MANAGEMENT LETTER
OF THE
UNIVERSITY OF NEBRASKA
SINGLE AUDIT

JULY 1, 2008 THROUGH JUNE 30, 2009

Issued on February 24, 2010

NEBRASKA AUDITOR OF PUBLIC ACCOUNTS

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February 12, 2010

The Board of Regents
University of Nebraska

Ladies and Gentlemen:

We have audited the financial statements of the University of Nebraska (the University) for the year ended June 30, 2009, and have issued our report thereon dated December 14, 2009. We also issued a management letter dated December 14, 2009, which included our findings related to the audit of the financial statements. We have also audited the University's compliance with requirements applicable to major Federal award programs and have issued our report dated February 12, 2010.

This management letter includes findings related to compliance with requirements applicable to each major program and on internal control over compliance in accordance with the Office of Management and Budget (OMB) Circular A-133. The matters disclosed in this letter are not required to be reported in the University's Single Audit report but are matters for the University's consideration. We have not considered internal control since the date of our report.

During our audit, we noted certain matters involving compliance and internal control over compliance that are presented for your consideration. Draft copies of this letter were furnished to the University to provide them an opportunity to review the letter and to respond to the comments and recommendations included in this letter. 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.

1. Journal Entry Review and Approval

Program: CFDA 93.389 – Research Infrastructure, CFDA 93.394 – Cancer Detection and Diagnosis, CFDA 47.074 – Biological Sciences, Allowability

Grant Number & Year: #34-5105-2022-008-Ali, May 1, 2008 to April 30, 2009; #5 U01 CA114778-04, June 1, 2008 to May 31, 2009; #701892, August 1, 2007 to July 31, 2009

Federal Grantor Agency: U.S. Department of Health and Human Services, National Science Foundation

Criteria: Good internal control requires a documented review and approval of journal entries before they are posted to the General Ledger. Good internal control also requires the access to process journal entries be given only to those individuals who routinely need to post journal entries.

OMB Circular A-133, Subpart C-Auditees § ____.300 Auditee responsibilities, states "The auditee shall: . . . (b) Maintain internal control over Federal programs that provides reasonable assurance that the auditee is managing Federal awards in compliance with laws, regulations, and the provisions of contracts or grant agreements that could have a material effect on each of its Federal programs."

Condition: Three of sixty transactions tested University-wide did not have supporting documentation of approval by someone other than the person preparing the transaction. All three transactions were journal entries.

Questioned Costs: None

Context: Our prior audit of the Basic Financial Statements for the fiscal year ended June 30, 2008, noted all campuses of the University had a large number of individuals (946 University-wide with 569 individuals processing over 41,000 journal entries) with the ability to prepare and post journal entries on SAP, the University's accounting system, without a review or approval by anyone else. At that time we recommended the University establish a policy that all journal entries be reviewed and approved by someone other than the person preparing the journal entry prior to it being posted in SAP. This approval should be done by an individual with the knowledge to understand the journal entry, to ensure it is properly supported, and to determine it is a proper journal entry for the University. We also recommended the University review the need for such a large number of individuals having access to process journal entries on SAP.

During our current audit of the Basic Financial Statements, the Auditor of Public Accounts (APA) followed up on this finding and we noted the University did a review of individuals who have access to process journal entries on SAP. After the review, the University decided to reduce the number of individuals having access to process journal entries from 946 to 676. For the fiscal year ended June 30, 2009, these individuals processed 40,914 journal entries. The University did not implement our recommendation to establish a policy that all journal entries be reviewed and approved by someone other than the person preparing the journal entry prior to it being posted in SAP.

The process of allowing one individual to prepare and post journal entry transactions without a review or approval by another individual is the same process used for journal entry transactions posted to the Research and Development Cluster. For the three journal entry transactions without documentation of approval noted during the audit of the Research and

Development Cluster, one was noted at the University of Nebraska – Omaha (UNO), one at the University of Nebraska Medical Center (UNMC), and one at the University of Nebraska – Lincoln (UNL). The amounts of the journal entries were $99, $47, and $735, respectively.

University management again indicated to us that most individuals who prepare and post journal entries are accounting clerks within the various departments. University management believes these individuals need the ability to perform this function. In addition, University management indicated an after the fact review of journal entries is made at various levels; however, this review is generally not required or documented.

Cause: Lack of policy for review and approval of all journal entries.

Effect: When a large number of individuals can prepare and post journal entries without a documented review and approval there is a greater risk erroneous or inappropriate journal entries could be posted and go undetected.

Recommendation: We recommend the University establish a policy that all journal entries be reviewed and approved by someone other than the person preparing the journal entry prior to it being posted in SAP. This approval should be done by an individual with the knowledge to understand the journal entry, to ensure it is properly supported, and to determine it is a proper journal entry for the University. We believe a proactive model with a real-time, work-flow review and approval process prior to journal entries being posted in SAP is reasonable and practicable. A proactive control is more likely to detect an erroneous or irregular journal entry than a detective control.

> **Management Response:** A response to this item was made in the management letter related to the general purpose financial statements. The University has deployed functionality of its administrative system to end users in departments and colleges, granting them authorization to charge expenses to sub-cost centers by journal entry and credit primary cost centers. The University agrees an ideal practice would be to have real time sign off, but the practicality of the ideal, in a decentralized, end-user empowered environment, with limited staffing in some areas, will not always be possible. The University has employed detective, budgetary, and other compensating controls to mitigate the risk of incorrect charges. Mitigating detective controls include the review of expenses by principal investigators and departmental staff through on-line real-time access to the system. Similar controls are present through review of transactions by campus sponsored programs office staff during the preparation and filing of federal financial status reports (FSR's 269, 270, and 272).
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> The "finding" for $99 described in the auditors observation is actually a correcting entry to a Federal grant prepared by the campus sponsored program finance office to remove an over-expenditure when the FSR reports were prepared – evidence the mitigating controls are operating as designed.
>
> **Corrective Action Plan:** The University will continue to scrutinize its practices in this area to achieve separation of end user duties in areas, where possible, and to maintain and enhance detective and budgetary controls in department research offices and the campus sponsored program finance offices.

Contact: Keith Lauber

Anticipated Completion Date: On-going.

2. **Retroactive Payroll Cost Transfers**

Program: Research and Development Cluster, Allowability

Grant Number & Year: Various

Federal Grantor Agency: Various

Criteria: Good internal controls require Retroactive Payroll Cost Transfer transactions that directly impact the expenditures of Federal grants be identified, monitored, reviewed, and approved. Good internal controls would also include maintaining adequate supporting documentation of the Retroactive Payroll Cost Transfer transactions and their review and approval.

OMB Circular A-133, Subpart C-Auditees § ____.300 Auditee responsibilities, states "The auditee shall: . . . (b) Maintain internal control over Federal programs that provides reasonable assurance that the auditee is managing Federal awards in compliance with laws, regulations, and the provisions of contracts or grant agreements that could have a material effect on each of its Federal programs."

Condition: Retroactive Payroll Cost Transfer expense adjustments were included in an individual's combined payroll expense transaction which included the employee's current pay period expense and retroactive expense adjustments. The combined payroll expense transactions for a cost center are posted to the general ledger as input from the payroll module, thus Retroactive Payroll Cost Transfer expense adjustments were not readily identifiable.

Questioned Costs: None

Context: Retroactive Payroll Cost Transfer expense adjustments are not recorded as journal entries and are not posted individually to the University's general ledger. Retroactive Payroll Cost Transfer expense adjustments do post to the general ledger but are combined with other payroll transactions so they are not readily identifiable. These transactions transfer payroll costs between various cost elements including Federal grants. In order to determine the number and dollar amount of Retroactive Payroll Cost Transfers the APA requested a list of Retroactive Payroll Cost Transfers for the fiscal year. A query was developed by the University which created a listing of Retroactive Payroll Cost Transfers. This listing did not include adequate detail to verify the report was complete and accurate. Additional requests were made by the APA and an SAP program was written which appears to provide a detailed listing of Retroactive Payroll Cost Transfers. The University has developed various processes to review and ensure Retroactive Cost Transfers are appropriate. UNMC had a workflow process which included an email being sent to sponsored programs personnel and a review of the transaction by sponsored programs personnel. There was no way to determine if emails were received for all transactions or that all emails were reviewed. UNL required a review by sponsored programs personnel for only those transactions over 90 days. This review was not documented. The net amount of Retroactive Payroll Cost Transfers made in fiscal year 2009 per the report developed at the request of the APA was $857,000.

Cause: Processing Retroactive Payroll Cost Transfers through the payroll portion of the University's SAP computer system is the University's standard operating procedure.

Effect: There is no direct audit trail when Retroactive Payroll Cost Transfers are processed directly through the payroll section of the University's SAP computer system.

Recommendation: We recommend a process be implemented which ensures Retroactive Payroll Cost Transfers are identified, monitored, reviewed, and approved. Adequate supporting documentation of the Retroactive Payroll Cost Transfer transactions and their review and approval should be maintained.

Management Response: The University understands the question raised by the auditor but believes the functionality of its administrative system processes retroactive payroll adjustments accurately. The system software adjusts payroll expenses according to the parameters of approved personnel action forms entered into the system. The University is not aware, nor has the auditor informed the University, of any instances of expense miscalculations or postings based on information entered into the system.

Corrective Action Plan: No corrective action plan was provided by the University.

Contact: Keith Lauber

Anticipated Completion Date: No anticipated completion date was provided by the University.

APA Response: Our comment does not question the University's SAP computer payroll system. Retroactive Payroll Cost Transfer expense adjustments post through the University's SAP computer system along with other payroll transactions so they were not readily identifiable. This comment relates to assurance that Retroactive Payroll Cost Transfers processed through the University's SAP computer payroll system are identified, monitored, reviewed, and approved by someone besides the preparer. Adequate supporting documentation of the Retroactive Payroll Cost Transfer transactions and their review and approval should also be maintained.

3. Internal Service Centers - UNMC

Program: Research and Development Cluster, Allowability

Grant Number & Year: Various

Federal Grantor Agency: Various

Criteria: The Office of Management and Budget (OMB) Circular A-133 Compliance Supplement provides guidelines to measure working capital reserves and ensure they are not excessive in amount. Generally, working capital reserves should not be greater than 60 days for cash expenses for normal operations incurred for the period exclusive of depreciation, capital costs, and debt principal costs. OMB Circular A-21, Section D.2, states "The cost of . . . services rendered by specialized facilities or other institutional service operations may be included as direct costs of sponsored agreements, provided such items are consistently treated, in like circumstances, by the institution as direct rather than facilities and administrative (F&A) costs, and are charged under a recognized method of computing actual costs, and conform to generally accepted cost accounting practices consistently followed by the institution." Good internal control requires internal service centers be identified and compliance with OMB Circular A-21 be monitored by management. Good internal control also requires documentation supporting rate calculations be maintained.

Condition: There was no centralized process in place at UNMC to identify and review internal service centers to ensure compliance with OMB Circular A-21 requirements including ensuring working capital reserves were not in excess of 60 days. Supporting documentation for 1 of 2 service center rate calculations tested was not adequate. UNMC developed a list of 76 internal service centers when a list was requested by the APA. This listing included internal service centers with working capital reserves in excess of 60 days. A portion of the internal service centers received Nebraska Research Initiative (NRI) funding. NRI funds are funds appropriated by the Nebraska Legislature to be used to provide a research base within the University. NRI funds were used to pay expenses of the internal service centers. This increased the internal service center working capital reserve. Additionally, UNMC did not account for the purchase of equipment or depreciation in the internal service centers. APA discussed the working capital reserves in excess of 60 days with UNMC staff. Subsequent to this discussion, UNMC staff identified the specific equipment for each internal service center and calculated the working capital reserve as if depreciation had been charged to the internal service center. After the calculations of working capital reserves were adjusted for NRI funding and depreciation, the working capital reserves for the UNMC internal service centers appeared reasonable.

Questioned Costs: None

Context: UNMC identified 76 service centers when APA requested a listing. Federal grants paid approximately $2,000,000 to UNMC internal service centers in fiscal year 2009.

Cause: Internal service centers at UNMC are the responsibility of various departments with little review by central management.

Effect: Without adequate management review of internal service center rates, charges for services may be higher than necessary and UNMC may not be in compliance with OMB Circular A-21.

Recommendation: We recommend UNMC develop policies which include a centralized process to identify and review internal service centers to ensure compliance with OMB Circular A-21 requirements. Internal service center working capital reserves should be reviewed to ensure they are not in excess of the 60 day guideline. Supporting documentation should be maintained for all internal service center rate calculations. Documentation supporting the review of compliance should be maintained. Purchases of equipment and associated depreciation should be accounted for in the internal service centers and associated reserve accounts.

Management Response: The University agrees service center rates should be examined to ensure billings to other departments and entities are consistently billed at proper rates to fund expenses and depreciation. The University has employed the services of a national consulting firm to prepare the billing rate for the UNMC Comparative Medicine Animal Research Facility. We are comforted that the APA did audit this service center which accounted for $1.2 million of the $2 million charged to Federal grants and contracts by service centers but did not identify any compliance problems.

Corrective Action Plan: UNMC will continue to review the billing rates of its service centers for compliance with OMB Circulars A-21 and A-133 to ensure costs are recorded properly.

Contact: William M. Lawlor

Anticipated Completion Date: On-going

4. <u>Suspension and Debarment</u>

Program: Various, Suspension and Debarment

Grant Number & Year: Various

Federal Grantor Agency: Various

Criteria: OMB Circular A-110 codified in 2 CFR Part 215, Appendix A-8, states "A contract award with an amount expected to equal or exceed $25,000 . . . shall not be made to parties listed on the government-wide Excluded Parties List System." Good internal controls require procedures which ensure contracts are not awarded to parties that are disqualified.

Condition: Based on a review of internal controls, no procedures were in place at UNO, UNL, and UNMC to ensure parties awarded contracts for $25,000 to $99,999 were not listed on the EPLS (Excluded Parties List System). Additionally, based on a review of internal controls, no procedures were in place at the University of Nebraska – Kearney (UNK) to ensure parties awarded contracts for $25,000 or more were not listed on the EPLS.

Questioned Costs: None

Context: Contract awards of $25,000 to $99,999 for UNO, UNL, and UNMC and contract awards of $25,000 or greater for UNK could have been made to suspended or debarred parties.

Cause: University policy was to review the EPLS for purchases of $100,000 or greater.

Effect: There is an increased risk debarred or suspended parties will be awarded a contract when procedures are not in place to ensure ineligible parties are not awarded contracts.

Recommendation: We recommend the University implement procedures which ensure no contract is awarded to parties listed on the General Services Administration's (GSA) - EPLS for awards over the small purchase threshold of $25,000.

Management Response: The University policy was to review contracts greater than $100,000 to ensure purchases were not made from parties listed on the government-wide Excluded Parties List System (EPLS).

Corrective Action Plan: The University will verify purchases and contracts that exceed the small purchase threshold of $25,000 by one or more of the following methods: 1) cross-checked to the EPLS debarment list before a purchase is made, 2) collecting a certification from the entity, or 3) adding a clause or condition to the covered transaction with that entity.

Contact: Keith Lauber

Anticipated Completion Date: March 31, 2010

Our audit procedures were designed primarily to enable us to form an opinion on the financial statements, and the schedule of expenditures of Federal awards. Our audit procedures were also designed to enable us to report on compliance with requirements applicable to each major program and on internal control over compliance in accordance with OMB Circular A-133 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 to make comments and suggestions that we hope will be useful to you.

We would be pleased to discuss these comments and recommendations with you at any time.

This communication is intended solely for the information and use of management, Board of Regents, others within the organization, the appropriate Federal and regulatory awarding agencies, and pass-through entities and is not intended to be and should not be used by anyone other than specified parties. However, this letter is a matter of public record and its distribution is not limited.

Sincerely,

Signed Original on File

Don Dunlap, CPA
Assistant Deputy Auditor