NEBRASKA AUDITOR OF PUBLIC ACCOUNTS

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December 19, 2014

Gerry A. Oligmueller, Acting Director
Department of Administrative Services
State Capitol, Room 1315
Lincoln, Nebraska 68509-4664

Dear Mr. Oligmueller:

We have audited the basic financial statements of the State of Nebraska (State) as of and for the year ended June 30, 2014, in accordance with auditing standards generally accepted in the United States of America and standards applicable to financial audits contained in *Government Auditing Standards* issued by the Comptroller General of the United States, and have issued our report thereon dated December 16, 2014. In planning and performing our audit, we considered the State's internal control over financial reporting (internal control) as a basis for designing audit procedures for the purpose of expressing our opinions on the basic financial statements of the State, but not for the purpose of expressing an opinion on the effectiveness of the State's internal control. Accordingly, we do not express an opinion on the effectiveness of the State's internal control.

In connection with our audit described above, we noted certain internal control or compliance matters related to the activities of the Nebraska Department of Administrative Services (Agency) or other operational matters that are presented below for your consideration. These comments and recommendations, which have been discussed with the appropriate members of the Agency's management, are intended to improve internal control or result in other operating efficiencies.

Our consideration of internal control included a review of prior year comments and recommendations. To the extent the situations that prompted the recommendations in the prior year still exist, they have been incorporated in the comments presented for the current year. All other prior year comments and recommendations (if applicable) have been satisfactorily resolved.

Our consideration of internal control was for the limited purpose described in the first paragraph and was not designed to identify all deficiencies in internal control that might be material weaknesses or significant deficiencies and, therefore, material weaknesses or significant deficiencies may exist that were not identified. However, as discussed below, we identified a certain deficiency in internal control that we consider to be a significant deficiency.

A deficiency in internal control exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent, or detect and correct misstatements on a timely basis. A material weakness is a deficiency, or a combination of deficiencies in internal control, such that there is a reasonable possibility that a material misstatement of the entity's financial statements will not be prevented, or detected and corrected, on a timely basis. We did not identify any deficiencies in internal control that we consider to be material weaknesses.

A significant deficiency is a deficiency, or combination of deficiencies, in internal control that is less severe than a material weakness, yet important enough to merit attention by those charged with governance. We consider Comment Number 1 (Review of CAFR Information) to be a significant deficiency.

This comment will also be reported in the State of Nebraska's Statewide Single Audit Report Schedule of Findings and Questioned Costs.

Draft copies of this letter were furnished to the Agency to provide management with an opportunity to review and to respond to the comments and recommendations contained herein. All formal responses received have been incorporated into this letter. Responses have been objectively evaluated and recognized, as appropriate, in the letter. Responses that indicate corrective action has been taken were not verified at this time, but will be verified in the next audit.

The following are our comments and recommendations for the year ended June 30, 2014.

1. Review of CAFR Information

A good internal control plan requires an adequate review of draft financial reports and information used to prepare the Comprehensive Annual Financial Report (CAFR), including the information provided by other agencies.

The Department of Administrative Services State Accounting Division (State Accounting) prepares the CAFR annually. In accordance with Neb. Rev. Stat. § 81-1125.01 (Reissue 2014), the CAFR is to be completed at least 20 days before the commencement of each regular session of the Legislature. Therefore, the Auditor of Public Accounts (APA) provided a list of items to be prepared by State Accounting, with dates for submission to the APA for testing, to ensure the CAFR would be completed timely. Throughout the audit, several items were not submitted timely.

For instance, State Accounting requested financial information from all State agencies to be provided by August 6, 2014. The APA requested this information be submitted for testing, with supporting documentation, by September 19, 2014. However, the last of the information was not provided until October 8, 2014, and supporting documentation was not included. Instead, the APA had to request the needed information directly from the agencies. This led to delays and inaccurate information.

Furthermore, the draft report submitted by State Accounting was incomplete and inaccurate. State Accounting provided the first draft on December 1, 2014, and two drafts thereafter, that required revisions for formatting and incorrect information, such as inaccurate management discussion and analysis, inaccurate statistical information, and inaccurate cash flow statements. The final draft was not provided until December 12, 2014.

During testing of the CAFR, we noted the following:

- State Accounting did not have adequate procedures to ensure the amounts submitted by State agencies were correct. The errors ranged from an overstatement of $3,430,203 for an incorrect payable to an understatement of $8,902,972 for an incorrect receivable, both performed by the Department of Health and Human Services.

- Errors were also noted in information prepared by State Accounting to support entries made to the financial statements and information to generate footnotes. Those errors included, but were not limited to the following: the College Savings Plan cash and cash equivalents was understated by $9,959,000 in the Statement of Net Position; an accrual for accounts payable was understated by $4,710,130; the property and equipment capital lease disclosure was understated by $2,500,000; the Internal Service Funds Statement of Cash Flows was misstated by $2,340,000; and the operating leases disclosure was overstated by $1,381,292.

A similar finding has been noted since the fiscal year 2007 audit.

State Accounting did make correcting entries for all material amounts, as recommended by the APA. Without adequate procedures in place to ensure the accuracy of the financial reports and information used to prepare the CAFR, there is a greater risk material misstatements may occur and remain undetected. Furthermore, when information is not submitted to the APA on a timely basis, there is an increased risk the CAFR will not be completed timely in accordance with State statute.

> We recommend State Accounting implement procedures to ensure information is complete, accurate, and submitted timely to the auditors. Furthermore, we recommend State Accounting continue to work with State agency personnel to ensure accrual information is supported and has a sound accounting base. State Accounting should also have procedures in place to review and verify that information is supported, reasonable, and accurate.

Agency Response: State Accounting has and will continue to work extensively with agencies to ensure that the amounts the agencies submit with the accrual questionnaires are correct. In this regard, State Accounting will meet with and assist many larger agencies to design, develop, implement and monitor proper procedures, as needed, so that accurate and timely reporting can be done after the year end. For the upcoming year, members from State Accounting will also attend exit conferences at various agencies to understand and enhance accounting procedures.

State Accounting has procedures in place to review work papers before they are given to the APA. We will review those procedures for adequacy and effectiveness and will make necessary changes, if needed. Please note that significant progress has been made in accrual reporting over the years.

2. **EnterpriseOne Timesheets**

Neb. Rev. Stat. § 84-1001(1) (Reissue 2014) 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.*

Sound business practices, as well as a good internal control plan, require hours actually worked by State employees to be adequately documented and such documentation to be kept on file to provide evidence of compliance with § 84-1001(1). Furthermore, a good internal control plan also requires employees who accrue vacation and sick leave to have adequate support that they actually earned the amounts recorded in their leave records.

Section 124-86, Payroll – Agency Records, of Nebraska Records Retention and Disposition Schedule 124, General Records, as issued by the Nebraska State Records Administrator, requires any "supporting records received or generated by an agency used to review, correct or adjust and certify agency payroll records" to be retained for five years. Per that same section, the supporting records may include timesheets and reports.

A good internal control plan requires the approval of timesheets to be documented for subsequent review.

The State's accounting system (EnterpriseOne) was utilized by 17 agencies during the fiscal year for time entry and leave reporting. For these 17 agencies, we noted the following:

- Overtime exempt employees were not required to maintain a timesheet or other form of documentation to show at least 40 hours were worked each week. Exempt employees were only required to record leave used in the system.

- EnterpriseOne timesheets were only maintained for the current pay period for 15 State agencies that used the time entry function in EnterpriseOne.

- Supervisors and human resource staff within the State agencies were able to change the employee's submitted timesheet without the employee's knowledge or documentation of the changes made.

- EnterpriseOne did not accurately track who approved timesheets in the system. Each employee was assigned a supervisor in his or her master file in the system. For State agencies that utilized timesheet entry in EnterpriseOne, the supervisor assigned to an employee approved the timesheet. However, supervisors were allowed to set up delegates in the system to approve timesheets in the supervisor's absence. The system did not record who actually approved the timesheet; if a delegate approved an employee timesheet, the system would record the assigned supervisor as the approver.

A similar finding was noted during the prior audit.

Without adequate records to support hours worked and approvals in the system, there is an increased risk for fraudulent or inaccurate payment of regular hours worked or accumulation of leave. A failure to retain important documentation risks noncompliance with Nebraska Records Retention and Disposition Schedule 124.

> We recommend the Agency establish a policy requiring all employees of State agencies to maintain adequate supporting documentation, such as timesheets or certifications, in compliance with the Nebraska Records Retention and Disposition Schedule. Furthermore, we recommend the Agency make the necessary changes to EnterpriseOne for the retention of timesheets, documentation of approvals, and changes to timesheets to ensure compliance with the Nebraska Records Retention and Disposition Schedule.

Agency Response: Exempt employees are required to only enter their leave exceptions into the NIS time entry time keeping program. If there are no leave exceptions, the approving supervisor does not approve a time record and the system pays them standard hours.

According to the Fair Labor Standards Act, exempt employees must receive the full salary for any week in which the employee performs any work without regard to the number of days or hours worked, unless certain exceptions are met. These allowable exceptions include certain deductions of one or more full days, but only if there is a bona fide plan, policy, or practice of providing compensation for a loss of salary.

Additionally, exempt employees do not track, earn or receive overtime compensation for extra hours worked. These employees are paid a salary for performing the whole job and not for actual hours worked. However, they are required to record and seek approval for any leave exceptions or if they are in a leave without pay status.

For the 15 agencies noted with current pay period timesheets, information is available in the system for what the employees were paid.

APA Response: As noted, Neb. Rev. Stat. § 84-1001(1) requires all state officers and heads of departments and their deputies, assistants, and employees to work no less than forty hours each week. Therefore, documentation should be retained, such as a certification or a detailed timesheet to document compliance with State statute.

Although the final pay is available in the system, there is no record of adjustments made to an employee's time after the employee submitted their timesheet.

3. <u>Deletions of Assets Not Properly Recorded</u>

Sound business practice and a good internal control plan require assets no longer owned by the State to be removed from the accounting records to ensure the accuracy of financial reporting.

The State sold six buildings and a tract of land valued in the accounting system at $1,220,765 but did not remove the assets from the system timely. The assets were sold in February 2014 and, as of November 2014, the assets still had not been removed from the accounting system.

When assets are not properly removed from the State's accounting records, there is an increased risk the financial statements and disclosures will be materially misstated.

> We recommend the Agency ensure sold assets are removed from accounting records in a timely manner.

Agency Response: The process within the State Building Division for adding or deleting land and buildings in the Statewide Building and Land Inventory is well established and has been in use for several years. Agencies that own or control buildings and land are familiar with the process. The process is reviewed for all agencies each year as part of the statutory requirement to perform an annual update and report.

The weakness in the current system which is highlighted in this finding is that the Building Division relies on each agency to fill out a form and submit it in a timely manner to the SBD Administrative Manager when a building needs to be added or deleted. All building and land additions or deletions in the EnterpriseOne System must be performed by the State Building Division.

Since the building surplus process for most state agencies is controlled by the Vacant Building and Excess Land (VBEL) committee, we have added a reminder and a copy of the surplus form to the VBEL notice to the agency when a building surplus action has been taken by the committee. Additionally, a copy of the VBEL Committee action is provided to the SBD Administrative Manager so he knows that a completed surplus form should be coming from the agency.

The above process is in place now and will be included in written VBEL procedures in the near future.

4. EnterpriseOne Access

Nebraska Information Technology Commission (NITC) Standards and Guidelines, Information Security Policy 8-101, Section 4.7.2, User Account Management, states:

> *A user account management process will be established and documented to identify all functions of user account management, to include the creation, distribution, modification and deletion of user accounts. Data owner(s) are responsible for determining who should have access to information and the appropriate access privileges (read, write, delete, etc.). The "Principle of Least Privilege" should be used to ensure that only authorized individuals have access to applications and information and that these users only have access to the resources required for the normal performance of their job responsibilities . . . .*
>
> *Agencies or data owner(s) should perform annual user reviews of access and appropriate privileges.*

NITC Standards and Guidelines, Information Security Policy 8-101, Section 4.7.3, Privileged Accounts Management, states:

> *The issuance and use of privileged accounts will be restricted and controlled. Processes must be developed to ensure that users of privileged accounts are monitored, and any suspected misuse is promptly investigated.*

Nebraska State Accounting Manual, AM-005, General Policies, Section 32, Terminated Employee Payroll and Finance Center ID's, states, in part:

> *Each agency shall have a documented procedure to immediately disable the Payroll and Financial Center ID of an employee who has terminated employment with the agency. It is the responsibility of the agency's authorized agent to request termination of the User ID from the computer system within five working days from the termination date . . . .*

A good internal control plan includes a process to ensure terminated users' access is removed timely and also includes utilizing logical access controls to ensure user access is commensurate with specific job responsibilities.

The employee termination process begins in Workday, the State's human resource application, which then interfaces with EnterpriseOne. For 20 of 25 terminated EnterpriseOne users tested, functional access to the application was not removed or disabled in a timely manner (within three business days). In addition, four of those IDs accessed EnterpriseOne after the user terminated. There were no batches created or posted by these individuals after their termination date. The delay in disabling the ID's ranged from 6 to 265 days.

One EnterpriseOne user, an employee of the University of Nebraska at Kearney, with batch management access, had the ability to create and post her own transactions in the system. In addition, two Department of Administrative Service employees had access, known as HR55, which enabled them to perform human resource and payroll statewide inquiry, maintenance, and reporting. This access was not reasonable based upon the users' job responsibilities.

A similar finding was noted during the prior audit.

When access to networks and applications is not terminated timely, it creates the opportunity for inappropriate access to State resources, as well as unauthorized processing of transactions. Such access may violate Federal laws regarding privacy issues. When an individual has access beyond what his or her job responsibilities require, there is an increased risk for unauthorized changes or transactions that could result in the loss of State funds.

> We recommend agencies manually disable employee IDs immediately upon termination. We also recommend agencies enter employee termination dates in Workday as soon as a termination date is determined. Finally, we recommend the Agency periodically review users with batch management, and users with access to higher level roles, such as HR55, to ensure their access is appropriate based on job responsibilities.

Agency Response: After noticing this issue, State Accounting sent an email to agencies on October 10, 2014, emphasizing the need to terminate employee access to the system on a timely manner.

5. EnterpriseOne Wage Garnishments

A good internal control plan includes procedures to ensure the correct exemption rates are used for garnished wages.

The Agency did not use the correct tables when calculating employee wage garnishments for delinquent State taxes. Instead, the Agency used the Federal exemption amounts, which did not agree to the Nebraska rates.

A similar finding was noted during the prior audit.

When the correct table for calculating garnishments for delinquent State taxes is not used, the employee's wage garnishment may be under withheld.

> We recommend the Agency work with the system vendor to add an additional table for the State exemptions for State tax levies.

Agency Response: The State tax table is not available in the current system, but will be available after the 9.1 upgrade.

6. Business Continuity Planning

COBIT 5, a business framework for the governance and management of enterprise information technology, BAI10.01 Establish and maintain a configuration model, states, in part:

> *Establish and maintain a logical model of the services, assets and infrastructure and how to record configuration items (CIs) and the relationships amongst them. Include the CIs considered necessary to manage services effectively and to provide a single reliable description of the assets in a service.*

DSS04.03 Develop and implement a business continuity response states, in part:

> *Develop a business continuity plan (BCP) based on the strategy that documents the procedures and information in readiness for use in an incident to enable the enterprise to continue its critical activities . . . . 4. Define the conditions and recovery procedures that would enable resumption of business processing, including updating and reconciliation of information databases to preserve information integrity . . .*

A good business continuity plan, which encompasses disaster recovery planning, includes making available reliable and useful information for decision making when faced with a disaster or other event causing, or creating the potential for, a loss of business continuity.

The Office of the Chief Information Officer (OCIO) Continuity of Operations Plan (COOP) plan did not include server-specific data, such as configuration files or locations, recovery file locations, dependencies between applications, etc. That information was maintained separately by each managing team. There was a central repository setup at one time where teams could place such pertinent business continuity information; however, it was not being utilized.

When reliable and useful information is not available for business continuity purposes, there is an increased risk of downtime, or extended downtime, of vital State services.

> We recommend the State work to continue improving business continuity and disaster recovery plans to include a central, backed-up repository of all reliable and useful information for resuming State information technology resources.

Agency Response: The Office of the CIO agrees with this suggestion. Although Technical Teams have individual internal systems with documented procedures to guide their efforts in the event of a disaster, there would be additional value to placing this information in a central repository with proper security controls.

7. <u>Nebraska Directory Services Password Settings</u>

NITC Standards and Guidelines, Password Standard 8-301, states, in part, "A password used to access Highly Restricted information must . . . Expire after 60 days" and "A password used to access Confidential information must . . . Expire after 90 days."

A good internal control plan includes system-enforced password reset intervals, combined with account lockout controls, based on a risk assessment and the likely consequences of an authentication error.

Access to the State of Nebraska portal, my.ne.gov, was controlled through Nebraska Directory Services (NDS). We noted NDS allowed users five grace logins after their password had expired. Allowing grace logins creates unknown variables in the life of a user's password, as reset intervals are not confined to established terms as required by NITC Standards and Guidelines.

Inadequate password control settings increase the risk of unauthorized users gaining access to sensitive information contained in State applications, using NDS for authentication.

> We recommend the OCIO review the need for grace logins and remove them if practicable or, if non-compliance can be adequately justified, request NITC approval for a waiver of the requirements contained in NITC standard 8-301 for NDS pertaining to the 60 and 90-day expiration requirement.

Agency Response: The Office of the CIO has disabled end-user grace logins within NDS to mitigate the risk of unauthorized users gaining access to sensitive information contained in State applications using NDS for authentication.

<u>Other Items – New Accounting Standards</u>

GASB Statement No. 68, *Accounting and Financial Reporting for Pensions – an amendment of GASB Statement No. 27.*

The primary objective of this Statement, effective for the fiscal years beginning after June 15, 2014, is to improve accounting and financial reporting by State and local governments for pensions. It also improves information provided by State and local governmental employers about financial support for pensions that is provided by other entities. This Statement results from a comprehensive review of the effectiveness of existing standards of accounting and financial reporting for pensions with regard to providing decision-useful information, supporting assessments of accountability and inter-period equity, and creating additional transparency.

GASB Statement No. 69, *Government Combinations and Disposals of Government Operations.*

This statement, effective for financial reporting periods beginning after December 15, 2013, establishes accounting and financial reporting standards related to government combinations and disposals of government operations. As used in this Statement, the term *government combinations* includes a variety of transactions referred to as mergers, acquisitions, and transfers of operations. This Statement requires the use of carrying values to measure the assets and liabilities in a government merger. This Statement also provides guidance for transfers of operations that do not constitute entire legally separate entities and in which no significant consideration is exchanged.

GASB Statement No. 71, *Pension Transition for Contributions Made Subsequent to the Measurement Date – an amendment of GASB Statement No. 68.*

This statement, effective for the fiscal years beginning after June 15, 2014, is to address an issue regarding application of the transition provisions of Statement No. 68, *Accounting and Financial Reporting for Pensions.* The issue relates to amounts associated with contributions, if any, made by a State or local government employer or nonemployer contributing entity to a defined benefit pension plan after the measurement date of the government's beginning net pension liability. This Statement amends paragraph 137 of Statement No. 68 to require that, at transition, a government recognize a beginning deferred outflow of resources for its pension contributions, if any, made subsequent to the measurement date of the beginning net pension liability. Statement 68, as amended, continues to require that beginning balances for other deferred outflows of resources and deferred inflows of resources related to pensions be reported at transition only if it is practical to determine *all* such amounts.

OMB Circular A-133

On December 26, 2013, the U.S. Office of Management and Budget (OMB) published final guidance in 2 C.F.R 200, titled Uniform Administrative Requirements, Cost Principles, and Audit Requirements for Federal Awards, to improve the effectiveness and efficiency of Federal financial assistance. Eight OMB Circulars, including A-133, *Audits of States, Local Governments, and Non-Profit Organizations,* have been combined into one "super circular." The effective date is covered in section 200.110, Effective/applicability date.

- Federal agencies must implement the requirements to be effective by December 26, 2014.

- Subpart F, Audit Requirements, will apply to audits of non-Federal entity fiscal years beginning on or after December 26, 2014. The revised audit requirements are not applicable to the fiscal years beginning prior to that date.

- Administrative requirements and cost principles will apply to new awards and to funding increments, in cases where the Federal agency considers funding increments to be an opportunity to modify the terms and conditions of the Federal award, to existing awards made on or after December 26, 2014.

- Existing Federal awards that do not receive incremental funding with new terms and conditions will continue to be governed by the terms and conditions of the Federal award.

* * * * *

Our audit procedures are designed primarily on a test basis and, therefore, may not bring to light all weaknesses in policies or procedures that may exist. Our objective is, however, to use our knowledge of the Agency and its interaction with other State agencies and administrative departments gained during our work to make comments and suggestions that we hope will be useful to the Agency.

This communication is intended solely for the information and use of the Agency, the Governor and State Legislature, others within the Agency, Federal awarding agencies, pass-through entities, and management of the State of Nebraska and is not intended to be, and should not be, used by anyone other than the specified parties. However, this communication is a matter of public record, and its distribution is not limited.

Pat Reding

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