NEBRASKA AUDITOR OF PUBLIC ACCOUNTS

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Jason Jackson, Director
Nebraska Department of Administrative Services
1526 K Street, Suite 240
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Dear Mr. Jackson:

In planning and performing our audit of the financial statements of the governmental activities, the business-type activities, the aggregate discretely presented component units, each major fund, and the aggregate remaining fund information of the State of Nebraska (State), as of and for the year ended June 30, 2018, 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, we have issued our report thereon dated January 4, 2019. 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 that are appropriate in the circumstances for the purpose of expressing our opinions on the 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 (DAS) or other operational matters that are presented below for your consideration. These comments and recommendations, which have been discussed with the appropriate members of DAS 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 material weakness.

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 consider Comment Number 1 (CAFR Preparation) to be material noncompliance and a material weakness.

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

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. We did not identify any deficiencies in internal control that we consider to be significant deficiencies.

In addition, we noted other matters involving internal control and its operation that we have reported to management of DAS, pursuant to AICPA Auditing Standards AU-C Section 265.A17, in a separate early communication letter dated September 27, 2018.

Draft copies of this letter were furnished to DAS 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 they will be verified in the next audit.

The following are our comments and recommendations for the year ended June 30, 2018.

1. CAFR Preparation

The Department of Administrative Services (DAS), State Accounting Division (DAS – State Accounting), prepares the State of Nebraska Comprehensive Annual Financial Report (CAFR). In accordance with Neb. Rev. Stat. § 81-1125.01 (Reissue 2014), the CAFR is to be completed "at least twenty days before the commencement of each regular session of the Legislature." For the fiscal year ended June 30, 2018, CAFR, this date was determined to be December 20, 2018.

Section 81-1125.01 states, in relevant part, the following:

> *It shall be the duty of the Director of Administrative Services to digest, prepare, and report to the Governor, the Tax Commissioner, the Clerk of the Legislature, and the Legislative Fiscal Analyst, at least twenty days before the commencement of each regular session of the Legislature:*
>
> * * * *
>
> *(2) The Comprehensive Annual Financial Report showing fully all liabilities and resources of the state[.]*

Article III-10 of the Nebraska State Constitution sets the beginning date for the annual legislative session:

> *Beginning with the year 1975, regular sessions of the Legislature shall be held annually, commencing at 10 a.m. on the first Wednesday after the first Monday in January of each year.*

DAS failed to issue the CAFR in accordance with 81-1125.01. Instead, the report was issued on January 4, 2019, or 15 days late. The Auditor of Public Accounts (APA) agreed to a list of items to be prepared by DAS – State Accounting and submitted to the APA for testing by specific dates. Contributing to the noncompliance with 81-1125.01, DAS submitted 57 items more than seven days after the agreed-upon dates.

Of those agreed-upon items, a first draft of the report was to be provided to the APA by December 4, 2018; however, it was not received until December 13, 2018. That first draft was incomplete, contained numerous errors, and required several revisions to correct formatting problems and incorrect or missing information. The final draft was to be provided to the APA by December 14, 2018, but was not received until January 4, 2019.

The State is a large, complex entity boasting $16.5 billion in primary government assets, and it processed $8.9 billion in primary government expenses during fiscal year 2018. The DAS CAFR team responsible for assimilating and reviewing the statewide information comprising the report, adhering to multifarious Generally Accepted Accounting Principles, including the preparation and posting of $16.8 billion in adjusting entries, was comprised of five full-time employees with duties extending beyond the annual CAFR project. It is the opinion of the APA that the DAS CAFR team was, and has been for many years, grossly understaffed for completing a project of this size and complexity in an accurate and efficient manner.

Due, in significant part, to the lack of DAS resources dedicated to the CAFR, we noted material errors in information processed and prepared by DAS – State Accounting, as follows:

- We proposed 38 adjustments during the audit, 14 of which were not made by DAS – State Accounting. At the fund level, the accumulated uncorrected errors ranged from an overstatement of $7,877,365 to an understatement of $4,978,699. There were also unadjusted investment misclassifications, totaling $21,168,728, in Footnote 2. At the government-wide level, the accumulated uncorrected errors ranged from an overstatement of $9,079,353 to an understatement of $8,363,338.

- When preparing the government-wide journal entries, DAS did not correctly record net pension expense, deferred outflows of resources, and deferred inflows of resources for the Omaha School Employee Retirement System (OSERS) plan due to a change in proportion of the net pension liability attributed to the State, a non-employer contributing entity. Net pension expense and deferred outflows of resources were overstated by $5,234,000 and $2,547,000, respectively. Deferred inflows of resources were understated by $22,885,000. As a result, education expenses were also understated by $30,983,975. An APA's proposed adjustment was posted by DAS.

- An entry to record miscellaneous trust investments receivables and payables was not proper and reasonable based on the accounting policy. DAS improperly recorded $13,000,000 of investments receivable to equity securities when it should have been recorded to healthcare fixed income. The APA proposed an adjustment to reallocate long-term investments and accounts receivable to various CAFR funds affected by the error. An APA's proposed adjustment was posted by DAS.

- DAS did not have adequate procedures to review miscellaneous adjustment object accounts to ensure balances in the accounts were proper and reflected current-year activity. DAS only reviewed entries greater than $500,000, leading to significant activity needing adjustment. The APA proposed $9,273,292 in adjustments to ensure the financial statements were properly reflected. DAS did not post the adjustment.

- DAS did not perform adequate procedures to ensure revenue activity recorded after the fiscal year end should have been accrued for financial reporting requirements. We tested 14 revenue documents posted after fiscal year end and noted that 8 of the 14 needed to be adjusted for inclusion in the financial statements. The APA proposed adjustments totaling $9,253,466. DAS did not post the adjustment.

- The OSERS appropriations receivable accrual was not consistent with the Nebraska Public Employees Retirement System (NPERS) entry. DAS recorded a receivable of $7,110,576 in the school retirement system CAFR fund, rather than the CAFR fund used for outside trust funds. Consequently, an adjustment was proposed to move the receivable from the fiduciary fund to the correct Agency Fund. The APA's proposed adjustment was posted by DAS.

- DAS did not initially include the College Savings Plan (CSP) in the investment holdings report used to create the investment footnote. DAS must manually add certain investments, including the CSP, held outside of the State's custodial bank, to the investment holdings report. The value of the College Savings Plan at June 30, 2018, was $4,854,902,120. DAS corrected the error after the APA brought it to its attention.

- When compiling the Component Units Statement of Net Position, DAS incorrectly included Chadron State College Foundation's investments in unrestricted cash and cash equivalents. Cash and cash equivalents was overstated and investments understated by $19,904,450. DAS corrected the error after the APA brought it to its attention.

- DAS did not obtain fair value reporting levels for deferred compensation retirement investments held by Mass Mutual totaling $33,934,810. Investments reported in Footnote 2 of the CAFR were to be classified in levels depending on how the fair value was determined, as required by Generally Accepted Accounting Principles. This amount was instead included as "Other Investments Not Classified."

- DAS did not perform an adequate review of journal entry activity posted after the year end for the period July through September 2018, which related to the fiscal year ended June 30, 2018. General Fund aggregate activity during that period was ($4,607,267), and Federal Fund aggregate activity was $4,719,952. The majority of activity occurred through five journal entries that moved expenditures from the General Fund to the Federal Fund. The APA proposed an adjusting entry to accurately record activity from those journal entries totaling $4,448,335. DAS posted the proposed adjustment.

- As of June 30, 2018, a bank account was inappropriately held by the State Treasurer outside of the State's accounting system, EnterpriseOne (E1). To record the cash for CAFR reporting, DAS used the balance as of July 23, 2018, the date the State Treasurer receipted the funds into E1. The CAFR entry recorded the entire balance to a revenue object account, instead of properly accounting for the beginning fund balance, actual revenues and expenditures, and ending fund balance. Consequently, the APA proposed an adjustment to record a beginning balance of $2,328,916, revenues of $1,447,316, expenditures of $842,173, and ending balance of $2,758,108. DAS posted the proposed adjustment.

- DAS omitted $5,468,507 budgeted for capital projects on the Budgetary Comparison Schedule – Revolving Funds. DAS revised the budgetary schedule when the APA brought the error to its attention.

- DAS did not properly post an APA's proposed adjusting entry to decrease proceeds from bond issuances. As a result, proceeds from other financing arrangements were overstated, and licenses, fees and permits revenue was understated on the governmental funds Statement of Revenues, Expenditures, and Changes in Fund Balances by $2,560,000.

- A reconciliation between unemployment compensation (UC) activity processed through the Department of Labor Tax Management System (TMS) and E1 identified the following:

  - A $1,672,683 payable at June 30, 2018, represented interfund activity that should have been eliminated. DAS posted an adjustment proposed by the APA.

  - The reversal of a UC correcting entry done in the fiscal year 2017 CAFR (reversed during fiscal year 2018) incorrectly affected "other revenue" when it should have been recorded as a transfer out. This resulted in an understatement of other revenue and transfers out of $1,613,119. DAS posted an adjustment proposed by the APA.

  - A June 30, 2018, a UC payable for interest and penalties, totaling $132,702, was appropriately recorded as due to another fund. A corresponding entry in the other fund was needed in order to establish a receivable and a transfer in for $132,702. DAS posted an adjustment proposed by the APA.

  - Bad debt expense was understated and receivables were overstated by $112,624 based on activity in TMS. The beginning fund balance and receivables were overstated by $317,707 for prior years' uncollectible amounts. DAS did not post an adjustment proposed by the APA.

- DAS did not perform a review of the object account used to record operating grants between State agencies to determine if adjusting entries were necessary for duplicative activity. Based on the APA's review, adjustments were proposed to eliminate $1,191,705 of revenues and expenditures from the Game and Parks CAFR fund, and $334,110 from other special revenue funds. An APA adjustment was also proposed to report $139,637 as transfers in and out in other special revenue funds and the Highway Fund, rather than revenues and expenditures. The proposed adjustments were not posted by DAS.

- Two capital assets had fiscal year 2017 acquisition dates but were included as additions in fiscal year 2018. This caused additions to be overstated and the beginning balance to be understated by $1,122,480. There were also prior year depreciation expenses that were not recorded, causing accumulated depreciation to be understated by $92,478. Five other capital assets did not have any depreciation expense reported, causing depreciation expense to be understated by $469,163.

- A prior year adjustment for child support enforcement cash was not properly reversed in fiscal year 2018, causing balances to be duplicated for activity recorded by the Department of Health and Human Services (DHHS). Cash was overstated in the General Fund, private purpose trust, and agency funds by $1,002,893, $199,102, and 123,613, respectively. The APA-proposed adjustment was not posted by DAS.

- DHHS calculated a State ward education payable, including payable activity through August 31, 2018. DAS also included the same amounts in a separate payable entry. As a result, payables and expenses were overstated by $745,658.

- DAS identified two fund balances, totaling $829,111, as unrestricted in the financial statements; however, both funds were established by State statutes, which restricted the funds' usage for specific purposes. Therefore, the funds should have been classified as restricted. DAS agreed and corrected the errors.

- The operating investment pool adjustment did not include the short-term liquidity fund dividend receivable of $451,673 or the time deposit fund interest receivable of $85,568. This caused the entry for cash and investment adjustments to be overstated.

- To verify that DAS had an adequate segregation of duties over CAFR entries, we reviewed 25 accrual entries in E1. Four were prepared, approved, and posted in E1 by the same individual. This increases the risk that an error could occur and remain undetected. Eight of the 25 entries tested were not included on a DAS tracking sheet provided to the APA.

- The following issues related to internal service fund capital assets:

  - Two assets acquired during fiscal year 2016 were transferred between two internal service funds during fiscal year 2018. The movement was reported as additions and deletions in the funds, totaling $381,803, with accumulated depreciation of $158,911. The transfer between funds should have been reported as a beginning balance adjustment.

  - One asset had costs of $8,990 removed due to prior year findings. The asset was incorrectly capitalized on January 17, 2017, and should have been a reduction to the beginning balance; however, DAS included the amount as a deletion.

- When preparing the proprietary funds statement of cash flows, DAS overstated net cash provided by (used for) investing activities and understated net cash provided by (used for) operating activities from the Nebraska Lottery audited Statement of Cash Flows by $364,000.

- The lease commitment footnote was incorrect. Two of five building leases tested did not agree to the support provided by DAS. Additionally, the APA followed up on issues revealed during the fiscal year 2017 audit, noting that three of five leases were still incorrect. The footnote disclosed commitments for each year from 2019 through 2023 and the aggregate amount committed for 2024 through 2028. All years contained errors. The errors ranged from overstatements of $523,065 to understatements of $166,622. DAS corrected the footnote.

- DAS did not record the Department of Correctional Services pharmacy inventory of $278,826 and the Department of Veteran's Affairs pharmacy inventory of $130,990 in the financial statements. DAS posted correcting entries for both.

- The master lease executive summaries prepared by DAS for the lease commitments footnote excluded a total of $169,153 in interest expense related to the 2017 Master Leases. DAS corrected the error.

- DAS performed a review of transfers between funds to eliminate interfund activity in accordance with financial reporting requirements. During the transfer review, DAS misclassified a transfer out of the Unemployment Compensation Fund to other special revenue funds for $133,949. This resulted in an overstatement of revenues, as $120,696 should have been eliminated and the remaining amount of $13,289 should have been reclassified as an expense. An APA-proposed adjustment was not posted by DAS.

- During procedures performed by DAS to eliminate internal service fund activity, to ensure there was no duplicative activity reported, DAS used prior year expenses in the allocation, causing expenses allocated by function to be incorrect by a total of $71,610.

- One capital asset was reported as an addition in fiscal year 2018; however, the asset was acquired on November 9, 2000. The error caused the capital asset's beginning balance to be understated by $70,000, and additions to be overstated by $70,000. The asset should have been entirely depreciated, causing beginning accumulated depreciation balance to be understated by $70,000 and depreciation expense to be overstated by $70,000.

- One capital asset completed and placed into service in fiscal year 2018 was entered in E1 with an acquisition date in fiscal year 2017. Depreciation expense was erroneously calculated using a fiscal year 2017 acquisition date, causing depreciation expense to be overstated by $41,296.

- An entry to adjust the Health and Social Services Fund cash understated both the assets and liabilities by $30,000. DAS incorrectly credited $30,000 to medium-term investments instead of crediting $30,000 to the Member Interest liability.

- The APA noted various errors in other DAS-prepared information, such as errors in restricted-for and assigned-to fund balances on the combining balance sheet for special revenue funds. Additionally, the summary of long-term liabilities footnote was not properly presented and required several revisions, fixed assets were incorrectly adjusted, and DAS did not reverse a prior year Department of Motor Vehicles receivable entry or consider the need for an entry for fiscal year 2018 to account for the change in the receivable.

Similar findings related to errors in the preparation of the CAFR have been noted since the fiscal year 2007 audit. Adequate DAS staff resources needed to prepare and review the CAFR and supporting documentation in a timely manner was lacking, and these deficiencies appear to have been the primary causes of the material noncompliance and material weakness addressed in this comment, as well as similar ones preceding it for the past several years.

DAS – State Accounting did make correcting entries for all material amounts, as recommended by the APA.

A good internal control plan requires an adequate review of draft financial reports and information used to prepare the CAFR, including the information provided by other State agencies. A sound business plan includes dedicating adequate staffing resources to meet the requirements of State statute.

Without adequate procedures and staffing to ensure the accuracy of the financial reports and information used to prepare the CAFR, there is an increased risk that material misstatements may occur and remain undetected. Furthermore, when DAS lacks adequate staff to prepare and submit information to the APA on a timely basis, there is an increased risk that DAS will be noncompliant with State statute.

> We recommend DAS dedicate or hire a sufficient number of staff to ensure internally prepared information is complete, accurate, and submitted timely to the auditors. We also recommend DAS utilize resources to work with State agency personnel to ensure accrual information is supported and has a sound accounting base.

DAS Response: State Accounting will assess resource allocation to CAFR process to ensure the function is adequately resourced.

2. Internally Generated Computer Software

DAS lacked adequate policies and procedures to ensure internally generated intangible assets were properly capitalized in accordance with Governmental Accounting Standards Board (GASB), Statement Number 51, *Accounting and Financial Reporting for Intangible Assets*. One internally generated computer system was incorrectly expensed, totaling $11,406,732, for costs incurred from July 1, 2016, through June 30, 2018. The APA's proposed adjustment was made by DAS to correct the error.

GASB Statement Number 51 provides, in relevant part, the following:

> *7. Intangible assets are considered internally generated if they are created or produced by the government or an entity contracted by the government, or if they are acquired from a third party but require more than minimal incremental effort on the part of the government to begin to achieve their expected level of service capacity.*
>
> * * * *
>
> *9. Computer software is a common type of intangible asset that is often internally generated. Computer software should be considered internally generated if it is developed in-house by the government's personnel or by a third-party contractor on behalf of the government. Commercially available software that is purchased or licensed by the government and modified using more than minimal incremental effort before being put into operation also should be considered internally generated for purposes of this Statement.*
>
> *10. The activities involved in developing and installing internally generated computer software can be grouped into the following states:*
>
> *a. Preliminary Project Stage. Activities in this stage include the conceptual formulation and evaluation of alternatives, the determination of the existence of needed technology, and the final selection of alternatives for the development of the software.*
>
> *b. Application Development Stage. Activities in this stage include the design of the chosen path, including software configuration and software interfaces, coding, installation to hardware, and testing, including the parallel processing phase.*
>
> *c. Post-Implementation/Operation Stage. Activities in this stage include application training and software maintenance.*

Activities in the application development stage should be capitalized, while the other two stages are expensed.

The DAS State Accounting Manual, General Policies Section 28, Capital Outlay, states, in relevant part, the following:

> *[C]omputer software that is internally developed or substantively modified, shall be capitalized as a separate asset if the acquisition value is One Hundred Thousand Dollars ($100,000) or more and has a life greater than one year.*

Good internal controls require DAS to implement policies and procedures to ensure internally generated software is properly capitalized or expensed in accordance with GASB standards and DAS policies.

When intangible assets, including computer software, are not properly recorded, there is an increased risk the financial statements will be materially misstated. When DAS policy does not align with GASB standards, there is an increased risk State agencies will not properly capitalize or expense computer software.

We recommend DAS implement policies and procedures to ensure internally generated software is properly expensed or capitalized in accordance with GASB and the State Accounting Manual.

DAS Response: State Accounting agrees that fixed asset policies and procedures need review and updated to provide agencies the proper guidance for expensing or capitalizing internally generated software. State Accounting will begin a review of the current policies and procedures for recording capital assets in accordance with GASB.

3. <u>Improper Payable</u>

E1 has the ability to identify payments as current-period or prior-period obligations. Payments made after the fiscal year end and entered as a prior-period obligation would be included as an accounts payable for CAFR reporting purposes.

Two payments for technology service agreements were incorrectly identified as prior-period obligations and, therefore, were included as expenditures and accounts payable in the fiscal year ended June 30, 2018, financial statements. The service agreements were for the time period June 1, 2018, through May 31, 2019; therefore, only one month of the payments were for the fiscal year ended June 30, 2018. As a result, expenditures and accounts payable were overstated by $8,643,462 on the fiscal year ended June 30, 2018, financial statements for the remaining 11 months.

Per Governmental Accounting Standards Board (GASB) Codification section 1100, Summary Statement of Principles, paragraph .110(a), "Expenditures should be recognized in the accounting period in which the fund liability is incurred, if measureable . . . ."

A good internal control plan requires procedures for ensuring that expenditures are properly recorded in the correct fiscal year.

Without such procedures, there is an increased risk of the financial statements being misstated.

A similar finding was noted during the prior audit.

We recommend DAS implement procedures to ensure expenditures are recorded in the proper fiscal year.

DAS Response: State Accounting agrees with the importance of recording expenditures in the proper fiscal year for accurate reporting in the CAFR. State Accounting will continue to develop and present training materials at semi-annual Business User Group meetings that will address prior period obligations and the process to determine correct recording of these expenditures.

4. <u>Master Lease Financing Period</u>

We noted two instances where equipment financed through the Master Lease Program (Program) was assigned a useful life in the State's accounting system that was shorter than the financing period of the lease. The Office of the Chief Information Officer (OCIO) financed $3,526,710 of equipment for mobile radios and network equipment and assigned the assets a useful life of three years within the State's accounting system; however, the financing period of the lease was five years.

Per the State of Nebraska's Master Lease Purchase Program Policy, "Repayment terms will be negotiated for each equipment group with a term not to exceed the expected life of the equipment being leased." The policy also states, "If the period of the master lease is longer than the default depreciation period" in the State's accounting system, the agency should "contact State Accounting to change the depreciable life for the master leased asset to the period of the master lease."

When assets are financed with a longer lease term than the useful life assigned to them within the State's accounting system, the purchase is noncompliant with Program policy. Likewise, there is an increased risk of the State paying for assets no longer in use.

> We recommend DAS implement procedures to ensure agencies utilizing the Program are properly recording financed assets within the State's accounting system and in accordance with Program policy.

DAS Response: State Accounting agrees that fixed assets purchased in the Master Lease program should be properly recorded as per the Program policy. State Accounting will address this issue in the training of new staff responsible for fixed asset reporting and in the semi-annual Business User Group training presentations.

5. <u>E1 Pay Rate Override</u>

E1 has a Speed Time Entry screen that was used to upload or enter in timecard information for State employees for each pay period. We noted that users with access to add, change, and delete information on the Speed Time Entry screen had the ability to override pay rates, including their own, without approval. No compensating controls were in place to determine when an employee used the override field. As of September 20, 2018, there were 1,100 user ID's with this access.

A good internal control plan includes an adequate segregation of duties, so no single individual has the ability to adjust his or her own pay rate.

A lack of segregation of duties related to the change or override of pay rates increases the risk of possible theft or misuse of State funds.

A similar finding was noted during the prior audit.

> We recommend DAS review options for either disabling the ability of users to override pay rates in E1 or implementing compensating controls to identify and review instances of users having engaged in such override activity.

DAS Response: DAS agrees with this finding and the segregation of duties related to this function will be addressed in the coming update to EnterpriseOne.

6. <u>E1 Timesheets</u>

Seventeen State agencies utilized E1 to record their employees' work 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 that at least 40 hours were worked each week. Exempt employees were required to record only leave used in the system.

- E1 timesheets were maintained only for the current pay period for 14 State agencies and one year for one State agency that used the time entry function in E1.

- Supervisors and human resource staff within the State agencies were able to change the employee's submitted E1 timesheet without the employee's knowledge or documentation of the changes made.

- E1 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 E1, 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.

Neb. Rev. Stat. § 84-1001(1) (Reissue 2014) states the following:

> *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 requires employers of employees who accrue vacation and sick leave to maintain adequate support that employees 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.

Without adequate records to support hours worked and approvals in the E1 system, there is an increased risk for fraudulent or inaccurate payment of regular hours worked or accumulation of leave. Additionally, failure to retain important payroll documentation risks noncompliance with Nebraska Records Retention and Disposition Schedule 124.

> We recommend DAS – State Accounting establish a policy requiring all employees of State agencies to maintain adequate supporting documentation, such as timesheets or certifications, in compliance with Nebraska Records Retention and Disposition Schedule 124. Furthermore, we recommend DAS – State Accounting make the necessary changes to E1, or save supporting documentation to a data warehouse, to allow for the retention of timesheets, documentation of approvals, and changes to timesheets to ensure compliance with Nebraska Records Retention and Disposition Schedule 124.

DAS Response: Timesheet images are maintained in EnterpriseOne until the payroll is processed; however, the electronic data is maintained in EnterpriseOne idefinitely. Agencies will be reminded to retain any information they may receive, generate or create outside of EnterpriseOne in support of an agency's payroll to be done in accordance with the Nebraska Records Retention and Disposition Schedule 124. This function will also be addressed in the coming update to EnterpriseOne.

7. E1 Special Handle a Voucher

The Special Handle a Voucher Function (Function) in E1, which allows users to change the payee of a payment voucher without going through the batch management process, is used by the following:

- DAS – State Accounting to provide support to agencies, so payments can continue in a timely manner if the agency lacks adequate personnel to process a transaction;
- DAS – State Accounting to process replacement warrants; and
- State agencies to correct vouchers without having to void and recreate another voucher.

We noted several issues with the Function in E1, including the following:

- Access to the Function was not restricted to only high-level users. Access was available instead to users who had access to Accounts Payable (AP) roles 20, 21, 30, 40, 41, 50, and 51. Essentially, anyone who had access to AP in E1, with the exception of inquiry-only access, was able to use the Function. Due to the type of activity that can be performed with this access, we believe access should be restricted to only a limited number of high-level users. Our review noted 793 users had access to the Function as of August 24, 2018.
- Users with the ability to add vendors and change vendor information in E1 also had access to the Function. The Address Book (AB) 50 role allowed users to add vendors and make changes to vendors. All seven users with AB 50 access also had access to the Function, creating an environment in which a user could set up fictitious vendors in the system or improperly change vendor information and then change payee information on vouchers to direct payment to the fictitious/modified vendor.

DAS – State Accounting indicated it uses the payee control approval process in E1, a required step in payment processing, to review and approve vendor changes made through the Function. However, we noted the following issues related to the payee control approval process:

- All seven users with access to the payee control approval process also had access to the Function. Thus, these users could change a payee on a voucher and then approve it, without involvement of a second person, resulting in a lack of segregation of duties.
- One user with access to the payee control approval process also had access to the Function and could add vendors or change vendor information in E1.

A good internal control plan requires an adequate segregation of duties to ensure that no one individual is able to perpetrate and/or to conceal errors and irregularities.

Nebraska Information Technology Commission (NITC) Standards and Guidelines, Information Security Policy 8-303(4) (July 2017), states the following, in relevant part:

> *To reduce the risk of accidental or deliberate system misuse, separation of duties must be implemented where practical. Whenever separation of duties is impractical, other compensatory controls such as monitoring of activities, increased auditing and management supervision must be implemented. At a minimum, the audit of security must remain independent and segregated from the security function.*

When an adequate segregation of duties does not exist, there is an increased risk for errors and fraud to occur and remain undetected.

A similar finding was noted in the prior audit.

> We recommend access to the Function be restricted to only certain high-level users. Moreover, we recommend removing access to the Function for users with the ability to add vendors and make changes to vendor information in E1. We recommend documentation be maintained to support review/approval of vendor changes through the payee control approval process. Finally, we recommend users with access to the payee control approval process be prevented from accessing the Function and/or from adding/changing vendor information in E1.

DAS Response: State Accounting will continue to review compensating control processes and procedures related to Payee Control and Special Handle a Voucher functions and will assure they are in place and functioning. The segregation of duties related to the vendor management function will also be addressed in the coming update to EnterpriseOne.

8. E1 Terminated User Access

For 22 of 25 terminated users tested, access to E1 was not disabled or removed in a timely manner (within three business days). Six of these users accessed the system after their termination date. The delay in disabling the user ID's ranged from 13 to 290 business days.

NITC Standards and Guidelines, Information Security Policy 8-701 (July 2017), states the following, in relevant part:

> *An agency review to ensure compliance with this policy and applicable NIST SP 800-53 security guidelines must be conducted at least annually.*

National Institute of Standards and Technology (NIST) Special Publication 800-53, Security and Privacy Controls for Federal Information Systems and Organizations, Access Control 6 Least Privilege, states, in part the following:

> *The organization employs the principle of least privilege, allowing only authorized accesses for users (or processes acting on behalf of users) which are necessary to accomplish assigned tasks in accordance with organizational missions and business functions.*

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

> *Each agency shall have a documented procedure to immediately disable the ENTERPRISEONE 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 the timely removal of terminated users' access to E1.

The lack of such a process creates the opportunity for inappropriate access to State resources, as well as unauthorized processing of transactions.

A similar finding was noted in the prior audit.

> We recommend DAS work with State agencies, through on-going training and monitoring of agency personnel, to ensure agencies request termination of E1 user ID's prior to, or immediately upon, termination. We recommend agencies trigger such requests by entering employee termination dates in Workday as soon as a termination date is determined.

DAS Response: DAS will continue to provide multiple training events during which agency personnel are reminded to deactivate a terminated user's EnterpriseOne access on a timely basis. This function will also be addressed in the coming update to EnterpriseOne.

9. <u>Changes to Vendor and Banking Information</u>

During our review of the process to change vendor and banking information in E1, we noted a lack of controls to ensure additions and/or changes to vendor addresses and banking information were proper and accurate. To change vendor addresses and banking information in the system, an authorized agent at the agency level submits a form W-9/ACH to DAS – State Accounting. This submission can be made by a single person at the agency. There is no required secondary approval of changes at the agency level to ensure additions and changes are proper.

In addition, we noted that DAS – State Accounting did not perform any other procedures to identify potentially fraudulent bank accounts in the system. A review could include querying for duplicate bank accounts or addresses existing for both a vendor and employee of the State.

A good internal control plan requires procedures to ensure that critical vendor and banking information within E1 is proper, and changes to that information is verified as accurate.

A lack of such procedures increases the risk of loss or misuse of State funds due to fraudulent activity within E1.

A similar finding was noted in the prior audit.

> We recommend DAS establish procedures to ensure vendor addresses and banking information in E1 are appropriate and accurate. These procedures should require a secondary approval of all vendor and banking information at the agency level when modifying W-9/ACH forms, ensuring that at least two knowledgeable individuals are involved in the changes. We also recommend DAS establish procedures, such as a periodic review for duplicate bank accounts and vendor addresses, to identify potential fraudulent bank accounts in the system.

DAS Response: DAS continues to review and improve procedures for vendor set-up and maintenance including accuracy of vendor records and review and identification of duplicate bank accounts and vendor addresses. Procedures for this function will also be addresses in the coming update to EnterpriseOne.

10. <u>Human Resource User Role 65</u>

We noted several DAS payroll batches that were prepared, approved, and posted by a single DAS payroll employee.

The Human Resource User Role 65 (HR 65) in E1 was used by DAS – State Accounting to perform the final update processing for payroll. However, the HR 65 role also allowed users to prepare, approve, and post transactions, as this role is not set up with batch management. We noted several payroll journal entries and vendor payroll deduction batches, including batches that contained DAS payroll that were prepared, approved, and posted by a single DAS employee.

A good internal control plan includes an adequate segregation of duties to ensure that at least two individuals are involved in processing payroll payments.

A lack of such procedures increases the risk of loss or misuse of State funds due to fraudulent activity within E1.

A similar finding was noted in the prior audit.

> We recommend DAS ensure any batches involving its own payroll be processed by at least two individuals.

DAS Response: DAS will establish compensating controls to incorporate procedures to review the activity of those DAS employees assigned User Role 65 who also have responsibility for processing internal payroll batches. This function will also be addressed in the coming update to EnterpriseOne.

11. <u>E1 Timeout Controls</u>

During testing of security settings in E1, we noted that the security system attribute to lock an inactive user in the system was set at 30 minutes. This did not comply with NITC standards, requiring no more than 15 minutes to lock an inactive session.

NITC Standards and Guidelines, Information Security Policy 8-403(3) (July 2017), states the following, in relevant part:

> *All network devices that contain or process CONFIDENTIAL or RESTRICTED data must be secured with a password-protected screen saver that automatically locks the session after no more than 15 minutes of inactivity.*

Good internal controls require procedures to ensure confidential or restricted data is adequately secured to prevent improper access.

A lack of such procedures increases the risk that confidential or restricted data will be accessed by improper users, which could lead to fraudulent activity within E1.

> We recommend DAS comply with NITC standards and ensure security settings are restricted to lock inactive users within 15 minutes of an inactive session.

DAS Response: DAS will review the NITC standards and the options available to comply with those security standards in the EnterpriseOne System. The function will be addressed in the coming update to EnterpriseOne.

12. <u>OCIO Service Center Ticket Controls</u>

During testing of the OCIO Service Center used by State agencies to request ID assignments to various systems, we noted access to tickets was not limited to the requesting agencies only. All IT Support Analysts at State agencies had access to review other agencies' tickets. Ticket information can include user credentials and temporary passwords to systems containing confidential and federally protected information.

NITC Standards and Guidelines, Information Security Policy 8-701 (July 2017), states the following, in relevant part:

> *An agency review to ensure compliance with this policy and applicable NIST SP 800-53 security guidelines must be conducted at least annually.*

NIST Special Publication 800-53, Security and Privacy Controls for Federal Information Systems and Organizations, Access Control 6 Least Privilege, states, in part, the following:

> *The organization employs the principle of least privilege, allowing only authorized accesses for users (or processes acting on behalf of users) which are necessary to accomplish assigned tasks in accordance with organizational missions and business functions.*

A good internal control plan includes limiting access to tickets to the requesting agency staff or support staff.

The lack of such a process creates the opportunity for inappropriate access to State resources, as well as unauthorized processing of transactions.

> We recommend DAS implement controls to prevent access to all tickets and instead restrict access based on the requesting agency.

DAS Response: The Service Portal is an enterprise ticketing system, which is being used by multiple state agencies. Thus, being open and accessible to all agencies is critical to the effectiveness and the efficiency of such tool. As such, we have disclaimer permanently displayed on the Service Portal that stated confidential or restricted information must not be entered into the Service Portal or tickets.

APA Response: Nebraska Information Technology Commission (NITC) Standards and Guidelines, Information Security Policy 8-902(2), confidential data classification is defined as:

> ***CONFIDENTIAL. This classification level is for sensitive information intended for use within an agency and controlled by special rules to specific personnel. Examples of this type of data include: federal tax information (FTI), protected health information (PHI) and other Patient Medical Records covered by Health Insurance Portability and Accountability Act (HIPAA), payment card industry (PCI) information, and personally identifiable information (PII);***

The APA believes information such as user ID's and temporary passwords contained in Service Portal tickets introduces a risk for inappropriate access to confidential information.

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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 DAS 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 DAS.

This communication is intended solely for the information and use of DAS, the Governor and State Legislature, others within DAS, 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.

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