MANAGEMENT LETTER
OF THE
NEBRASKA STATE COLLEGE SYSTEM

JULY 1, 2009 THROUGH JUNE 30, 2010

Issued on December 23, 2010

NEBRASKA AUDITOR OF PUBLIC ACCOUNTS

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December 22, 2010

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, 2010, and have issued our report thereon dated December 22, 2010. We have also audited the NSCS's compliance with requirements applicable to major Federal award programs and have issued our report thereon dated December 22, 2010. 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 the 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.

1. **Payroll Vendor Payments – *Nebraska State College System***

Oracle's JD Edwards EnterpriseOne (EnterpriseOne) is a computer application accounting software used by the State of Nebraska (State) to record all of its official financial records in one centralized system. The NSCS uses a separate computer application accounting software, Systems, Applications, and Products in Data Processing (SAP), which is then interfaced with EnterpriseOne. The NSCS and the University of Nebraska (University) entered into a business operations service agreement, in which the University provides support for the NSCS payroll and other processes in the SAP system.

Payroll vendor payments are set up differently in the SAP system implemented by the NSCS than in the EnterpriseOne system utilized by the State. Payments made to vendors through the State's payroll process are recorded as vendor payments in EnterpriseOne. However, instead of generating vendor payments through SAP or EnterpriseOne during the payroll process, the University, on behalf of the NSCS, sends payroll payment instructions directly to the State's bank, authorizing the automatic deposit of payments to the vendors' banks. As a result, a vendor payment entry is not created in either accounting system; rather, a mere journal entry is made to record such payments. Because neither accounting system records vendor payments by the NSCS to health insurance vendors, such as Blue Cross and Blue Shield of Nebraska (BCBS), the total amounts paid to these vendors cannot be determined or identified by general users of the two systems.

The following amounts were paid through the payroll process by the NSCS between July 1, 2009, and June 30, 2010:

Vendor	State Colleges
Payment for Health and Dental Insurance*	$ 7,995,927
TIAA/CREF (retirement)	$ 6,120,153
All other Payments	$ 1,049,503
Total	$ 15,165,583

* Payments made for the NSCS's fully-insured employee health insurance plan go directly to its health insurance carrier, BCBS.

After discussing with the NSCS Office, the Auditor of Public Accounts (APA) obtained this payroll process information from the University, as the University provides the NSCS payroll feeds from SAP to EnterpriseOne.

Sound accounting procedures include complete and accurate reporting of all payments to vendors to allow users of the State accounting system to review and report on all vendor payments. According to Neb. Rev. Stat. § 81-1110.01 (Reissue 2008), the purpose of the accounting division of the Department of Administrative Services (DAS) is:

> *"[T]o prescribe, coordinate, and administer a centralized, uniform state accounting and payroll system and personnel information system, to establish and enforce accounting policies and procedures for all state agencies, boards, and commissions, to monitor and*

> *enforce state expenditure limitations established by approved state appropriations and budget allotments, and to administer the federal Social Security Act for the state and the state's political subdivisions."*

When vendor payments do not originate from the State's accounting system, it is difficult for users of the two systems to ascertain the total amount paid to all vendors.

> We recommend the NSCS work with DAS and/or the University to develop a process that allows vendor payments to be recorded in SAP or EnterpriseOne.

NSCS's Response: The NSCS understands that the payments to BCBS and TIAA-CREF are processed differently than accounts payable, as part of the payroll clearing process. While the information is not available within the vendor file, it is available in SAP as part of the journal entry that makes the clearing entries. The amounts provided in the journal entry are reconciled by the NSCS each month to assure that the correct transfers were made. The NSCS will consult with the University and the Department of Administrative Services, as recommended. Under the current process, the NSCS will assure that reconciliation is completed and documented each month to assure the payroll journal entries are completed accurately.

2. SAP Access (Journal Entry Type Document Approvals and Invoices/Payables) – *Nebraska State College System*

A good internal control plan requires a documented review and approval of all journal entry (JE) type documents (including, but not limited to JEs, NDs, UAs, UUs, UDs, PAs, PJs, etc.) before they are posted to the General Ledger (GL). In addition, a good internal control plan requires proper segregation of duties to ensure no one individual can process a transaction from beginning to end.

During our review of access to and financial activity recorded in the SAP system, we noted the following:

- At the current time, the workflow in the SAP system does not require separate preparers and approvers of JE type transactions. As a result, certain individuals throughout the NSCS have the capability of preparing and posting these types of entries without prior review or separate, documented approval. During the fiscal year ended June 30, 2010, there were 3,424 such entries entered/posted in SAP. In total there were 34 individuals with access to create/post journal entry type documents to the NSCS's GL, 28 of which were NSCS employees and 6 of which were members of the University Administrative Services Group. The total dollar figure of these journal entries amounted to $543,879,212. The NSCS does not have one united, consistent approach to addressing this inherent SAP system weakness but instead leave it up to each user location to develop and employ their own compensating controls, some of which include procedures such as manually signed batch header sheets and/or transaction log books for some, but not all, document types.

- There is no separation of roles in SAP when employees have been authorized with the NSC_MM_AP_MAINTAIN function, a function which allows an employee to enter an invoice/payable, modify an invoice/payable, and post/approve an invoice/payable. CSC, PSC, and WSC, (the Colleges) and the NSCS Office had 20 employees set up in SAP in this manner as of June 2010. The NSCS must use EnterpriseOne to make all cash payments out of the State Treasury. It was also noted that the Colleges and the NSCS Office had 12 employees who could post and approve documents in EnterpriseOne, as well as having the NSC_MM_AP_MAINTAIN function in SAP, thus enabling these 12 employees to process a transaction from beginning to end.

When individuals can prepare and post JEs without a documented review and approval prior to posting, there is a greater risk of erroneous or inappropriate JEs occurring and going undetected. In addition, in the absence of an adequate segregation of duties there is an increased risk of loss, theft, or misuse of funds.

> We recommend the NSCS locations all work together to establish consistent, best practice compensating controls over JE document type transactions in the event they are unable to implement an adequate segregation of duties. Approval of JE document-types, transactions which can often be complex, should be done by an individual with sufficient knowledge of the transactions being performed. We also recommend the NSCS review overall SAP access and roles, including the NSC_MM_AP_MAINTAIN function as mentioned, and revise roles, wherever practicable, to ensure that no one employee has SAP system capability to process transactions from beginning to end.

NSCS's Response: With one year now completed on the SAP System, the NSCS is more knowledgeable regarding the various roles and security in SAP. The NSCS will review JE approval processes to establish consistent, best practices. The NSCS will also review SAP access and roles, as recommended.

3. Leave Accrual – *Nebraska State College System*

Nebraska State College System Board Policy 5103, Professional Staff Excluded From the NSCPA Bargaining Unit, states "Accrual of vacation leave shall begin the first day of the first complete calendar month of employment." It goes on to state, "Employees, upon retirement, dismissal or separation from employment, shall be paid for unused accumulated vacation leave."

Nebraska State College System Board Policy 5104, Support Staff Employees Excluded From the NAPE/AFSCME Bargaining Unit, regarding employees hired after July 1, 1993, states "Accrual of vacation leave shall begin the first day of the first complete calendar month of employment." And for both employees hired prior to, as well as after July 1, 1993, states employees are to "…accrue paid vacation leave at the rate of eight (8) hours for each calendar month of service completed…."

During payroll testing, system evaluation, and discussion with the Colleges' personnel it was determined the NSCS was not consistently administering the accrual of vacation leave, both at the time of employee hire as well as upon termination. In the case of new hires, the SAP system begins accruing employee leave the day an employee begins employment instead of on the first day of the first complete calendar month of employment. Conversely, upon employee termination, the SAP system does not calculate a prorated leave accrual for the employees final month of employment but instead leaves it up to Human Resources' professional judgment as to whether or not to manually enter an accrual adjustment into the SAP system for the final month of employment and, as a result, final month leave adjustments are inconsistent across the NSCS.

When leave is not accrued in accordance with Board Policy and is inconsistently administered within the NSCS, there is an increased risk employees may dispute their leave accruals and final payouts upon separation.

> We recommend all employee leave is accrued in accordance with Board Policy and is consistently administered across the NSCS.

NSCS's Response: This comment impacts employee leave accruals only in the first and final months of employment. The NSCS will review policies, bargaining agreements, and SAP calculations to determine changes necessary to bring leave accruals for the first month and final month of employment in accordance with policy and in a consistent manner across the NSCS.

4. State Claims Board – *Nebraska State College System*

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.…"

During our review of the NSCS's accounts receivable write-off procedures, we noted each of the Colleges annually submits accounts receivable, including tuition and fees and revenue bond and other fund accounts, to its Board of Trustees for write-off approval. However, no procedures were in place to further submit these write-offs to the State Claims Board for their approval. Based on historical data from 2004-2010, the NSCS average annual write-off for all three of the Colleges was approximately $117,924.

When delinquent accounts receivable are not submitted to the State Claims Board for write-off approval, the NSCS is not in compliance with State statute.

> We recommend receivables be submitted to the State Claims Board, in accordance with State statute, before they are formally written off.

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.

5. <u>Change Management – *Nebraska State College System*</u>

A good internal control plan requires a documented change process be in place to support computer application changes and an adequate segregation of duties be in place to ensure no one individual can complete the entire change management process from beginning to end without an independent, documented review of changes.

During review of SAP change management procedures, we noted the following:

- One of 25 changes selected for testing did not have adequate documentation on file to support changes requested, tested, or approved using the Lotus Notes change request form prior to moving them into the SAP production environment.

- Changes provided by third-party vendors or SAP patches were not documented using the Lotus Notes change request form or another documentation process.

- Two individuals had access to complete the entire change management process and any review of changes made by these two individuals was not documented. Furthermore, of the 25 changes tested, one change was identified as being developed, tested, approved, and promoted by one of the individuals capable of completing the entire change process from beginning to end.

A similar finding has been included in prior University audits (the University of Nebraska essentially functions as a third-party system administrator for the NSCS with regard to the SAP system).

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

> We recommend the NSCS work with the University, acting as a third-party system administrator for the NSCS with regard to the SAP system, to implement a documented review of changes made by employees capable of completing the entire change process from beginning to end. We also recommend the NSCS work with the University to document all changes affecting SAP through their normal change management process, including patches or updates from third-party vendors and patches from SAP. Lastly, we recommend the NSCS document its discussions and/or communications with the University regarding resolution of any NSCS issues related to SAP.

NSCS's Response: The NSCS will follow the recommendation of the APA and discuss this recommendation with the University.

6. Fiscal Operations Report and Application to Participate (FISAP) – *Wayne State College*

A good internal control plan requires adequate procedures be in place to ensure complete and accurate Federal reporting. In addition, U.S. Department of Education instructions for completion of the annual FISAP report requires entities to provide accurate report data and warns that if inaccurate data is provided, entities might not receive all funds to which they would otherwise be entitled or may risk return of funds.

During testing of WSC's FISAP report for the July 1, 2008, through June 30, 2009, grant award year, we noted a discrepancy for the total amount expended for State grants and scholarships made to undergraduates and in the information on eligible aid applicants enrolled in the 2008-2009 school year. WSC reported $455,022 for expended State grants and scholarships; the correct amount that should have been reported was $437,378; a variance of $17,644. WSC also transposed statistical numbers reported for Independent Undergraduates with Baccalaureate/1st Prof. Degree with Independent Graduate/Professional Students. The number of such eligible aid applicants should have been reported as 46 for Independent Undergraduates with Baccalaureate/1st Prof. Degree and Independent Graduate/ Professional should have been reported as 252.

When required Federal reporting is not complete and accurate, there is an increased risk of inaccurate reporting of program activity and other related statistics.

> We recommend WSC review its FISAP reporting procedures, including report preparation and review, to ensure complete and accurate reporting.

NSCS's Response: The discrepancies noted were immediately corrected by Wayne State College. The College will institute an additional checking process for the recorded numbers on the FISAP report.

7. Financial Aid Monitoring – *Wayne State College*

34 CFR § 668.22(a) (July 1, 2009) states, "….When a recipient of title IV grant or loan assistance withdraws from an institution during a payment period or period of enrollment in which the recipient began attendance, the institution must determine the amount of title IV grant or loan assistance that the student earned as of the student's withdrawal date…." In addition, 34 CFR § 668.32(f) (July 1, 2009) states, a student is only eligible to receive title IV assistance if they maintain satisfactory progress in their course of study according to the institution's published standards of satisfactory progress that satisfy the provision of 34 CFR 668.16(e). Furthermore, all institutions of higher education participating in Student Financial Aid programs should have adequate procedures in place to monitor, on an ongoing basis, student eligibility and, when required, timely calculation and return of title IV funds.

During testing of return of title IV funds we noted that WSC had inadvertently failed to include one particular group/class of student, students with undergraduate degrees returning to obtain additional undergraduate degrees, in the parameters of a computerized report used to monitor students for academic probation/suspension or return of title IV funds. For the fiscal year ended June 30, 2010, a total of 26 such students had been inadvertently not included in WSC's parameters. Eligibility of each of these students was reviewed by the APA and each was determined to have been eligible for aid during the 2009/2010 award year with only one student having unearned Fs; however, in that particular case the student had completed more than 60% of the term at which point no return of title IV funds would have been required.

Without adequate procedures to monitor for student probation/suspension or potential for return of title IV funds, there is an increased risk WSC may incorrectly disburse aid to ineligible students who do not make satisfactory academic progress or inadvertently not return Student Financial Aid title monies, when appropriate, to the Federal government.

> We recommend WSC implement procedures to ensure all students who receive aid are timely monitored for probation, suspension, or potential for return of title IV funds.

NSCS's Response: Students with undergraduate degrees returning to obtain additional undergraduate degrees have now been added to the parameters of the computerized report used to monitor students for academic probation/suspension or return of title IV funds. With the inclusion of this group, we believe that all students who receive aid will be timely monitored for probation, suspension or potential for return to title.

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

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's employees for the cooperation and courtesy extended to us during the course of the audit.

Sincerely,

Signed Original on File

Don Dunlap, CPA
Assistant Deputy Auditor