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December 14, 2009

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, 2009, and have issued our report thereon dated December 14, 2009. 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. Draft copies of this letter were furnished to the University to provide them an opportunity to review the letter and to respond to the comments and recommendations included in this letter. The formal responses received have been incorporated into this letter. The responses have been objectively evaluated and recognized, as appropriate, in the letter. A response that indicates corrective action has been taken was not verified at this time, but will be verified in the next audit. 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 states "The internal audit organization should report regularly to those charged with governance."

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

During our fiscal year ended June 30, 2008, audit of the University, we noted employees performing an internal audit function were not part of a single internal audit organization and were not free from organizational impairments. At that time we recommended the University of Nebraska Board of Regents consider restructuring those individuals performing an internal audit function into a single internal audit organization. We also recommended 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 recommended that the internal audit organization document the conditions allowing it to be considered free of organizational impairments.

Our fiscal year ended June 30, 2009, audit follow up to the above recommendations noted the following:

a. University of Nebraska Board of Regents Audit Committee (Audit Committee) did restructure the internal audit function and made organizational changes. The Operations Analysis Director (OAD) at the University of Nebraska at Lincoln (UNL) administratively reports to the UNL Chancellor and organizationally to the Audit Committee. Organizationally the Audit Committee also changed who the Director of Internal Audit (DIA) reports to. The DIA at Central Administration (CA) no longer reports directly to the Vice President of Business Affairs of the University for the internal audit work performed but reports all internal audit work to the Audit Committee. This change was reflected in the University's updated "Charter of the Audit Committee of the University of Nebraska" dated April 24, 2009. Thus the OAD at UNL and the DIA at CA are organizationally independent as outlined by GAGAS.

   However, per discussion with the OAD at UNL and the DIA at CA the two internal audit areas function almost entirely independently. Operational Analysis considers internal audit areas at UNL and the Internal Audit at CA considers University-wide internal audit areas. Thus the Audit Committee did not implement our recommendation to organize the internal audit function into a single internal audit organization for the

University. In our fiscal year ended June 30, 2008, management letter we suggested 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 continue to believe a single organization would be able to more effectively utilize University resources, coordinate projects, and ensure no duplication or overlap of work by the employees performing internal audit work.

We also noted the Charter of Audit Committee of the University of Nebraska stated the following:

> *"All University Audit and Advisory Services and operations analysis staff (audit staff) shall report to their organizational leadership for administrative support and shall report to the Committee as to the process and content of their internal audit function and reporting. All audit staff work products will be provided to the Director of Audit and Advisory Services and be reported to the Committee."*

The wording seems to conflict. The first sentence indicates that all audit staff—University Audit and Advisory Services staff and operations analysis staff (i.e. UNL internal audit staff) report directly to the Audit Committee. The second sentence seems to indicate all audit staff work products will be provided to the Director of Audit and Advisory Services and he will report that work to the Audit Committee.

In addition, in reviewing the Operations Analysis Department Charter we noted the following related to reporting hierarchy and independence:

> "*Operations Analysis reports administratively to the Vice Chancellor for Business and Finance, University of Nebraska-Lincoln. Operations Analysis reports to the Audit Committee of the University of Nebraska Board of Regents regarding the process and content of internal audit reports."*

The wording in this charter indicates Operations Analysis staff report directly to the Audit Committee regarding internal audit reports.

b. It was determined from discussion with the DIA at CA that he believes he is not independent in performing his duties as an internal auditor. He explained a significant amount of his time is spent directly on management decisions regarding the University's main accounting system commonly identified as SAP. Organizationally, the DIA job title is "Internal Auditor/Assistant Vice President of Business and Finance." In performing his job responsibilities related to the University's accounting system, the DIA reports directly to the Vice President of Business Affairs of the University. The DIA believes he cannot be responsible for decisions regarding the University's accounting system and also independently report on this system or activity going through this system. The Auditor of Public Accounts (APA) agrees with this conclusion based on the GAGAS criteria noted above and believes his responsibilities related to the University's accounting system precludes the DIA from being independent in any internal audit work the DIA performs.

When University 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 continue to recommend that the Audit Committee consider restructuring those individuals performing an internal audit function for the University into a single internal audit organization. In addition, we recommend the wording in the University's charters be reviewed and changed to clarify who the internal audit staff reports to. We also recommend the Audit Committee review the job responsibilities of the DIA to determine if those job responsibilities can be restructured to ensure the DIA can meet the independence criteria in GAGAS.

University's Response: The Audit Committee has, on several occasions, through both written and verbal messages, informed the internal audit staffs that they have direct access to the audit committee and the governing board. We will again emphasize that to those staff members.

We do not disagree with the observation on creating a single internal audit organization, and have taken steps to achieve greater coordination, including all audit reports flowing through the Director of Audit and Advisory Services (DAAS) and to the Board as needed. At the same time, the University perceives benefit in allowing Chancellors to have the ability to access these resources to address issues particular to their campuses. The latter action is balanced by creating communication between the audit groups so that there is minimal overlap and coordination of efforts where possible.

We will address the duties currently performed by the DAAS so as to eliminate independence concerns that he may have.

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

Our prior audit for the fiscal year ended June 30, 2008, noted all campuses of the University had a large number of individuals (946 University-wide with 569 individuals processing over 41,000 journal entries in the amount of $8.6 billion) with the ability to prepare and post journal entries on SAP, the University's accounting system, without a review or approval by anyone else. At that time we recommended 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 recommended the University review the need for such a large number of individuals having access to process journal entries on SAP.

During our current audit the APA followed up on this finding and we noted the University did a review of individuals who have access to process journal entries on SAP. After the review, the University decided to reduce the number of individuals having access to process journal entries from 956 to 676. For the fiscal year ended June 30, 2009, these individual processed 40,914 journal entries in the amount of $9.9 billion. The University did not implement our recommendation to 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.

University management again indicated to us that 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.

We again reiterate that 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 posted and go undetected.

> We again 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 believe a proactive model with a real-time, work-flow review and approval process prior to journal entries being posted in SAP is reasonable and practicable. A proactive control is more likely to detect an erroneous or irregular journal entry than a detective control.

University's Response: The University agrees that the ideal practice would be to have real time sign-off, but the practicality of that ideal, in a decentralized processing environment, with limited staffing in some areas, will not always be possible. Therefore, it becomes necessary to employ detective, budgetary and other compensating controls. At the current time, the workflow in SAP is not in deployed functionality.

We will continue to scrutinize practices in this area to achieve separation of duties, where possible, and strengthening detective controls where real-time sign-off is not practicable.

3. <u>Timesheets</u>

Our prior audit for the fiscal year ended June 30, 2008, noted that by University policy, monthly salaried employees were not required to complete timesheets. At that time we recommended employees that do not maintain timesheets document their compliance with Neb. Rev. Stat. § 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."

During our current audit we followed up on this finding and noted the University did review and understood the finding. There is also substantial Federal law in this area, much of which may have been promulgated since the State law cited. The University wanted to make sure that in following the State regulation, they are not in violation of Federal law should they, as suggested, have salaried personnel start keeping track of hours. They planned to examine the options in navigating between potentially conflicting laws in this area with counsel during the current year.

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 again 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.
>
> 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.

University's Response: The University believes the suggested practice would be a step that could create problems with Federal laws, many of those laws not having been contemplated or in existence at the time of the foregoing state statute. The University will continue to rely on faculty and staff to ascertain that salaried employees under their supervision are performing as expected versus introducing a written document that, in keeping track of hours, even indirectly as proposed, could put the University at odds with Federal law.

4. **Payroll Process**

During our prior audit for the fiscal year ended June 30, 2008, we noted some variation in the University payroll process at each of the campuses, 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 CA or their review of the "Payroll Expense Distribution Report by Cost Object" 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. We recommended 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 payroll.

The University responded to our prior year comment by indicating they understood our observation, but believed other controls presented in the system provide many of the features sought in the recommendation. In addition, while the procedure suggested has merit, they believed it would require additional personnel and recordkeeping without providing a commensurate increase in controls.

Given the fact timesheets are not kept by many employees and there is 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 again 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 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. While the suggested procedure has merit, we believe it will require additional personnel and recordkeeping without a commensurate increase in controls.

5. **Capital Assets**

Our prior audit for the fiscal year ended June 30, 2008, noted the University did not have a University-wide policy to account for property that cannot be located. At that time we noted UNL had a policy but it was not being followed; however, the University of Nebraska at Kearney (UNK), the University of Nebraska at Omaha (UNO), and the University of Nebraska Medical Center (UNMC) did not have a policy.

During the fiscal year ended June 30, 2009, each of the campuses developed and implemented policies. These changes took place in May 2009 for UNMC, UNL, and UNK and in July 2009 for UNO. The various campus policies now include the following ways to account for the missing property:

- Produce a copy of a signed "Request for Pickup-Surplus/Excess Property" 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.
- Complete a "Capitalized Asset Affidavit" form stating that the item cannot be located. Cite specific and valid reasons why the item should be deleted from the inventory listing. This form must be signed by the department head and the person responsible for capital assets in the department.
- Missing property from the third option above is approved by the Assistant Vice Chancellor of Business and Finance or the Associate Vice Chancellor of Business and Finance prior to the deletion from the inventory records.

We believe these policies, if followed, will improve accountability over missing property.

Our review for the fiscal year ended June 30, 2009, of University capital asset records noted UNK had no items they could not locate. However, UNL, UNO, and UNMC removed capital assets from their records that they could not locate. UNO removed 37 capital assets with an original cost of over $850,000 (See **Exhibit A**) from their capital asset records (prior year 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, which hadn't changed from the prior year. Our review by campus noted some follow up by the campuses, but documentation for most items appeared to be that they were sent to surplus property to be disposed of; however, documentation could not be 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.

Also during our prior fiscal year ended June 30, 2008, audit we noted several areas where control over University capital assets could be improved. During our current audit we noted the University took some corrective action based on our prior recommendation but we again noted the following in our review of the capital asset records at the various campuses:

a. 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."

b. 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. UNL is currently in the process of implementing a procedure to inventory such items on SAP using the "Objects on Loan" feature in the Human Resources module. After completing its implementation, UNL will share information related to the "Objects on Loan" function with the other campuses.

c. 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 statutory accountability requirements are not being followed, the University assumes additional risks assets will be misused or stolen.

We again recommend the following:

1. The University follow their newly implemented procedures and keep documentation to support the reason the capital assets could not be located and the action taken to locate the item and also have management level approval for the removal of the capital assets from their 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 considers 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 intends to follow its new procedures on "assets not located."

The University has adopted the SAP system Objects on Loan function to establish accountability for items susceptible to theft. Items that are not capitalized according to the University's capitalization policy but are susceptible to theft are being added to the Objects on Loan module during 2009-10.

The University believes its cycling of inventory is a reasonable practice and more cost effective in light of the exposure risks. A two year cycle is also congruent with Federal guidelines.

APA Response: We believe our comment demonstrates the need for the University to improve its accountability over capital assets. We also believe the University is required to comply with State statute, and perform an annual inventory of capital assets. We believe inventorying the University's capital assets on an annual basis in compliance with State statue is reasonable and would be an important step in improving the University's accountability over their capital assets.

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

Our prior audit for the fiscal year ended June 30, 2008, noted that in 1997 the 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 prior review for the fiscal year ended June 30, 2008, of the University's accounting for this investment in joint venture and the related equity in earnings of joint venture noted the following:

- The 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.

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

Our prior year recommendation was that the University review generally accepted accounting principles and consider following all provisions of the equity method of accounting for investment in joint venture and 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.

The University's prior year response to our recommendation was that they recognized the need to communicate with their venture partner and believed that communication has improved greatly, but, as with any partnership, improved communications should be a year-in and year-out goal. The University also maintained that the amount in their financial statements was conservatively stated as it agrees to their ownership percentage interest in the equity balances displayed in the separately audited financial statements of the venture.

The generally accepted accounting principles associated with the equity method of valuing investment in joint venture is outlined in Accounting Principles Board (APB) Opinion 18—This opinion states in part: 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."

In working with University management on this issue for the fiscal year ended June 30, 2009, audit we noted the management did review APB Opinion 18 and based on that review they believed they were substantially in compliance with this opinion even though their method of calculating the investment in joint venture is different than their joint venture partner—Clarkson. The University's method of calculating their investment in the joint venture is simple—from the audited financial statements of the joint venture the University calculates 50% of the net asset of the joint venture. This then is their 50% share of the investment in joint venture in accordance with the partnership agreement. Although this method may approximate the requirements of APB Opinion 18 it does not consider the adjustments required by APB Opinion 18 such as adjustments similar to those made in preparing consolidated statements including adjustments to eliminate intercompany gains and losses. The APA believes the method of calculating the investment in joint venture by Clarkson meets all the requirements of APB Opinion 18 and the University method does not. The APA believes the accumulated effect of the University not considering certain adjustments as required by APB Opinion 18 for the fiscal year ended June 30, 2009, is an understatement of the investment in joint venture by the University of approximately $21 million.

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 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 again 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 continue to 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's "ownership" percentage in the joint venture is 50%. The carrying value in the University's financial statements represents 50% of the equity reflected in the separately audited financial statements of the joint venture. We communicated with the auditor in a separate memo in 2008 on this subject and stated that our carrying value is that anticipated by GAAP once the intangible assets that might have been created in a transaction had been fully amortized. We do not believe that increasing our carrying value (assets) by approximately $21 million dollars, as suggested by the auditor, is as conservative, understandable and verifiable, with a value pegged to an audit of the venture, which is the valuation used by the University. We believe the alternative treatment suggested by the auditor would cast doubt on our financial statements by users.

APA Response: We believe the University's current accounting for their investment in joint venture is not fully in accordance with Generally Accepted Accounting Principles (GAAP). We continue to recommend the University work with their joint venture partner to account for their investment in joint venture in accordance with GAAP.

7. Accounts Receivable Write-off Procedures

During our prior audit we noted the University was not in compliance with Neb. Rev. Stat. § 81-8,297 (Reissue 2003) as accounts receivable being written-off were not submitted to the State Claims Board).

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, ..."

Our current audit noted there has been no change in the University procedures on this issue from our previous audit as the write-off of accounts receivable by the University are not being submitted to the State Claims Board.

When amounts written-off are not submitted to the State Claims Board, the University is not in compliance with State statute.

> We again recommend all write-off of receivables be formally submitted to the State Claims Board in accordance with Neb. Rev. Stat. § 81-8,297 (Reissue 2003).

University's Response: Based on the auditors' observation in 2008, the University consulted with the University's general counsel. Our general counsel feels our internal practice is compliant with the University's responsibilities per their reading of the statute.

APA Response: We believe the State statute requiring write-off of receivables is applicable to the University and should be followed. The University's response to our comment does not provide a basis for their conclusion. We therefore recommend the University consult with the Nebraska State Attorney General's Office to clarify this issue.

8. <u>Electronic Personnel Action Form (E-PAF) Approval</u>

E-PAF forms are used to process all personnel actions including processing new hires and pay changes. During our testing of payroll transactions on all campuses of the University, we noted some University departments do not document approval of the E-PAF process in SAP, the University's accounting system.

When a new employee is hired an email is sent to the approving official to notify them that a new hire E-PAF has been "parked" in SAP. E-PAF's are not required to be approved. They are normally processed on a negative approval basis. What this means is the new hire E-PAF will be processed by the HR department unless the HR department receives some information from the department head that the information submitted is incorrect. E-PAFs processed for pay changes are also generally processed on a negative approval basis and are processed at the departmental level and do not go through the HR department first since the employee is already in the system.

During our transaction testing we noted an instance where an employee received a pay raise subsequent to the budget book (contains a listing of salaries for all employees, approved by the Board of Regents for each campus annually) and there was no documentation kept on file indicating the correct amount or approval of the pay change. Also, there was an instance of an E-PAF that was incorrect and a Journal Entry was used to correct the error.

Good internal control requires adequate documentation to support whether a supervisor/manager has approved the E-PAF.

Given the fact that it is a negative approving process, an employee might be hired or have a pay change without the approval of the supervisor/manager if their emails are not checked on a regular basis.

> We recommend the E-PAF be a positive approval, where there is documentation of the appropriate supervisor/manager's review and approval on file.

University's Response: The University understands the auditors' observation and will look into controls to help mitigate risks in this area.

9. University of Nebraska Purchasing Card Program

A review separate from this audit was performed by the APA on the University's purchasing card program. The program consists of VISA-issued credit cards – referred to as procurement cards, purchasing cards or, more commonly, p-cards – used by several thousand University employees to make approximately 145,000 separate transactions per year totaling well over $40 million in annual purchases. A sample of transactions, as well as corresponding accounting controls over those transactions were tested, that occurred during an 18-month period ending December 31, 2008. The report discloses details on nearly 1,600 separate transactions that were tested by the APA. This report was issued on October 29, 2009, a copy of the full report can be found on the APA's website (www.auditors.state.ne.us).

The review noted the following related to policies and guidelines and internal controls over the purchasing card program:

1. The University does not have universal comprehensive purchasing card guidelines or policies. Each campus administers its own program, including the establishment of policies/guidelines, the authorization and distribution of cards to employees, maintenance of supporting documentation, and the reconciliation of each cardholder's purchases. The policies/guidelines at each campus have not been formally approved by the University Board of Regents.
2. The University has not established universal standard internal controls over purchasing cards or purchases. Each campus develops it own control procedures to provide oversight and monitoring of the use of the purchasing cards.

The review found significant deficiencies in many areas of University controls over the employees' use of the cards, resulting in purchases that were unauthorized, not properly documented, in violation of policies and guidelines, or possibly inappropriate. Moreover, minimal existing guidelines and policies were often ignored.

The review had nine separate findings and recommendations for the improvement of policies/guidelines and internal controls over the University's purchasing card program. These findings and recommendations will be followed up on in our next annual audit.

University's Response: Since the auditors' work relating to the purchasing cards were not a part of the 2009 financial statement audit, which is the basis for this communication, we believe the inclusion of these observations is duplicative and unnecessary. We have responded to the auditors' attestation report on purchasing cards for the January 1, 2007 to December 31, 2008 in a separate communication.

10. Information Technology (IT)

A. Change Management - (University's Accounting System - SAP)

For 7 of 25 changes selected for testing by the APA, documentation was not on file to support changes were tested, or to support the changes were approved prior to moving to production. We noted a similar finding in our prior audit.

We also observed 2 individuals with access to complete the entire change management process. The review of changes made by these two individuals was not documented. Of the 25 changes, noted above, 2 were identified as being developed, tested, approved, and promoted by the two individuals who are able to complete the entire change process. We noted a similar finding in our prior audit.

Both a lack of segregation of duties in the change management process and the lack of a documented change process increases the risk unauthorized and/or untested changes could be promoted to production. Unauthorized changes may result in the loss of University resources or SAP not operating in accordance with management's intentions.

> We recommend the University implement a documented review of changes made by employees able to complete the entire change process. We recommend the University consider this when implementing the new SAP change tool. We also recommend the University document all changes affecting SAP through their normal change management process. This would include patches or updates from third party vendors and patches from SAP.

University's Response: We agree that several production changes occurred during the period between July 2008 and June 2009 that were not fully documented (7 of 25) These changes transported to production were due to time constraints and specific emergency corrections that were needed during this period. A list of these identified transports and respective explanations was provided to APA in June 2009. We agree production changes should have formal approval and will strive to follow our policy in the future.

The two staff members with ability to approve and transport changes to production are core technical SAP system administrators and require production access to perform their support responsibilities for the University. They each are senior level specialists and work directly with the business leads, CSN and ASG management, to complete transports into production. The University considers these two senior individuals and their respective access critical to support the SAP system. We believe the University's review of changes mitigates the proposed risk.

The normal technical change management process (i.e. outside of upgrade and maintenance time periods), provides all changes are documented online, in the change transport system, and go into production upon management approval. The CSN Associate CIO or his designee reviews the technical changes in the change transport system periodically, typically the first working day of each month. A reminder email is automatically sent to the Associate CIO to prompt for the monthly review process. The review is online, and includes who completed them, what they were for, when they were completed, and the status of each. In the future, we will document this periodic review process and any identified findings.

B. SAP User Access

During our review of critical transaction codes in SAP, we noted the following:

- A total of 109 User IDs had access to the critical transaction code SA38, which allows users to bypass transaction level security and run programs they are not explicitly authorized to run. Two of these User IDs had their access to SA38 removed after an initial inquiry by the APA. Some of these users could also run programs via transaction codes SE37, SE38, or SE80.

- A total of 121 User IDs had access to critical transaction codes SM31 or SM30, which allow users to modify certain critical tables in SAP.

- Two Internal Auditors appear to have access which exceeds their needs to perform day to day activities. It appears this access was granted as a result of the implementation of the SAP Audit Information System (AIS) tool.

- One User ID, for a past consultant, was administratively locked but still possessed SAP access through profiles.

Allowing large numbers of users access to critical transaction codes increases the risk a user could accidentally or purposefully alter SAP in a way that impairs its functionality or accuracy of reflecting actual financial performance.

> We recommend the University review user access to the critical transaction codes identified and where feasible, establish transaction codes and/or standard menu access to the programs they require to perform their job function. We also recommend removing user access to these transaction codes for users who have been setup with alternative access to the programs they require. We also recommend the University review the access of the Internal Auditors to determine if their access is necessary. Additionally, we recommend the University implement procedures to ensure user access is removed upon separation from the University.

University's Response: We agree to assign transaction codes to programs that need to be run by individuals outside the core SAP system support group and to remove access to transaction code SA38 for those individuals

The University removed non-essential access to transaction codes SM30 and SM31 in July 2009, leaving a population of 38 core SAP system support staff with access to these codes.

The University agrees with the recommendation to remove access that exceeds the needs of the two internal auditors and has already begun the process by removing the SA 38 transition role.

The University has an automated process in place to lock an individual user ID upon a separation action, preventing any system access from that point forward, followed by removing all security roles from the user ID 30 days later. Procedures will be reviewed to assure that the same standard is applied to any consultant or other non-employee user ID upon completion of their engagements.

C. Change Control – Student Information System (SIS)-UNK, UNL, and UNO

Three developers were able to promote changes to production at UNK. UNK did not have a compensating control in place, such as, a management level review of changes.

One developer was able to promote changes to production at UNL and UNO. UNL and UNO did not have compensating controls in place, such as, a management level review of changes.

Developers with access to both develop changes and move those changes into production increases the risk an inappropriate change could be made which is not in accordance with management's intentions.

> We recommend UNK, UNL, and UNO not allow developers to move changes into production. If restricting their access is not possible, we recommend they implement a management level documented review of changes promoted to production. This management level individual should have an understanding of what changes should be made so they can determine whether or not all changes made are appropriate.

University's Response: A new SIS will be implemented and will be completed by October. This implementation will eliminate the ability for individual campus developers to move changes into the Production SIS environment for all University campuses.

11. <u>New Accounting Standards</u>

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

This statement 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 and is not intended to be and should not be used by anyone other than specified parties. However, this letter is a matter of public record and its distribution is not limited.

Sincerely,

Signed Original on File

Don Dunlap, CPA
Assistant Deputy Auditor

Exhibit A

Un-located Capital Assets at UNO

Description	Note 1 Capture Date	Acquired Amount	Life-to-Date Deprecation	End Book Value	Note 2 Deactivation Date
IBM THINKPAD LAPTOP	7/1/1999	$ 6,116.82	$ (6,116.82)	$ -	8/26/2008
DELL POWERVAULT MODEL 650F	5/12/2000	10,204.78	(10,204.78)	-	7/1/2008
NETWORK HUB CISCO 5000	6/1/1999	35,493.50	(32,245.50)	3,248.00	7/1/2008
NETWORK HUB CISCO 5000	6/1/1999	51,754.50	(47,015.50)	4,739.00	7/1/2008
NETWORK HUB CISCO 6000	6/1/1999	74,441.50	(67,625.50)	6,816.00	7/1/2008
NETWORK HUB CISCO 6000 D SECTION	6/1/1999	13,986.00	(12,708.00)	1,278.00	7/1/2008
NETWORK HUB CISCO 5000	6/1/1999	42,486.50	(38,595.50)	3,891.00	7/1/2008
NETWORK HUB CISCO 6000	6/1/1999	83,538.00	(75,882.00)	7,656.00	7/1/2008
NETWORK HUB CISCO 6000	6/1/1999	83,538.00	(75,882.00)	7,656.00	7/1/2008
NETWORK HUB CISCO 6000	6/1/1999	74,441.50	(67,625.50)	6,816.00	7/1/2008
GATEWAY SOLO LAPTOP PC 44301	8/1/1997	5,352.00	(5,352.00)	-	8/26/2008
WORKSTATION SERVER	4/1/1992	21,496.94	(21,496.94)	-	8/26/2008
IBM CASH REGISTER 050906 44251	5/1/1994	5,136.25	(5,136.25)	-	8/26/2008
IBM CASH REGISTER 050906 44251	5/1/1994	5,136.25	(5,136.25)	-	8/26/2008
IBM CASH REGISTER 050906 44251	5/1/1994	5,136.25	(5,136.25)	-	8/26/2008
IBM CASH REGISTER 050906 44251	5/1/1994	5,136.25	(5,136.25)	-	8/26/2008
IBM CASH REGISTER 050906 44251	5/1/1994	5,136.26	(5,136.26)	-	8/26/2008
IBM CASH REGISTER 050906 44251	5/1/1994	5,136.26	(5,136.26)	-	8/26/2008
IBM CASH REGISTER 050906 44251	5/1/1994	5,136.26	(5,136.26)	-	8/26/2008
IBM AS400 PC LOWER LEVEL	3/1/1993	34,993.00	(34,993.00)	-	8/26/2008
CART EXERCISE MMC	6/1/1988	32,120.00	(32,120.00)	-	8/26/2008
MODULAR SPIROMETRY- BODY COMP RM	10/1/1996	12,274.00	(12,274.00)	-	8/26/2008
TREADMILL 2482	1/1/1980	11,025.00	(11,025.00)	-	8/26/2008
ASSEMBLY AMPLIFIER	1/1/1983	14,580.00	(14,580.00)	-	8/26/2008
LOCAM 16MM CAMERA LOCKED CABINET	10/1/1980	7,829.00	(7,829.00)	-	8/26/2008
BVU-800 SONY	1/1/1982	12,980.00	(12,980.00)	-	7/1/2008
BVU-800 SONY	1/1/1982	12,980.00	(12,980.00)	-	7/1/2008
EDIT CONTROLLER 141T BACK OF UNIT	5/1/1990	26,435.00	(26,435.00)	-	7/1/2008
CASSETTE RECORDER (TAG IN DOOR)	10/1/1990	8,584.00	(8,584.00)	-	7/1/2008
CASSETTE RECORDER (TAG IN DOOR)	10/1/1990	8,584.00	(8,584.00)	-	7/1/2008
AMPEX TBC II	12/1/1981	12,500.00	(12,500.00)	-	7/1/2008
AMPEX VPR 2	5/1/1980	39,665.00	(39,665.00)	-	7/1/2008
AMPEX VPR 2	5/1/1980	38,965.00	(38,965.00)	-	7/1/2008
DNP PRINTER	12/4/2000	9,400.71	(9,400.71)	-	8/26/2008
CISCO 6500 ROUTER	5/25/2001	10,739.00	(10,739.00)	-	7/1/2008
MODULE OXYGEN ANALYZER (BLACK CASE)	6/28/2001	10,531.59	(10,531.59)	-	8/26/2008
DELL POWERVAULT MODEL 630F	7/8/2001	8,410.76	(8,410.76)	-	7/1/2008
	Totals	$ 851,399.88	$ (809,299.88)	$ 42,100.00	

Note 1: Capture date represents the day that the item was put into service, it should be relatively close to the purchase date.

Note 2: Deactivation date represents the day that UNO deactivate the item in the system, because it was unable to be located.