MANAGEMENT LETTER
OF THE
NEBRASKA STATE COLLEGE SYSTEM

JULY 1, 2008 THROUGH JUNE 30, 2009

Issued on February 11, 2010

NEBRASKA AUDITOR OF PUBLIC ACCOUNTS
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December 21, 2009

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

Dear Mr. Carpenter:

We have audited the basic financial statements of the Nebraska State College System (NSCS) for the fiscal year ended June 30, 2009, and have issued our report thereon dated December 21, 2009. We have also audited the NSCS's compliance with requirements applicable to major Federal award programs and have issued our report thereon dated December 21, 2009. In planning and performing our audit, we considered the NSCS's internal controls in order to determine our auditing procedures for the purpose of expressing our opinions on the basic financial statements of the NSCS and to report on internal control in accordance with the Office of Management and Budget (OMB) Circular A-133 and not to provide assurance on internal control. Internal control and compliance matters required by *Government Auditing Standards* and OMB Circular A-133 were reported in the above reports. The matters disclosed in this letter are not required to be reported in the above reports but are matters for NSCS's consideration. We have not considered internal control since the date of our reports.

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

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

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

1. <u>Accounts Receivable Write-Off Procedures – *Nebraska State College System*</u>

Neb. Rev. Stat. § 81-8,297 (Reissue 2008) 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 our review of the NSCS's accounts receivable write-off procedures, we noted each College annually submits accounts receivable, including tuition and fees and revenue bonds and other fund accounts, to its Board of Trustees for approval. However, no procedures are in place to further submit these write-offs to the State Claims Board for their approval. Based on historical data from 2004-2009, the average annual write-off for all three Colleges has totaled approximately $97,782.

When uncollectible amounts are written off without first being submitted to and approved by the State Claims Board the NSCS is not in compliance with State Statute.

> We recommend that all receivables be submitted to and approved by the State Claims Board in accordance with Neb. Rev. Stat. § 81-8,297 (Reissue 2008) before being written off by the Colleges.

NSCS's Response: The NSCS follows formalized write-off procedures that include Board of Trustees approval of write-offs in accordance with Board Policy #6008. The Board reviews and authorizes write-offs annually. In response to the management letter comment, the NSCS will check further into the requirements of the statute noted.

2. <u>Presidents' Contracts – *Nebraska State College System*</u>

The Internal Revenue Code ("Code"), codified as Title 26 of the U.S. Code ("U.S.C."), outlines at Title 26 U.S.C. § 119(d) (2008) – Title 26, Subtitle A, Chapter 1, Subchapter B, Part III, § 119(d) - complex, fact-specific, provisions related to lodging furnished to employees by certain educational institutions; Neb. Rev. Stat. § 49-1493(13) (Reissue 2004) requires statements of financial interest to be filed with the Nebraska Accountability and Disclosure Commission (NADC) by certain individuals; and Title 4 NAC 2-002.13(13) (2007) expands upon the language in Neb. Rev. Stat § 49-1493(13) specifying that "state college presidents" must file statements of financial interest with NADC. Transparency of government requires a complete and accurate disclosure of all governmental activities, including, but not limited to, significant employment contracts.

In our review of Board of Trustee proceedings, College foundation audit reports issued by other auditors, and financial activities of each College, the following was noted:

- Presidents of each of the Colleges currently receive a housing allowance ranging from $9,000 (PSC) to $14,000 (WSC and CSC) annually.

- In addition to housing allowances, the College Presidents at PSC and CSC are currently provided physical residences for which the respective Colleges pay all costs of ownership, including, but not limited to, maintenance, utilities, insurance, and mowing/snow removal.
- The home provided to the PSC President has an estimated market value of approximately \$100,000-\$125,000. The home acquired September 1, 2009, and provided to the CSC President had a 2008 assessed market value of \$372,330.
- No logs or similar records are maintained to document use of these homes for hosting of official events of the Colleges.
- The PSC and CSC Presidents' employment contracts make no mention of homes being provided to those Presidents in addition to their housing allowances. As such, the employment contracts do not address any specific rights and/or responsibilities related to the homes, including, but not limited to, whether College Presidents are <u>required</u> to reside in the homes, responsibility for costs routinely associated with home ownership, such as maintenance, utilities, and insurance, and any required documentation to support use of the homes in an official capacity.
- The Board of Trustees' resolutions approving salaries and contract extensions make no mention of homes being provided to the PSC and CSC Presidents in addition to their housing allowances.
- NADC makes available the "Statement of Financial Interest" form NADC C-1 to facilitate financial interest reporting. It is unclear from existing NADC guidance whether being provided a physical residence in the above-noted situations is considered an added benefit requiring reporting on form NADC C-1.

When all relevant facts and information related to significant employment contracts are not completely and accurately disclosed, the NSCS is at an increased risk of having a perceived lack of transparency in its operations. In addition, when housing arrangements similar to those existing at PSC and CSC are not clearly defined and disclosed, the NSCS increases its risk of noncompliance with a complex, fact-specific IRS Code provisions governing such arrangements. Lastly, without clear NADC guidance in this issue, the NSCS is at an increased risk of individual noncompliance with the intention of Nebraska's accountability and disclosure laws.

> We recommend the NSCS completely and accurately disclose, both in its employment contracts as well as in its Board of Trustees proceedings, all aspects and conditions of private residences being provided, in addition to monetary housing allowances, to its College Presidents. We further recommend the NSCS review Title 26 U.S.C. §119(d), along with any other relevant provisions of the IRS Code relating to housing expenses, to ensure compliance, in all aspects, with the Code, as any such final determination is very fact specific and is contingent upon a correct understanding and application of the facts in each particular case. Lastly, we recommend the NSCS seek an advisory opinion from NADC as to whether the PSC and CSC Presidents' living arrangements must be revealed on NADC Form C-1.

NSCS's Response: The Presidents' monetary housing allowances are provided in Board materials; and Board action on the housing allowances are reflected in the minutes of the Board Meeting each year. IRS requirements have been reviewed in the past for compliance, however, the NSCS will review current practices involving Presidents' employment contracts and housing arrangements in the context of both IRS and NADC requirements.

3. President's Discretionary Fund – *Nebraska State College System*

Since the mid 1980s PSC has contracted with Peru State Advancement Inc. (PSAI), a private, non-profit corporation to provide a College bookstore on the PSC campus. PSAI uses its revenues almost exclusively to provide "discretionary" funds to the PSC President via checking accounts under the direct control of the PSC President.

As of the management letter issue date this complex, highly unusual arrangement continues to be reviewed by the Auditor of Public Accounts (APA) in order to fully determine operational and/or administrative deficiencies and assess fraud risk. Once the APA review of this issue has been completed a separate written communication will be provided to the State Colleges Board of Trustees which will include detailed information including specific APA recommendations.

NSCS's Response: PSAI provided critical bookstore services for our students at a time when they were not otherwise available. Following a period of growth and stability at Peru State, the NSCS now believes that the services of PSAI are no longer required. Thus, negotiations are underway to have the bookstore contract directly with the College.

We anticipate the new arrangement will be approved by the Board of Trustees this spring. With the change, the College will have direct control of receipts and expenditures within the revenue bond program. Additionally, the new arrangement will assure adequate internal controls and administrative oversight by Peru. PSAI, Peru State, and the System Office are working together to ensure adequate controls and oversight until the above change is implemented.

4. Internal Cash Control Review – *Nebraska State College System*

Good internal controls and sound business practices are both fundamental in reducing theft within an organization and begin with the creation of a climate which supports and reinforces an organization's goals, objectives, and values.

In August 2009, the NSCS self-reported to the Auditor of Public Accounts (APA) the following:

- A burglary/theft occurred in two buildings at CSC (one being the Sandoz Center and the other being CSC's business office in Crites Hall). A combination of checks, cash, and credit card receipts were taken in the burglary/theft. A criminal investigation is ongoing and being conducted by the Chadron Police Department, with assistance from the Nebraska State Patrol as it relates to statement analysis and polygraphs. CSC estimated its loss to be approximately $6,200 in cash.
- A burglary/theft occurred in one location at WSC. Similar to the CSC burglary/theft, a combination of checks, cash, and credit card receipts were taken. WSC estimated its loss to be approximately $2,500 in cash.

- In direct response to the CSC burglary/theft the NSCS hired one of its recently retired Vice Presidents of Administration and Finance to perform a review of the incident and make recommendations to executive management. The written report, which contained many specific recommendations, identified two areas as primary contributing factors: 1) physical building limitations and/or deficiencies; and 2) lack of day-to-day management oversight of employees due to their extensive time away from the College during design and implementation of new accounting and student information systems. A similar review was not conducted at WSC as executive management was able to readily identify factors which contributed to that incident.

As previously mentioned, good internal controls and sound business practices are essential to reducing theft. However, even when controls and/or procedures are logical and well designed; if they are not correctly and consistently used they can quickly become ineffective. As a result, ongoing monitoring of control compliance is a very significant act.

We commend the NSCS for quickly self-reporting both of these incidents and for just as quickly undertaking a review of contributing factors.

> We recommend the internal control review report received by executive management be closely evaluated and recommendations, where both practical and cost beneficial, be implemented to the extent possible. Furthermore, while we understand the internal control review report is specific to CSC's burglary/theft incident, we would recommend the NSCS also, to the extent possible, apply the reports overall recommendations to each of the other two Colleges in the NSCS.

NSCS's Response: All three Colleges have completed reviews to identify all campus locations where cash is collected and the processes for safeguarding funds collected. The Council of Business Officers has discussed their experiences and findings from those reviews. Some changes have already been implemented while others are under consideration. These discussions and the implementation of additional changes will continue.

5. IT Segregation of Duties – *Peru State College, Wayne State College, and Chadron State College*

Control Objectives for Information and related Technology 4.1 (COBIT) – Control Objective PO4.11 (Segregation of Duties) states an organization should "Implement a division of roles and responsibilities that reduces the possibility for a single individual to compromise a critical process and make sure that personnel are performing only authorized duties relevant to their respective jobs and positions." Control Objective PO4.13 (Key IT Personnel) states an organization should define and identify key IT personnel and minimize reliance on a single individual performing a critical job function. COBIT also defines segregation/separation of duties as "A basic internal control that prevents or detects errors and irregularities by assigning to separate individuals responsibility for initiating and recording transactions and custody of assets to separate individuals." Good internal controls include the segregation of IT functions so that no one individual is in a position to produce and migrate fraudulent or malicious code into production without detection. A sound compensating control for a lack of segregation of duties surrounding IT processes includes a documented review of audit logs that can identify programming changes, and changes to security settings and user provisioning.

At all three Colleges it was noted that at least one developer had full update access to the entire production environment, the change management process lacked adequate segregation of duties, and one individual could make changes and migrate them to production without an independent review being done. PSC and WSC both implemented procedures to review particular data changes made by programmers to compensate for their access to live data. However, these reviews did not include information on security changes made by the developer including adding and removing users, adding and removing access to SIS screens, or changes made to audited events/screens.

Without a review of programming changes, relevant audit log information, and user provisioning changes made by the developer, there is an increased risk developers could make unauthorized, undetected changes.

This issue was also previously reported in the prior six audits.

> We recommend the Colleges implement a process to report and review SIS programming and security changes made by developers to the production environment.

NSCS's Response: The size of the existing programming staff at the Colleges does not allow for compliance with the COBIT guidelines referenced. Compensating controls through functional units in the colleges are in place to review and balance reports from the system. These compensating controls continue to be reviewed and revised.

The Nebraska State College System (NSCS) is currently in the implementation phase of a new student information system (NeSIS). Database management for the systems will reside at a central location in Lincoln, providing additional segregation of duties.

6. Password Complexity – *Peru State College and Chadron State College*

Nebraska Information Technology Commission (NITC) Standards and Guidelines establish a reasonable set of best practices in many areas including application authentication and authorization. NITC Standard 8-301 regarding password construction, while not specifically applicable to higher education, includes minimum password settings to protect against unauthorized access. The password complexity rules include a minimum password length of eight characters, a password history rule that does not allow the use of the same password in a one-year period, and a password expiration policy of 90 days depending on the criticality of the application. These minimum password complexity rules should be strengthened based on the criticality of the application and the confidentiality level of the data it processes.

During testing of password complexity we noted the following:

- *Peru State College:* The minimum password length for the Student Information System (SIS) was set to five characters. SIS maintained a password history of two passwords, which was the system default established in 1995.
- *Chadron State College:* SIS users with update access were required to change their password every 180 days. Read-only users were never required to change their passwords.

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

> We recommend the Colleges establish a minimum password length of eight, consider changing the password expiration to 30-90 days, and increase password history so that a user cannot use the same password in a one-year period.

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

7. Federal Family Education Loans (FFEL) Notifications – *Peru State College*

34 CFR 668.165 (a)(2) (July 1, 2008) states, "…if an institution credits a student's account at the institution with Direct Loan, FFEL, Federal Perkins Loan, or TEACH Grant Program funds, the institution must notify the student or parent of (i) The anticipated date and amount of the disbursement; (ii) The student's right or parent's right to cancel all or a portion of that loan…and have the loan proceeds returned to the holder of that loan…; and (iii) The procedures and time by which the student or parent must notify the institution that he or she wishes to cancel the loan…" Additionally, 34 CFR 668.165 (a)(3) states, "The institution must provide the notice described in paragraph (a)(2) of this section in writing (i) No earlier than 30 days before, and no later than 30 days after, crediting the student's account at the institution…"

During testing of FFEL disbursements we noted that required FFEL disbursement notifications were not performed for all seven students tested. PSC immediately implemented notification procedures beginning with the 2009/2010 school year once this issue was brought to its attention.

When students and/or parents do not receive adequate loan disbursement notification there is an increased risk of repayment dispute.

> We recommend PSC continue to ensure all FFEL disbursement notifications are sent to students and/or parents in a timely manner.

NSCS's Response: PSC will continue to follow its procedures to ensure timely notification of student loan disbursements.

8. <u>Student Status Changes of Graduated Students – *Chadron State College*</u>

34 CFR 682.610 (c) and 34 CFR 685.309 (b) (July 1, 2008) require schools to complete and return within 30 days, unless the school expects to send a submission within the next 60 days, a student status confirmation report form to the Secretary or a guaranty agency.

During testing of student status changes we noted 12 of 22 students tested did not have their "graduated" enrollment status reported to the Student Clearinghouse. CSC reports all withdrawals, graduations, and other changes in status to the Student Clearinghouse. The Clearinghouse in turn reports CSC's student status change information to the National Student Loan Data System (NSLDS). For reporting of graduated student status changes, schools can elect to have the Clearinghouse use a "Degree Verify" file to update enrollment status of graduated students rather than reporting these changes separately; however, the school must first authorize the Clearinghouse to update graduated student status using this particular file. For the 12 of 22 students noted in our testing, the Student Clearinghouse's system automatically changed the status of these students, who appeared on the prior semester's report but did not appear on the new semester's report, to "w" (withdrawn). The proper reporting code, which would have been reflected had the College properly reported the graduated status of these students, would have been "g" (graduated). The last time CSC updated enrollment status for <u>graduated</u> students was the Fall 2007 semester.

When student status changes are not completely and accurately reported not only is the College not in compliance with applicable Federal regulations but lenders and others relying on reported data do not have accurate representations of each students' true enrollment status.

> Following this issue being brought to its attention, CSC immediately took corrective action to include authorizing the Student Clearinghouse to use the College's "Degree Verify" submission files to update enrollment status of graduated students. This change should be sufficient to adequately resolve this finding hereafter.

NSCS's Response: As indicated, CSC immediately corrected this issue, so this should not occur again.

9. <u>Timely Disbursement of Loan Proceeds – *Chadron State College*</u>

34 CFR 668.167 (b) (July 1, 2008) states "…an institution must return FFEL Program funds to a lender if the institution does not disburse those funds to a student or parent for a payment period within…thirty days after the institution receives the funds if a lender provides those funds by a check payable or co-payable to the borrower and the institution."

During our testing of loan proceed disbursements; we noted two of twenty-two FFEL disbursements were not disbursed within the 30 days required for loan checks made payable to the borrower and/or co-payable to the borrower and the College.

When loan proceeds are not disbursed in a timely manner the College is at increased risk of noncompliance with governing Federal regulations.

> The College should review the timely disbursement requirements of 34 CFR 668.167 (b) and implement procedures to ensure compliance.

NSCS's Response: This comment concerns FFEL Program funds. As of the Fall Semester, 2009, CSC no longer issues FFEL loans and is 100% Direct Loan.

10. Reporting of Administrative Cost Allowance (ACA) – Campus Based Programs – *Chadron State College*

Good internal controls require adequate procedures be in place to ensure completeness and accuracy of all required Federal reporting.

During our testing of CSC's Fiscal Operations Report and Application to Participate (FISAP) report for grant award year July 1, 2007, through June 30, 2008, we noted discrepancies in how CSC reported its total administrative cost allowance and how they actually took those allowances in its accounting system. CSC reported a total administrative cost allowance of $29,138 on its FISAP and split that allowance out with $16,401 claimed against the Federal Perkins Loan (FPL) program; $0 claimed against the Federal Supplemental Educational Opportunity Grants (FSEOG); and $12,737 claimed against the Federal Work Study (FWS) program. However, when administrative costs were actually entered into CSC's financial accounting system the $29,138 of total administrative cost allowance was split out with $5,000 against the FPL program, $15,138 against the FSEOG program, and $9,000 against the FWS program.

When required Federal reporting is not completely and accurately supported by the College's financial accounting records, there is an increased risk of inaccurate reporting of program activity.

> We recommend CSC review its procedures for FISAP reporting of ACA in relation to its actual journal entry transactions of such total cost to the various campus-based programs and seek to resolve any discrepancies.

NSCS's Response: CSC will review its procedures to ensure that the Administrative Cost Allowance listed in the FISAP report is in agreement with the journal entry recording the Administrative Cost Allowance in the accounting system.

11. SIS Backup Tapes – *Chadron State College*

NITC Standards and Guidelines, while not specifically applicable to higher education, establish a reasonable set of best practices in many areas including information technology business continuity and disaster recovery. NITC Standard 8-201 regarding disaster recovery plans includes the development of an offsite storage strategy and methods to protect storage media. Backup tapes should be maintained a safe distance from the data center to improve chances of data recovery should a disaster strike.

The weekly backup tapes of the SIS application are stored at the CSC library which is approximately 100 yards from the data center. Once the Colleges implement the new SIS application, the backups will be done at the University and University Computing Services will be responsible for backup site locations. The current plan will be to mirror data to the University of Nebraska Medical Center (UNMC) and to the 501 Building.

When backup tapes are not adequately protected there is an increased risk restoration of data cannot be done in the event of a disaster.

> We recommend CSC ensure tape backups are stored a proper distance from the data center to ensure recovery of data should a disaster occur.

NSCS's Response: This management letter comment will be resolved with the software conversion process to NeSIS when data will be stored off-site. The primary data base for the system will reside at a central location in Lincoln with the backup system in Omaha.

12. Bids for Purchases – *Wayne State College*

NSCS Board Policy 7010 states, in part, "All purchases of and contracts for services, materials, supplies, or equipment, and all leases of property, shall be made in the following manner, except in emergencies approved by the Board of Trustee's Chancellor:…By a competitive informal bidding in all cases in which the purchases are of estimated value equal to or exceeding ten thousand dollars ($10,000) but less than twenty-five thousand dollars ($25,000)." Board Policy 7010 further states, "If articles are to be purchased by competitive bidding, the State Colleges and System Office shall prepare standards and specifications for these articles in such a manner it will be possible for three or more manufacturers, vendors, or suppliers to submit competitive bids."

During testing of expenditures, we noted three bids were not procured for a $43,543 purchase of office furniture for WSC's Rice Auditorium and Stadium project.

When purchases are not made in compliance with NSCS Board policy there is an increased risk of dispute.

> We recommend WSC strengthen its procedures to ensure all purchases are made in accordance with NSCS Board policy.

NSCS's Response: The use of a vendor that was thought to be a part of state purchasing was used to secure the office furniture during the renovation of Rice Auditorium. The College is aware of Board policy regarding competitive bidding and procedures and will review future purchases more carefully for state contracts and Board policy compliance.

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

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

Sincerely,

Signed Original on File

Don Dunlap, CPA
Assistant State Auditor