The University of Nebraska

Management Letter

For the Year Ended June 30, 2017

Issued on January 31, 2018

NEBRASKA AUDITOR OF PUBLIC ACCOUNTS

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December 11, 2017

The Board of Regents
University of Nebraska

We have audited the financial statements of the University of Nebraska (University), a component unit of the State of Nebraska, for the year ended June 30, 2017, and have issued our report thereon dated December 11, 2017.

Our audit procedures were designed primarily to enable us to form an opinion on the Basic Financial Statements. Our audit procedures were also designed to enable us to report on internal control over financial reporting and on compliance and other matters based on an audit of financial statements performed in accordance with government auditing standards 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, and we make the following comments and recommendations that we hope will be useful to you.

The following is a summary of our Report on Internal Control Over Financial Reporting and on Compliance and Other Matters Based on an Audit of Financial Statements Performed in Accordance with *Government Auditing Standards*. Our complete report can be found with our report on the financial statements of the University dated December 11, 2017.

We have audited, in accordance with the auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards* issued by the Comptroller General of the United States, the financial statements of the business-type activities, and the discretely presented component unit of the University as of and for the year ended June 30, 2017, and the related notes to the financial statements, which collectively comprise the University's basic financial statements, and have issued our report thereon dated December 11, 2017. Our report includes a reference to other auditors who audited the financial statements of the University of Nebraska Foundation (Foundation), a discretely presented component unit of the University, the University of Nebraska Facilities Corporation, the University Technology Development Corporation, the University Dental Associates, the UNeHealth, the UNMC Science Research Fund, and the Nebraska Utility Corporation, blended component units of the University (collectively identified as the Blended Component Units), and the activity relating to the Members of the Obligated Group Under the Master Trust Indenture, as described in our report on the University's financial statements. The financial statements of the Foundation, the University of Nebraska Facilities Corporation, the University Dental Associates, the UNeHealth, the UNMC Science Research

Fund, and the Nebraska Utility Corporation were not audited in accordance with *Government Auditing Standards* and, accordingly, this report does not include reporting on internal control over financial reporting or instances of reportable noncompliance associated with these entities.

Internal Control Over Financial Reporting

In planning and performing our audit of the financial statements, we considered the University's internal control over financial reporting (internal control) to determine the audit procedures that are appropriate in the circumstances 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.

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. A *significant deficiency* is a deficiency, or a 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.

Our consideration of internal control was for the limited purpose described in the first paragraph of this section and was not designed to identify all deficiencies in internal control that might be material weaknesses or significant deficiencies. Given these limitations, during our audit we did not identify any deficiencies in internal control that we consider to be material weaknesses. However, material weaknesses may exist that have not been identified.

Compliance and Other Matters

As part of obtaining reasonable assurance about whether the University's financial statements are free from material misstatement, we performed tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements, noncompliance with which could have a direct and material effect on the determination of financial statement amounts. However, providing an opinion on compliance with those provisions was not an objective of our audit and, accordingly, we do not express such an opinion. The results of our tests disclosed no instances of noncompliance or other matters that are required to be reported under *Government Auditing Standards.*

We did note certain other matters that we reported to management, which are included in the following Schedule of Findings and Responses.

University's Response to Findings

The University's responses to our findings are described below. The University's responses were not subjected to the auditing procedures applied in the audit of the financial statements and accordingly, we express no opinion on them.

SCHEDULE OF FINDINGS AND RESPONSES

1. **Audit Differences**

A good internal control plan and sound accounting practices require financial information to be complete and accurate. This includes procedures to ensure the financial statements are correct, and adjustments are made to rectify all known significant ($1,000,000 or more) misstatements.

During our audit of the financial statements, we noted errors that resulted in significant misstatements. We proposed that the University adjust its statements to correct all of these errors. The University did adjust the statements for all corrections proposed.

The following are significant misstatements that the University corrected:

- The University of Nebraska–Lincoln (UNL) did not properly eliminate cash flows associated with Nebraska Utility Corporation (NuCorp) sales to UNL on its Statement of Cash Flows. This resulted in cash inflows from sales and services of educational activities being overstated by $30,268,369 and cash outflows from payments to vendors being overstated by the same amount. Since NuCorp is a blended component unit of the University, these cash flows should have been eliminated.

- UNL recorded accounts receivable owed by NuCorp for $3,723,493 at June 30, 2017, and $4,186,469 at June 30, 2016. Since NuCorp is a blended component unit of the University, these receivables should have been eliminated.

- The University of Nebraska Central Administration Office (UNCA) recorded gift revenue for $3,806,168; however, this should have been recorded as unearned revenue at June 30, 2017, as the revenue was not earned until fiscal year (FY) 2018.

- The University of Nebraska Medical Center (UNMC) did not have an adequate explanation for a $4,110,666 reclassification of FY17 expenditures from scholarships and fellowships to contractual services. It also made a similar $3,371,369 reclassification in FY16 moving expenses between the two line items but could not adequately explain the entry. Additionally, after the APA brought the above error to UNMC's attention, although UNMC properly corrected its Statement of Net Position, it did not properly update its Statement of Cash Flows. The $3,371,369 FY16 expenditure reclassification was not properly reflected as an increase in cash outflows from scholarships paid to students and a decrease in cash outflows for payments to vendors for $3,371,369.

- UNMC classified $4,378,541 in FY17 and $4,695,784 in FY16 employee, spousal, dependent, and graduate assistant waivers/remissions expenses as scholarships and fellowships expenses even though by nature they appear to be benefits expenses. Additionally, UNMC's presentation was inconsistent with that of the other University campuses, all of which presented these as benefits expenses.

- UNMC did not properly reflect the FY16 $3,110,723 claim reserve of one of its component units, the Science Research Fund (SRF), on its Statement of Net Position. It reflected the liability as current, when it is actually a non-current liability per SRF's audited financial statements.

- The University of Nebraska Omaha (UNO) improperly calculated the adjustment required to reflect its investments at fair market value. This resulted in both investments and increase (decrease) in fair market value of investments being understated by $1,159,383.

- UNMC incorrectly recorded accounts receivable and unearned revenue for $2,234,138. These funds passed through UNMC in fiscal year 2018, and so they should not have been recorded on the University's financials at June 30, 2017.

Without strong internal control procedures and accounting practices to ensure financial information is complete, accurate, and in accordance with accounting standards, there is a greater risk that material misstatements may occur and remain undetected.

A similar finding was noted in our prior audits.

> We recommend the University implement procedures to ensure financial information is complete, accurate, and in accordance with accounting standards.

Management Response: *It should be noted that most of the misstatements listed by the auditor have no impact on net position or net assets as reported. In our terminology, we call those items listed "reclassifications" as they move balances from one revenue/expense line item to another and do not impact the bottom line. We will re-examine the closing process to determine how to better capture reclassifications made at the campus level in preparing the combined statements.*

APA Response: The evaluation of the fair presentation of the financial statements is based on not only the Net Position line item, but also on the fair presentation of all financial statement items presented.

Generally Accepted Auditing Standard AU-C 450.04 discusses evaluating misstatements identified and defines misstatements as a difference between: the amount, classification, presentation, or disclosure of a reported financial statement item and that which is required for the item to be presented fairly in accordance with the applicable financial reporting framework.

2. <u>General Ledger Transactions in SAP</u>

The workflow in the SAP system does not require separate preparers and posters of General Ledger (GL) type transactions, primarily journal entries that do not result in vendor payments. As a result, certain individuals throughout the University had the capability of completing GL transactions from beginning to end without a documented secondary review and approval in SAP. The University did have a policy in place to review any journal entries (JE), payroll journal entries (PJ), NIS (refers to E1) journal entries (ND), University-only journal entries (UU), and non-Federal ACH receipt (CN) transactions over $49,999, or $499 when involving Federal funds, to address this inherent system weakness.

During our audit of the GL security roles in SAP, we identified 582 users with the ability to prepare and post GL entries in SAP without a system required secondary review or approval. The 582 users are noted by location below, along with the GL document types they could prepare and post:

Campus	# of Users
UNK	5
UNL	310
UNMC	215
UNO	41
UNCA	11

(Document Types: JE – Journal Entry, IB – Internal Charges Batch, and IC – Internal Charges Online)

A secondary role allowed 80 of those users to prepare and post additional GL document types. The 80 are noted by location below, along with the GL document types they could prepare and post:

Campus	# of Users
UNK	5
UNL	30
UNMC	26
UNO	14
UNCA	5

(Document Types: CN – ACH Receipt, ND – NIS Journal Entry, UU – University Only Journal Entry, UA – Accrual Journal Entry, TN – Interstate Billing Transaction, and PJ – Payroll Journal Entry)*

**NIS refers to the State's EnterpriseOne accounting system.*

During our testing of the University's policy to review journal entries, as described in the first paragraph of this section, we noted that UNL's JE population was not complete for three of three monthly non-Federal JE reviews examined. The following table provides a summary of the un-reviewed population:

Month Reviewed	Document Type Missing	# of Documents Missing	$ Amount
July 2016	CN	14	$ 13,703,651
October 2016	CN	29	$ 21,800,664
January 2017	CN	32	$ 21,956,236

Additionally, for the one monthly JE review that we tested at UNMC, UNMC's reviews were not completed in a timely manner. The October 2016 Federal review was completed in March 2017. The October 2016 non-Federal review was completed in December 2016 along with the months of June 2016 through November 2016, which is not timely.

A good internal control plan requires a proper segregation of duties to ensure no one individual can process a transaction from beginning to end. A good internal control plan also includes adequate security controls, through the design, creation, approval, and assignment of user roles, to prevent users from performing functions that do not allow for a proper segregation of duties.

The University of Nebraska Journal Entry (JE) Review Policy states in relevant part:

> *The University of Nebraska will review certain journal entry transactions to reduce the risk of incorrect postings or inappropriate entries. Journal entry transactions will be reviewed according to two budgetary types, those being 1) University budgeted funds (Non-Federal) and 2) Federal and Federal pass through grants and contracts . . . The threshold to review Non-Federal journal entry transactions is $50,000, or transactions greater than $49,999.99 . . . Journal entry reviews will be made monthly from printed or electronic file reports . . . The reports will include document types JE, PJ, UU, CN, and ND.*

When individuals are able to complete GL transactions without a system required secondary review or approval prior to posting the transaction to the GL, there is a greater risk for error and inappropriate GL transactions to occur and remain undetected. Additionally, in the absence of an adequate segregation of duties, there is an increased risk of loss, theft, or misuse of funds.

If the journal entry review control process to compensate for the lack of segregation of duties within SAP does not contain a complete population or reviews are not performed timely, there is an increased risk of journal entries posting incorrectly or inappropriately.

A similar finding was noted in our prior audits.

> We recognize that the University has a policy to review higher-risk general ledger transactions to mitigate risks related to the SAP system not having an established workflow, which would automatically require a segregation of duties in the preparation and posting of general ledger entries. Nevertheless, we continue to recommend that the University modify its role configuration for the 582 users identified, so that those users will not have the ability to post any GL transaction types in SAP without a system required secondary review or approval.
>
> We also recommend the University improve its procedures for reviewing journal entries. This includes ensuring that the populations of journal entries reviewed are complete, and the reviews are completed timely.

Management Response: *The University believes a secondary approval of journal entries contributes to controlling material financial risk. In particular, we believe the following University administrative practices work to significantly mitigate the financial risks associated with journal entries. First, certain journal entry transaction codes are reviewed if the entry is posted to Federal funds and the dollar amount exceeds $500; in addition, we review all other entries if the dollar amount exceeds $50,000. Second, departments verify posted charges, including journal entries, reducing the risk of inappropriate entries. Third, grants officers review charges when preparing Federal grant expenses reports. Finally, risk is further mitigated by the fact that journal entries primarily relate to cost distribution rather than adjusting the values of monetary assets.*

3. Contracts not on the State Contracts Database

During testing of 31 expenditures governed by contracts, six contracts and/or amendments were not included on the State Contracts Database, as required by State statute. The contracts and/or amendments not included on the State Contracts Database were two at UNK, two at UNL, and two at UNMC.

Neb. Rev. Stat. § 84-602.04(4)(a)(i) (Cum. Supp. 2016) states, in relevant part, the following:

> *A data base that includes a copy of each active contract that is a basis for an expenditure of state funds, including any amendment to such contract and any document incorporated by reference in such contract. For purposes of this subdivision, amendment means an agreement to modify a contract which has been reduced to writing and signed by each party to the contract, and agreement to extend the duration of a contract, or an agreement to renew a contract. The data base shall be accessible by the public and searchable by vendor, by state entity, and by dollar amount. All state entities shall provide to the Department of Administrative Services, in electronic form, copies of such contracts for inclusion in the data base beginning with contracts that are active on and after January 1, 2014 . . . .*

A similar finding was noted in our prior audit.

> We recommend the University include all of its contracts on the State Contracts Database in a timely manner to stay compliant with State statute.

Management Response: *The University will strive to continue filing contracts in the State Contracts Database on a timely basis. We will reevaluate our current processes to see where improvements can be made. We also wish to point out that in discussing the recommendations with the auditor, we shared how the database increases the risk of fraud and asked for assistance in working with the legislature to mitigate this risk.*

4. User Terminations

For 3 of 25 SAP terminated users tested, access was not removed within three business days. The time it took to remove access ranged from 12 to 14 business days and involved 1 UNO employee and 2 UNL employees.

For 10 of 25 NeSIS terminated users tested, access was not removed within three business days. The time it took to remove access ranged from 4 to 216 business days. Two of the 10 users logged into NeSIS multiple times between their termination date and the date access was removed. Both of these users were students, 1 at UNL and 1 at UNO. The 10 users with access not removed timely included 7 at UNL, 2 at UNMC, and 1 at UNO.

Additionally, it was noted UNL staff are notified of terminations twice a month when they receive a terminations report from SAP. The report is generally received on the first and third Monday of each month. This process would allow users to potentially retain access for more than two weeks after their termination date.

Finally, we noted the following terminated staff still had access to EnterpriseOne (E1), the State's accounting system, as of our testing in May 2017:

- 3 UNMC employees with termination dates ranging from August 2016 through January 2017

- 1 UNL employee terminated in August 2016

The University of Nebraska Executive Memorandum No.16 (Section 5) states the following:

> *Unauthorized access to information systems is prohibited . . . . When any user terminates his or her relation with the University of Nebraska, his or her ID and password shall be denied further access to University computing resources.*

InCommon Identity Assurance Profiles: Bronze & Silver (February 11, 2013), Section 4.2.4.2, states, "The IdPO shall revoke Credentials within 72 hours after being notified that a Credential is no longer valid or is compromised." Human resource staff are responsible for notifying the Identity Provider Operator (IdPO) of terminations and should work to achieve access removal within a 72-hour period.

A good internal control plan requires that terminated user access be removed timely and documentation, whether by system audit records or access removal forms, or both, be available to indicate that such access was properly removed.

A similar finding was noted in our prior audits.

Failure to terminate user access timely creates the opportunity for unauthorized processing of transactions.

> We recommend the University implement a formal documented procedure at each campus to ensure the appropriate staff is notified of all terminations in order to remove NeSIS, SAP, and E1 access within three business days. We recommend the process include entering termination dates – when they are known – in SAP prior to the actual termination.

Management Response: *All identified records will be reviewed with the campus security coordinators and addressed.*

5. <u>TrueYou Password Settings</u>

The University's Identity Management system, known as TrueYou, is used for authenticating to SAP. UNK, UNL, and UNO also use TrueYou to authenticate to NeSIS. The TrueYou secondary authentication policy allows users to select prompts from a set of six questions and to reset their password by providing answers to only two of those questions, generated randomly. These parameters do not meet National Institute of Standards and Technology (NIST) standards.

The University's Password Policy, Version 1.1 (Revised March 4, 2014), states:

> *Any credential which identifies a subject or service account should follow recommendations outlined in National Institute of Standards (NIST) 800-63-2 [2], [3] using a token method and the level of entropy or randomness as outlined in §§ 6.1.2 and 6.3.*

InCommon Identity Assurance Profiles: Bronze and Silver, Version 1.2, presents token (password) requirements for various levels of assurance (LOA). Token requirements for LOA1 for pre-registered knowledge tokens state, "If the questions are not supplied by the user, the user shall select prompts from a set of at least five questions." An example of a question from a selected prompt could be, "What was your first pet's name?", with the answer becoming the pre-registered knowledge token. LOA1 requires a verifier to submit correct answers for at least three questions. Token requirements for LOA2 for pre-registered knowledge tokens state, "If the questions are not supplied by the user, the user shall select prompts from a set of at least seven questions." LOA2 requires a verifier to submit correct answers to at least five questions.

Good internal control includes system enforced password parameters to ensure users meet minimum password standards.

A similar finding was noted in our prior audits.

Inadequate password settings increase the risk of unauthorized users gaining access to sensitive information contained in both the NeSIS and SAP applications.

> We recommend the University continue working to update system password parameters to meet policy including minimum standards for pre-registered knowledge tokens.

Management Response: *The TrueYou Identity Management System was replaced in 2017 with a new, vendor based solution. During this replacement, the number of required security questions was increased to the recommended minimum of three questions. NIST password parameter requirements will continue to be reviewed and changed as appropriate within the new solution.*

6. Inconsistent Fee Coding between Campuses

The campuses did not consistently code fees charged to students for financial statement presentation purposes. Technology, Late, Course/Lab, Academic Success, Registration, Distance Education, Multicultural, ID Card, and University Program and Facility (UPFF) fees were not coded consistently by the campuses. The table below provides a summary of how various fees tested were coded at each campus:

	Financial Statement Line Item			
Fee Type	**Tuition & Fees**	**Sales & Services of Educational Activities**	**Sales & Services of Auxiliary Operations**	**Sales & Services of Auxiliary Segments**
Technology Fee	UNMC	UNK UNL UNMC UNO		
Late Fee	UNK UNL UNO	UNK UNL	UNL	UNK UNL

Fee Type	Financial Statement Line Item			
	Tuition & Fees	Sales & Services of Educational Activities	Sales & Services of Auxiliary Operations	Sales & Services of Auxiliary Segments
Course/Lab Fee		UNK UNL UNMC UNO	UNMC	
Academic Success Fee/Student Access & Success Fee	UNO	UNK		
New Student Enrollment Fee /Registration Fee	UNL	UNK		
Distance Education Fee	UNK UNO	UNL	UNMC	
Multicultural Fee/Cultural Enrichment Fee	UNO	UNK		
ID Card Fee	UNO		UNK UNL	
UPFF Fee	UNL UNMC UNO UNK		UNMC	UNO

Sound accounting practice requires consistent coding of fees to ensure the financial statements are reported accurately.

As the campuses did not record fees consistently, they are not consistently reflected on the University's financial statements.

> We recommend the campuses work together to ensure fees are reflected consistently on the financial statements.

Management Response: *The University will work to ensure fees are treated consistently between campuses when applicable.*

7. Unclaimed Federal Financial Aid Refund Warrants

UNO did not have adequate procedures in place to comply with Federal regulations related to returning unclaimed (uncashed) Federal student financial aid refund warrants (State-issued checks) to the Secretary of Education within the required timeframe.

Per 34 CFR § 668.164(l)(3) (July 1, 2016), if a school attempts to disburse the credit balance due to a student for Federal financial assistance by check and the check is not cashed, the school must return the funds to the Secretary of Education no later than 240 days after the date the school issued the check.

A good internal control plan requires procedures to remit unclaimed Federal financial aid refund warrants to the Secretary of Education within the required timeframe.

We identified 65 UNO-issued Federal financial aid refund warrants, totaling $54,707, that the campus did not properly return to the Secretary of Education within the required timeframe.

Additionally, although UNO indicated it hoped to satisfy Federal requirements by contacting students who have not cashed their refund checks, the campus acknowledged it does not yet have a process in place to remit unclaimed funds back to the grantor (the Secretary of Education) within the required timeframe.

A similar finding has been communicated to management in our prior audits.

> We recommend UNO implement procedures to remit unclaimed Federal student financial aid refund warrants to the Secretary of Education within the required timeframe.

Management Response: *We will continue to refine and re-emphasize procedures which will allow UNO to remit Federal student financial aid from uncashed warrants to the Secretary of Education within the required timeframe.*

* * * * *

It should be noted that this letter is critical in nature, as it contains only our comments and recommendations and does not include our observations on any strengths of the University.

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

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

Sincerely,

Mark Avery

Mark Avery, CPA
Audit Manager