fiscal or accounting procedures." In addition, good internal controls require management approval before accounts receivable are written off and a segregation of duties between staff that receipt money and staff with the ability to write-off account receivable amounts in the accounting records.

When there is no approval for the write-off of accounts receivable by the Vice Chancellor or Assistant Vice Chancellor for Business and Finance and an individual has the ability to receipt money and write-off amounts in the accounts receivable records there is a greater risk that irregularities could occur and not be detected. In addition, when amounts written off are not submitted to the State Claims Board, the University is not in compliance with State Statute.

> We recommend the University establish University-wide write-off procedures to include approval for the write-off of accounts receivable by the Vice Chancellor or Assistant Vice Chancellor for Business and Finance. We also recommend before those receivables are formally written off, they be submitted to the State Claims Board in accordance with Neb. Rev. Stat. § 81-8,297 (Reissue 2003). In addition, we recommend the University segregate duties so no one individual has the ability to receipt money and to write-off account receivables in the accounting records.

*University's Response: The University agrees formal write-off procedures are necessary for adequate internal control and to ensure accounts receivable are accurately recorded and included on the statement of net assets. University practices do not permit persons who record cash receipts to approve the write off of accounts receivables. However, the procedures for writing off accounts receivables will be re-examined to ensure accounts receivables write-offs are approved at an appropriate administrative level within the University.*

*Based on the auditors observation, the University will consult with counsel so that we are in compliance with regulations while meeting the needs of all parties.*

## 8. Information Technology (IT)

Our review of the University's IT operations noted the following:

A. SAP Change Management

We noted 2 of 10 individuals with the ability to approve changes for transport to the production environment also perform the transport. These individuals also have the ability to develop changes. We noted one additional individual with the ability to develop changes and transport them into production. In addition, there was no supporting documentation on file approving a change for transport to production for 5 of 24 changes tested. One of 24 changes was approved via email rather than the established approval process.

The individuals who approve changes are typically from the Administrative Services Group. However, two individuals from the Basis Team who transport changes can also approve changes for transport and have development capabilities. In addition, Basis Team members with the ability to develop and transport changes could circumvent the change management process.

Good internal control includes a segregation of duties surrounding the change management process to ensure one individual does not have the ability to complete a change from beginning to end. When a proper segregation of duties cannot be established, a good compensating control includes a documented review of production changes made by developers. Good internal control also includes a documented approval to changes made to production.

When individuals with the ability to approve changes for transport to the production environment also perform the transport and also have the ability to develop changes without documented approval, there is an increased risk unauthorized and/or untested changes could be made to production, with unauthorized changes resulting in the loss of University resources due to error or fraud.

> We recommend the University establish a segregation of duties around the change management process or establish a periodic documented review of the SAP transport log.

B. SIS Change Management

We noted 3 developers and the Enterprise Information Solutions Interim Director share a username and password to the Student Information System. This ID allows the developers to make changes to the production environment. There was no documented review of changes made by these individuals.

The University noted the shared ID exists for emergency changes needed overnight. The developers who share this ID are on-call to resolve processing errors. There is a lack of accountability in the event of an unauthorized change due to the use of a shared ID.

Good internal control includes a segregation of duties surrounding the change management process to ensure one individual does not have the ability to complete a change from beginning to end. When a proper segregation of duties cannot be established, a good compensating control includes a documented review of production changes made by developers.

There is a lack of accountability in the event of an unauthorized change due to the use of a shared ID. This increases the risk of unauthorized and/or untested changes being made to production and could result in loss of University resources due to error or fraud.

> We recommend the University establish procedures to document the periodic review of changes made to the production environment to ensure no unauthorized changes were made. We also recommend establishing separate user IDs to make developers accountable for all actions taken in production.

*University's Response: The University agrees with the auditors observation about segregation of duties in the change management process. The University has continued to work to reduce the risk of unauthorized changes to the administrative system by adopting procedures that segregate the duties of developers over the past several years. Two senior level system administration support staff has the authority to approve changes for transport to the production environment and also perform the transport. The minimal risk of allowing the ability to transport changes into production is accepted to facilitate support requirements that can occur daily. We agree with the auditor that a periodic review is necessary to mitigate the risk associated with permitting these developers to approve and transport changes to production. A review that is intended to mitigate this risk is performed on the first* *of each month by the associate chief information officer of Computer Services Network. The risk is further mitigated by having each of these two developers backup and review the work of the other.*

*The University also agrees with the auditors suggestion on change authorizations. Separate user ID's have been established for each developer. The single shared account with access to the production environment has been disabled. Production access is restricted to two individuals, one a non-developer in charge of changes and the second being their backup. The implementation of additional procedures is under consideration to monitor and review changes to the production environment to ensure unauthorized changes have not been made.*

**9. <u>New Accounting Standards</u>**

**<u>GASB Statement No. 49 - Accounting and Financial Reporting for Pollution Remediation Obligations</u>**

This statement, effective for fiscal years beginning after December 15, 2007, addresses accounting and financial reporting standards for pollution (including contamination) remediation obligations, which are obligations to address the current or potential detrimental effects of *existing* pollution by participating in pollution remediation activities such as site assessments and cleanups. The scope of the document excludes pollution *prevention* or *control* obligations with respect to current operations, and future pollution remediation activities that are required upon retirement of an asset, such as landfill closure and postclosure care and nuclear power plant decommissioning.

**<u>GASB Statement No. 51 - Accounting and Financial Reporting for Intangible Assets</u>**

This Statement effective for financial statements for periods beginning after June 15, 2009, requires that all intangible assets not specifically excluded by its scope provisions be classified as capital assets. Accordingly, existing authoritative guidance related to the accounting and financial reporting for capital assets should be applied to these intangible assets, as applicable. This Statement requires that an intangible asset be recognized in the statement of net assets only if it is considered identifiable. Additionally, this Statement establishes a specified-conditions approach to recognizing intangible assets that are internally generated. Effectively, outlays associated with the development of such assets should not begin to be capitalized until certain criteria are met. Outlays incurred prior to meeting these criteria should be expensed as incurred. This Statement also provides guidance on recognizing internally generated computer software as an intangible asset. This guidance serves as an application of the specified-conditions approach described above to the development cycle of computer software.

The provisions of this Statement generally are required to be applied retroactively. For governments that were classified as phase 1 or phase 2 governments for the purpose of implementing Statement 34, retroactive reporting is required for intangible assets acquired in fiscal years ending after June 30, 1980, except for those considered to have indefinite useful lives as of the effective date of this Statement and those that would be considered internally generated. Retroactive reporting of these intangible assets by phase 3 governments is encouraged but not required. Retroactive reporting is not required but is permitted for intangible assets considered to have indefinite useful lives as of the effective date of this Statement and those considered to be internally generated.

## GASB Statement No. 52 - Land and Other Real Estate Held as Investments by Endowments

This Statement establishes standards for accounting and financial reporting for land and other real estate held as investments by endowments. Endowments include permanent and term endowments, and permanent funds. This Statement does not apply to lands granted by the Federal government in connection with a state being admitted to the United States. It also does not apply to quasi-endowments. This Statement applies to all state and local governments.

Land and other real estate held as investments by endowments should be reported at fair value at the reporting date. Changes in fair value during the period should be reported as investment income.

Endowments also should apply the applicable disclosure provisions in Statement 31 (paragraph 15**)** to their land and other real estate held as investments.

Endowments were previously required to report their land and other real estate held for investment purposes at historical cost. However, such investments are reported at fair value by similar entities, such as pension plans. Questions have arisen regarding the appropriateness of this difference in the accounting standards. The objective of this Statement is to enhance the comparability and usefulness of financial reporting by endowments by establishing a common approach to reporting land and other real estate held as investments.

Accounting standards previously required permanent and term endowments, including permanent funds, to report land and other real estate held as investments at their historical cost. Endowments exist to invest resources for the purpose of generating income. Other entities that exist for similar purposes—pension and other postemployment benefit plans, external investment pools, and Internal Revenue Code Section 457 deferred compensation plans—however, report land and other real estate held as investments at their fair value.

The provisions of this Statement are effective for financial statements for periods beginning after June 15, 2008. Earlier application is encouraged. In the first period that this Statement is applied, changes made to comply with this Statement should be treated as an adjustment of prior periods, and financial statements presented for the periods affected should be restated. If restatement of the financial statements for prior periods is not practical, the cumulative effect of applying this Statement should be reported as a restatement of beginning net assets (or equity or fund balance, as appropriate) for the earliest period restated (generally, the current period). In the first period that this Statement is applied, the financial statements should disclose the nature of the restatement and its effect.

## GASB Statement No. 53 - Accounting and Financial Reporting for Derivative Instruments

This state is effective for fiscal years beginning after June 15, 2009 and 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.

Our audit procedures are designed primarily to enable us to form an opinion on the financial statements, and therefore, may not bring to light all weaknesses in policies or procedures that may exist. We aim, however, to use our knowledge of the University's organization gained during our work to make comments and suggestions that we hope will be useful to you.

We would be pleased to discuss these comments and recommendations with you at any time.

This communication is intended solely for the information and use of management, Board of Regents, and others within the organization. However, this letter is a matter of public record and its distribution is not limited.

Sincerely,

Signed Original on File

Don Dunlap
Assistant Deputy Auditor

January 15, 2009

Board of Regents
University of Nebraska
Lincoln, Nebraska

Dear Board Members:

We have received the draft management letter from the Auditor of Public Accounts. As is our practice, we supply a response to the comments contained in those letters. This letter is designed to furnish you with our responses to the observations in that letter. The format of this letter is to repeat the comment made by the auditors so that you have a context for understanding our response, which immediately follows each comment.

**Journal Entry Processing.**

Auditors Comment: All campuses of the University of Nebraska have a large number of individuals with the ability to prepare and post journal entries on SAP, the University's accounting system, without a review or approval by anyone else. During fiscal year ended June 30, 2008 the University had 569 individuals who prepared and posted over 41,000 journal entries in the amount of $14.5 Billion. The University as a whole has 946 individuals who have access to prepare and post journal entries. Of those 946 individuals, 377 individuals did not post any journal entries during the fiscal year, and 159 individuals posted 9 or less journal entries throughout the fiscal year. Per discussion with University Management, most individuals who prepare and post journal entries are accounting clerks within the various Departments. University Management believes these individuals need the ability to perform this function. In addition, University Management indicated an after the fact review of journal entries is made at various levels, however, this review is generally not required or documented.

Good internal control requires a documented review and approval of journal entries before they are posted to the General Ledger. Good internal control also requires the access to process journal entries be given only to those individuals who routinely need to post journal entries. When a large number of individuals can prepare and post journal entries without a documented review and approval there is a greater risk erroneous or inappropriate journal entries could be made and go undetected.

We recommend the University establish a policy that all journal entries be reviewed and approved by someone other than the person preparing the journal entry prior to it being posted in SAP. This approval should be done by an individual with the knowledge to understand the journal entry, to ensure it is properly supported, and to determine it is a proper journal entry for the University. We also recommend the University review the need for 946 individuals having access to process journal entries on SAP.

Response: The University will examine the number of users authorized to enter journal entries to ensure those who require access have the ability to enter journal entries.

While the University understands the auditors comment and will examine the number of users, the volume statistics cited may mistakenly lead the reader to believe the system is not functioning properly. In addition, there are other controls in the internal control structure which mitigate the condition cited. The following paragraphs are designed to give additional background to the observation forepart of the recommendation.

Part of the reason there are a large number of users and entries is because, unlike traditional or less robust accounting systems, SAP is a decentralized system that gathers data at a granular level and pushes information to the fingertips of the ultimate user. Our number of users may appear outsized at first blush, but the utility of the system is diluted if the ultimate user, say a Dean or Director who normally or infrequently would make entries, cannot fully access the system and examine his/her accounts and make corrections.

Secondly, while 41,000 entries and $14.5 billion of journal entries may seem large to the uninitiated, the complexity of the enterprise and the different "cuts" at the same information required as part of everyday activities drive a substantial amount of this volume. A couple of examples may help. Many of the entries relate to year end closings and reversals which are confined to a relatively few persons. Other entries relate to cost accounting wherein costs are reallocated to departments and projects, which is critical as the department and project level is the point where budgetary controls exist. The University wants these allocations and resultant journal entries to be done in SAP versus creating additional shadow systems. Another driver is that accounting information, often the same information, must be broken out two or three ways so separate accountings can be provided to Federal, State and other organizations. Within this as background, the volume becomes more understandable.

Lastly, the controls offered by project and departmental budgets are a strong detective control that partially offsets the preventive control contained in the observation. In addition, the on-line review of transactions by end users, including deans and directors, helps to ensure costs are properly posted. If improper costs are posted to a cost center or project, they should be detected on a monthly or even real time basis.

**Timesheets.**

Auditors Comment: By University policy, monthly salaried employees are not required to complete timesheets. Neb. Rev. Stat. § 84-1001(1) (Reissue 1999) states, "All state officers and heads of departments and their deputies, assistants, and employees, except permanent part-time employees, temporary employees, and members of any board or commission not required to render full-time service, shall render not less than forty hours of labor each week except any week in which a paid holiday may occur." In addition, sound business practices, as well as good internal control, requires hours actually worked be adequately documented, for example, via timesheets, time logs, etc., and such documentation be kept on file to provide evidence of compliance with the requirements of § 84-1001(1). Furthermore, good internal control also requires that whenever employees accrue vacation and sick leave, adequate documentation should be maintained to support the employees' having "earned" the amounts recorded in the leave records by documenting not less than forty hours of work each week. We recommend employees that do not maintain timesheets document their compliance with § 84-1001 by signing and dating the following certification, and having their immediate supervisor approve the certification. "I certify that I have worked or been on approved leave for at least 40 hours each week of this pay period or in accordance with a separate employment contract and/or agreement". This language would apply to all faculty, professional, and support staff. Hourly employees using timecards or timesheets would not have this language as actual hours are reported and paid accordingly.

Response: The University understands the auditors observation. There is also substantial Federal law in this area, much of which may have been promulgated since the State law cited. We need to make sure that in following the state regulation, we are not in violation of Federal law should we, as suggested, have salaried personnel start keeping track of hours. We will examine our options in navigating between potentially conflicting laws in this area with counsel during the coming year.

**Payroll Process.**

Auditors Comment: In our review of the University payroll process at each of the campuses we noted some variation in the payroll processes but generally the University's payroll process is best described as a negative reporting system. This means employees will be paid the same amount each pay period unless the Human Resource (HR) department receives information from the department head to change an employee's payroll. University departments generally do not document their review and approval that payroll is ready to be processed by Central Administration or their review of the "Payroll Expense Distribution Report by Cost Object" report after payroll has been processed on SAP, the University's accounting system. There is an after the fact payroll report sent to some departments for their review which reports individual employees' payroll information. However, there is no requirement for the department to respond back to the HR department that the payroll processed was accurate and complete.

Given the fact timesheets are not kept by many employees and no documentation that payroll was actually reviewed by the employees' supervisor, there is a greater risk of errors or irregularities occurring in the payroll process and going undetected.

We recommend a payroll report be sent to all departments and that this report be reviewed and approved by appropriate department management/supervisors having knowledge of the completeness and accuracy of the department's payroll before payroll is processed and that these supervisors be required to respond to HR with their documented approval of the payroll.

Response: The University understands the auditors observation, but believes other controls present in the system provide many of the features sought in the recommendation. In addition, while the procedure suggested has merit, we believe it would require additional personnel and recordkeeping without providing a commensurate increase in controls.

**Capital Assets.**

Auditors Comment: In our review of the capital asset records at the various campuses of the University we noted the following:

1. The University does not have a University-wide policy to account for property that cannot be located. The University of Nebraska at Kearney (UNK), University of Nebraska Omaha (UNO), and University of Nebraska Medical Center (UNMC) do not have policies to account for property that cannot be located. The University of Nebraska at Lincoln (UNL) has a policy but it is not being followed. UNL's policy requires staff to account for property that cannot be located in one of three ways:

    - Produce a copy of a signed "Request for pick-up" form, showing the item was returned to inventory.
    - Produce a copy of an "Incident Report", from the University Police Department, showing the item was reported as stolen.
    - Obtain a letter from the department head citing the item cannot be located and noting specific and valid reasons why the item should be deleted.

Our review of University capital asset records noted UNK had no items they could not locate. In our review of UNL, UNO, and UNMC capital asset records, we noted each campus removed capital assets from their records that they could not locate. For fiscal year ended June 30, 2008, UNO removed 42 capital assets with an original cost of nearly $500,000 from their capital asset records; UNMC and UNL removed capital assets from their records but the number and dollar amount of the assets removed was not readily available from their capital asset records. We also noted that disposal documents were prepared by staff responsible for the capital asset records. We generally noted no documentation to support why the capital assets were not located. In addition to the general lack of documentation to support the reason the capital assets could not be located and the action taken to locate the item, the disposal documents generally did not have management level approval for the removal of the capital assets from their records.

2. The University does not require equipment costing less than $5,000 to be marked as "Property of the State of Nebraska". Neb. Rev. Stat. § 81-1118.02(3) (Reissue 1999) states, "Each such executive, department, commission, or other state agency shall indelibly tag, mark, or stamp all such property belonging to the State of Nebraska, with the following: Property of the State of Nebraska. In the inventory required by subsection (1) of this section, each such executive, department, commission, or other state agency shall state positively that each item of such property has been so tagged, marked, or stamped."

3. The University does not have University-wide procedures to control access to certain types of equipment under $5,000—such as laptop computers, cameras, and other electronic equipment. Good internal control requires procedures to ensure certain types of equipment are monitored to help ensure the equipment is not lost or misappropriated.

4. The University's policy is to take an inventory of their capital assets every two years. However, State statute requires an inventory be taken annually. Neb. Rev. Stat. § 81-1118.02(1) (Reissue 1999) states, "Each executive, department, commission, or other state agency, including the Supreme Court, the Board of Regents of the University of Nebraska, the State Board of Community Colleges, and the Board of Trustees of the Nebraska State Colleges, shall annually make or cause to be made an inventory of all property, including furniture and equipment, belonging to the State of Nebraska and in the possession, custody, or control of any executive, department, commission or other state agency. The inventory shall include property in the possession, custody, or control of each executive, department, commission, or other state agency as of June 30 and shall be completed and filed with the materiel administrator by August 31 of each year."

When strong controls and procedures are not in place to account for items that cannot be located or when there is a lack of accountability over certain equipment that is susceptible to misuse or theft, there is greater risk of loss or misappropriation of University assets will occur. In addition, when statutory accountability requirements are not being followed, the University assumes additional risk assets will be misused or stolen.

We recommend the following:

1. The University develop written procedures to be followed when capital assets cannot be located. Procedures should include steps to ensure all reasonable efforts have been made to locate the asset, including the possibility the asset was misappropriated, and to require appropriate level management approval for the removal of an asset from the capital asset records.

2. Property belonging to the State of Nebraska be marked "Property of the State of Nebraska" as required by State statute.

3. The University consider establishing University-wide policies and procedures establishing accountability over items more susceptible to theft. Those controls might include requiring a listing of such items, which indentifies the item and to whom it is assigned.

4. The University take an annual inventory as required by State statute.

Response: The University agrees documentation should be bolstered relating to items that cannot be located during inventories and will formalize its procedures in that area.

The University understands the auditors recommendations on capitalization, but, like many of our peers, has adopted guidelines set forth in Federal Office of Management and Budget Circular A-21 so as to not have a number of different capitalization thresholds. A-21 defines capital equipment as being "personal property having a useful life of more than one year and acquisition cost which equals or exceeds the lesser of the capitalization level established by the organization for financial statement purposes, or $5,000." The University's policy capitalizes equipment with a useful life of one year or more and a cost greater than $5,000. Items costing less than $5,000 are charged to expense.

Departments are responsible for the protection and maintenance of equipment available to them. Certain items susceptible to theft in various departments are tracked by them outside of SAP fixed assets but are not included as capital assets on the balance sheet

Capital equipment is inventoried every two years, which is congruent with Federal guidelines. The University went to biennial inventories as it was more cost effective. We would hope that state regulations could be brought into agreement with the Federal policies which would also allow us to continue to realize the savings captured by moving to biennial inventories.

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**Accounting for Investment in Joint Venture and Related Equity in Earnings of Joint Venture.**

Auditors Comment: In 1997 the University of Nebraska (University) and Clarkson Regional Health Services, Inc. (Clarkson) entered into a Joint Operating Agreement forming the Nebraska Medical Center (NMC). A Board of Directors comprised of six members appointed by Clarkson and six members appointed by the Board of Regents govern NMC. Upon dissolution of NMC, the University and Clarkson will share equally in the remaining net assets. The University has chosen to account for its investment in joint venture using the equity method.

Our review of University's accounting for this investment in joint venture and the related equity in earnings of joint venture noted the following:

- University is not following all provisions of the generally accepted accounting principles associated with the equity method of valuing its investment in joint venture and the related equity in earnings of joint venture.
- University and Clarkson are using different methods of valuing their investment in joint venture and the related equity in earnings of joint venture.

Accounting Principles Board Opinion 18—The Equity Method of Accounting for Investments in Common Stock states "An investor initially records an investment in the stock of an investee at cost, and adjusts the carrying amount of the investment to recognize the investor's share of the earnings or losses of the investee after the date of acquisition. The amount of the adjustment is included in the determination of net income by the investor, and such amount reflects adjustments similar to those made in preparing consolidated statements including adjustments to eliminate intercompany gains and losses, and to amortize, if appropriate, any difference between investor cost and underlying equity in net assets of the investee at the date of investment. The investment of an investor is also adjusted to reflect the investor's share of changes in the investee's capital. Dividends received from an investee reduce the carrying amount of the investment."

Good business practices also require communication between co-sponsors of a joint venture, ensuring that their individual valuations of their investment in joint venture and the related equity in earnings of joint venture are consistent and comparable. Because the University has an ongoing financial interest in NMC, it is using the equity method to account for its investment in joint venture and the related equity in earnings of joint venture, but omits certain provisions. Clarkson is also using the equity method, however, they are also following provisions that the University has chosen to omit.

We have discussed these differences with the University's management. They have provided us documentation supporting their application of the equity method which we considered in developing this comment and recommendation.

The University's investment in joint venture and equity in earnings of joint venture may not comply with all generally accepted accounting principles related to the equity method and the joint venture co-sponsors methods of accounting for their investment in joint venture and the related equity in earnings of joint venture are not consistent and comparable.

> We recommend the University review generally accepted accounting principles and consider following all provisions of the equity method of accounting for investment in joint venture. We also recommend the University communicate with their co-sponsor in the joint venture and create a dialog regarding both sponsors method of determining their investment in joint venture and adopt comparable methods.

Response: The University recognizes the need to communicate with our venture partner and believe that communication has improved greatly, but, as with any partnership, improved communications should be a year-in and year-out goal.

We have communicated with the auditor in a separate memo on this subject. The auditor has asserted that our investment in joint venture and net assets be increased by approximately $20 million dollars. We maintain that the amount in our financial statements is conservatively stated as it agrees to our ownership percentage interest in the equity balances displayed in the separately audited financial statements of the venture.

**Accounts Receivable Write-off Procedures.**

Auditors Comment: In our review of the University's account receivables write-off procedures, we noted each campus of the University performs its own write-off of accounts receivable. Although procedures at each campus varies, each campus follows collection procedures which include preparation of late notice letters and submission to collection agencies. If these procedures prove unsuccessful, the amounts are written-off from the University's records after two years. Our review also noted certain procedures were not being followed at the various campuses, that if followed, would improve the controls over write-off of accounts receivables of the University.

At all campuses, we noted no formal approval of the write-off of receivables by the Vice Chancellor or Assistant Vice Chancellor for Business and Finance and no procedures to submit write-offs to the State Claims Board in accordance with Neb. Rev. Stat. § 81-8,297 (Reissue 1999). We also noted the University of Nebraska at Omaha (UNO) campus had a lack of segregation of duties in their process. The staff in the cashiering department who receipt money also had the ability to write-off accounts in the University's receivables system.

Records of the University show for fiscal year ended June 30, 2008, UNO wrote off over $500,000 in tuition and fees, University of Nebraska at Lincoln (UNL) wrote off $911,000, University of Nebraska at Kearney (UNK) wrote off $168,000, and the University Nebraska Medical Center wrote off $16,000.

Neb. Rev. Stat. § 81-8,297 (Reissue 2003) states, in part, "The State Claims Board shall have the power and authority to receive, investigate, and otherwise carry out its duties with regard to…all requests on behalf of any department, board, or commission of the state for waiver or cancellation of money or charges when necessary for fiscal or accounting procedures." In addition, good internal controls require management approval before accounts receivable are written off and a segregation of duties between staff that receipt money and staff with the ability to write-off account receivable amounts in the accounting records.

When there is no approval for the write-off of accounts receivable by the Vice Chancellor or Assistant Vice Chancellor for Business and Finance and an individual has the ability to receipt money and write-off amounts in the accounts receivable records there is a greater risk that irregularities could occur and not be detected. In addition, when amounts written off are not submitted to the State Claims Board, the University is not in compliance with State Statute.

> We recommend the University establish University-wide write-off procedures to include approval for the write-off of accounts receivable by the Vice Chancellor or Assistant Vice Chancellor for Business and Finance. We also recommend before those receivables are formally written off, they be submitted to the State Claims Board in accordance with Neb. Rev. Stat. § 81-8,297 (Reissue 2003). In addition, we recommend the University segregate duties so no one individual has the ability to receipt money and to write-off account receivables in the accounting records.

Response: The University agrees formal write-off procedures are necessary for adequate internal control and to ensure accounts receivable are accurately recorded and included on the statement of net assets. University practices do not permit persons who record cash receipts to approve the write off of accounts receivables. However, the procedures for writing off accounts receivables will be re-examined to ensure accounts receivables write-offs are approved at an appropriate administrative level within the University.

Based on the auditors observation, the University will consult with counsel so that we are in compliance with regulations while meeting the needs of all parties.

**Information Technology.**

Auditors Comment: Our review of the University's IT operations noted the following:

A. SAP Change Management

We noted 2 of 10 individuals with the ability to approve changes for transport to the production environment also perform the transport. These individuals also have the ability to develop changes. We noted one additional individual with the ability to develop changes and transport them into production. In addition, there was no supporting documentation on file approving a change for transport to production for 5 of 24 changes tested. One of 24 changes was approved via email rather than the established approval process.

The individuals who approve changes are typically from the Administrative Services Group. However, two individuals from the Basis Team who transport changes can also approve changes for transport and have development capabilities. In addition, Basis Team members with the ability to develop and transport changes could circumvent the change management process.

Good internal control includes a segregation of duties surrounding the change management process to ensure one individual does not have the ability to complete a change from beginning to end. When a proper segregation of duties cannot be established, a good compensating control includes a documented review of production changes made by developers. Good internal control also includes a documented approval to changes made to production. When individuals with the ability to approve changes for transport to the production environment also perform the transport and also have the ability to develop changes without documented approval, there is an increased risk unauthorized and/or untested changes could be made to production, with unauthorized changes resulting in the loss of University resources due to error or fraud.

We recommend the University establish a segregation of duties around the change management process or establish a periodic documented review of the SAP transport log.

B. SIS Change Management

We noted 3 developers and the Enterprise Information Solutions Interim Director share a username and password to the Student Information System. This ID allows the developers to make changes to the production environment. There was no documented review of changes made by these individuals.

The University noted the shared ID exists for emergency changes needed overnight. The developers who share this ID are on-call to resolve processing errors. There is a lack of accountability in the event of an unauthorized change due to the use of a shared ID.

Good internal control includes a segregation of duties surrounding the change management process to ensure one individual does not have the ability to complete a change from beginning to end. When a proper segregation of duties cannot be established, a good compensating control includes a documented review of production changes made by developers.

There is a lack of accountability in the event of an unauthorized change due to the use of a shared ID. This increases the risk of unauthorized and/or untested changes being made to production and could result in loss of University resources due to error or fraud.

We recommend the University establish procedures to document the periodic review of changes made to the production environment to ensure no unauthorized changes were made. We also recommend establishing separate user IDs to make developers accountable for all actions taken in production.

Response: The University agrees with the auditors observation about segregation of duties in the change management process. The University has continued to work to reduce the risk of unauthorized changes to the administrative system by adopting procedures that segregate the duties of developers over the past several years. Two senior level system administration support staff has the authority to approve changes for transport to the production environment and also perform the transport. The minimal risk of allowing the ability to transport changes into production is accepted to facilitate support requirements that can occur daily. We agree with the auditor that a periodic review is necessary to mitigate the risk associated with permitting these developers to approve and transport changes to production. A review that is intended to mitigate this risk is performed on the first of each month by the associate chief information officer of Computer Services Network. The risk is further mitigated by having each of these two developers backup and review the work of the other.

The University also agrees with the auditors suggestion on change authorizations. Separate user ID's have been established for each developer. The single shared account with access to the production environment has been disabled. Production access is restricted to two individuals, one a non-developer in charge of changes and the second being their backup. The implementation of additional procedures is under consideration to monitor and review changes to the production environment to ensure unauthorized changes have not been made.

* * * * *

Please feel free to contact this office with any questions or desired clarifications.

Sincerely,

David E. Lechner
Vice President for Business & Finance

The University's response to the internal audit function recommendation is printed below. The response was provided after the internal audit comment was subsequently added to a draft copy of the management letter.

**University Internal Audit Organization**

Response: The University agrees with the proposed change in reporting structure Central Administration Director of Internal Audit as it formalizes the informal structure that has existed for a period of time. The internal auditor, as well as internal audit on the campuses, has long enjoyed unrestricted access to the audit committee. In fact, when the Board of Regents started its separate audit committee at the advent of Sarbanes Oxley in 2002-2003, Audit Committee chairman McClurg, stated the following in a memo dated November 3, 2003 which was sent to all of the internal audit/operations analysis professionals at the University.

> “Any changes in employment or responsibilities of University of Nebraska internal auditors will be approved by the Chairperson of the Audit Committee prior to the action being taken.”
>
> “If at any time, you feel your professional judgment is being compromised or should you feel the need to obtain outside feedback on an issue, do not hesitate to contact any of us. The committee members and their phone numbers and mailing addresses are as follows…..”

In addition to the statements above, in each audit committee meeting, there are separate executive sessions with internal and external auditors, without management present, to help ensure that the auditors are being given unrestricted access to information to allow them to discharge their responsibilities.

With regard to the comment on changes in reporting for campus-based auditors, we agree with the comment that seeks to formalize reporting to the Chancellors of the campuses and to the audit committee. Again, the 2003 memo cited above was designed to make clear that the campus-based auditors/operations analysis groups enjoyed access to the audit committee and should report any instances where they felt their independence was being compromised to the committee. The University also agrees that greater coordination and of efforts and collaboration between the central administration Director of Internal Audit and the campus-based units would increase efficiencies and take maximum advantage of those resources.