

Northern Arizona University

Report on Internal Control
and on Compliance

Year Ended June 30, 2023



A Report to the Arizona Legislature

Lindsey A. Perry
Auditor General





The Arizona Auditor General’s mission is to provide independent and impartial information and specific recommendations to improve the operations of State and local government entities. To this end, the Office provides financial audits and accounting services to the State and political subdivisions, investigates possible misuse of public monies, and conducts performance audits and special reviews of school districts, State agencies, and the programs they administer.

The Joint Legislative Audit Committee

Representative **Matt Gress**, Vice Chair
Representative **Tim Dunn**
Representative **Alma Hernandez**
Representative **Beverly Pingerelli**
Representative **Marcelino Quiñonez**
Representative **Ben Toma** (ex officio)

Senator **Sonny Borrelli**, Chair
Senator **David C. Farnsworth**
Senator **Anthony Kern**
Senator **Juan Mendez**
Senator **Catherine Miranda**
Senator **Warren Petersen** (ex officio)

Audit Staff

Melanie M. Chesney, Deputy Auditor General and Acting Director, Financial Audit Division
Taryn Stangle, Manager

Contact Information

Arizona Auditor General
2910 N. 44th St., Ste. 410
Phoenix, AZ 85018-7271

(602) 553-0333

contact@azauditor.gov

www.azauditor.gov



TABLE OF CONTENTS

Independent auditors' report on internal control over financial reporting and on compliance and other matters based on an audit of basic financial statements performed in accordance with <i>Government Auditing Standards</i>	1
Schedule of findings and recommendations	3
Financial statement findings	3
University response	
Corrective action plan	
Report issued separately	
Annual Comprehensive Financial Report	



LINDSEY A. PERRY
AUDITOR GENERAL

ARIZONA
AUDITOR GENERAL

MELANIE M. CHESNEY
DEPUTY AUDITOR GENERAL

Independent auditors' report on internal control over financial reporting and on compliance and other matters based on an audit of basic financial statements performed in accordance with *Government Auditing Standards*

Members of the Arizona State Legislature

The Arizona Board of Regents

We have audited, in accordance with U.S. generally accepted auditing standards and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the U.S. Comptroller General, the financial statements of the business-type activities and discretely presented component unit of Northern Arizona University as of and for the year ended June 30, 2023, and the related notes to the financial statements, which collectively comprise the University's basic financial statements, and have issued our report thereon dated October 31, 2023. Our report includes a reference to other auditors who audited the financial statements of the Northern Arizona University Foundation, the discretely presented component unit, as described in our report on the University's financial statements. The Foundation's financial statements 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 the Foundation.

Report on 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) as a basis for designing audit procedures that are appropriate in the circumstances for the purpose of expressing our opinions on the basic 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 University's basic 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, and therefore, material weaknesses or significant deficiencies may exist that were not identified. Given these limitations, during our audit we did not identify any deficiencies

in internal control that we consider to be material weaknesses. We identified certain deficiencies in internal control, described in the accompanying schedule of findings and recommendations as items 2023-02 and 2023-03, that we consider to be significant deficiencies.

Report on compliance and other matters

As part of obtaining reasonable assurance about whether the University's basic 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 financial statements. 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 an other matter that is required to be reported under *Government Auditing Standards* and that is described in the accompanying schedule of findings and recommendations as item 2023-01.

University response to findings

Government Auditing Standards requires the auditor to perform limited procedures on the University's responses to the findings identified in our audit that are presented in its corrective action plan at the end of this report. The University is responsible for preparing a corrective action plan to address each finding. The University's responses and corrective action plan were not subjected to the other auditing procedures applied in the audit of the basic financial statements, and accordingly, we express no opinion on them.

Purpose of this report

The purpose of this report is solely to describe the scope of our testing of internal control and compliance and the results of that testing, and not to provide an opinion on the effectiveness of the University's internal control or on compliance. This report is an integral part of an audit performed in accordance with *Government Auditing Standards* in considering the University's internal control and compliance. Accordingly, this communication is not suitable for any other purpose.

Lindsey A. Perry

Lindsey A. Perry, CPA, CFE
Auditor General

October 31, 2023



SCHEDULE OF FINDINGS AND RECOMMENDATIONS

Financial statement findings

2023-01

Former employee made unallowable purchases totaling \$69,877 and falsely claimed they resulted from their procurement card’s information being stolen, which was possible because of the University’s lack of reviewing and monitoring procurement card activities, resulting in potential misuse of public monies

Condition—The University’s Contracts, Purchasing, and Risk Management Department (Purchasing Department) was notified by its bank and reported to us that a former employee made unallowable purchases while employed with the University totaling \$69,877 using a University procurement card and falsely claimed that the unallowable purchases resulted from their procurement card’s information being stolen between May 2022 and March 2023. Specifically, rather than reporting the fraudulent or erroneous purchases to the Purchasing Department as required by University policy, the former employee reported these purchases directly to the University’s bank and requested charges to be reversed and replacement cards to be issued on 3 different occasions. The employee further alleged that purchases for gift cards and other personal items prohibited by University policy on their procurement card were fraudulent or erroneous. The University’s bank reversed the charges and issued the former employee a replacement card each time, as follows:

Time period	Procurement card issued	Amount of unallowable purchases
May 2022	Initial card	\$ 1,964
May 2022 – June 2022	First replacement card	4,102
June 2022 – March 2023	Second replacement card	62,608
March 2023	Third replacement card	1,203
Total		\$69,877

In May 2023, the University became aware of the scheme when \$67,607 was charged back to the former employee’s procurement card after the bank’s investigation revealed that the unallowable purchases were made by the former employee. Further, we noted that that the Purchasing Department did not adequately track expenditures they marked as violations of its policies to ensure that all violations were resolved, and the University recovered monies for unallowed purchases.¹

Effect—The University’s former employee may have misused \$69,877 of public monies with these unallowable purchases. As of this report’s release, the University paid the bank \$67,607 for the charges, and the University’s bank is still investigating the remaining \$2,270. Further, the NAU Police Department is performing an investigation to determine if formal charges will be filed against the former employee.²

Further, there is a risk that other unallowable expenses have not been investigated or recovered by the University.

Cause—The University’s lack of reviewing and monitoring procurement card activities created an opportunity for the former employee to make unallowable purchases. Specifically, in August 2022, the Purchasing Department was notified by its bank of potential fraudulent or erroneous charges on the procurement card, and the University reported that it believed the employee’s statement that their procurement card’s information was stolen. Therefore, rather than investigating the claims, the Purchasing Department allowed the former employee to coordinate directly with the bank to provide additional information without its involvement, allowing the former employee to repeat this scheme of making unallowable purchases, falsely claiming the purchases were fraudulent or erroneous, and potentially stealing public monies without reporting fraudulent charges to the Purchasing Department. In addition, the former employee’s direct supervisor, who was responsible for reviewing and approving the purchases to ensure compliance with University policy, did not perform a sufficiently detailed review to identify the unallowable purchases and disallow them. Further, the University’s policy lacked a process to be alerted either by the bank or through an analysis of active procurement card numbers of replacement procurement cards issued to its employees, and it lacked additional monitoring requirements such as data analysis to help detect fraudulent purchases. Finally, the Purchasing Department did not have a sufficient process to record, track, and monitor all potential procurement card violations.

Criteria—University policy requires its employee cardholders to report any fraudulent charges or card changes to the Purchasing Department (NAU Procurement Card Policy). Also, University policy prohibits procurement card purchases of gift cards and personal items unless intended for student use and an exception is approved before the purchase is made (*Northern Arizona University Comptroller Manual*, CMP 401-03). In addition, University policy requires an independent review and approval of all purchases to ensure that they are appropriate, accurate, and comply with applicable laws and regulations and University policies and procedures (*Northern Arizona University Comptroller Manual*, CMP 603). Finally, monitoring employees’ procurement card activities to respond to identified fraud risks is an essential part of internal control standards, such as the *Standards for Internal Control in the Federal Government*, issued by the Comptroller General of the United States, and integral to ensuring only authorized purchases are made with University procurement cards.³

Recommendations—The University should improve its procurement card policies and procedures by requiring its Purchasing Department to:

1. Enforce the University’s procurement card policies and procedures by requiring procurement cardholders to report to the Department when they have concerns about fraudulent or erroneous purchases and need to request a replacement procurement card. Upon notification, the Department should oversee the process of reporting to the bank any concerns of fraudulent or erroneous procurement card purchases. The Department’s involvement related to reported issues may also include performing heightened monitoring or analysis of a cardholder’s activity to verify the validity of any such claims.
2. Work with the University’s bank to ensure that the University is alerted of a cardholder being issued a replacement procurement card or perform an analysis of active procurement card numbers each month to alert them of card number changes.
3. Train procurement cardholders and their supervisors on the University’s procurement card policies and procedures regarding allowable purchases and what documentation should be retained for review and approval.

4. Periodically monitor employees' procurement card activities using data analysis to help detect fraudulent purchases, including identifying suspicious purchasing patterns, vendors, merchant category codes, and amounts.
5. Develop a process to record, track, and monitor all procurement card violations to ensure that the University recovers all unallowable expenses from the employee or Foundation and prevent further unallowable expenses from occurring.

The University's corrective action plan at the end of this report includes the views and planned corrective action of its responsible officials. We are not required to audit and have not audited these responses and planned corrective actions and therefore provide no assurances as to their accuracy.

¹ In a sample of transactions selected for test work, we noted that 1 \$27 food purchase transaction related to a retirement celebration was marked as a procurement card violation but was not resolved with the employee before we brought it to the University's attention, 6 months after the transaction occurred. Similar violations have been noted by the University but there is no central tracking mechanism to quantify the potential dollar amount and if all unallowable expenses were recovered. The University provided a summary to us of 175 procurement card violation transactions recovered since 2018, totaling \$15,954. This summary did not include violations that had not been resolved or violations recovered for expenses that were allowable to be paid for by the NAU Foundation.

² On May 11, 2023, the University terminated the employee, and on May 18, 2023, the University filed a police report with the NAU Police Department.

³ The U.S. Government Accountability Office (GAO). (2014). *Standards for internal control in the federal government*. Washington, DC. Retrieved 11/1/23 from <https://www.gao.gov/assets/670/665712.pdf>.

2023-02

The University's initial financial statements contained note disclosure omissions and misclassifications, which increased the risk that those relying on the reported financial information could be misinformed

Condition—Contrary to U.S. generally accepted accounting principles (GAAP), the University's initial financial statements contained several note disclosure misclassifications and omissions we identified and recommended the University correct so that the University's financial statements would correctly present required information. The University's Comptroller's Office (Office) subsequently corrected these errors to the financial statement note disclosures, the most significant of which included:

- \$71.4 million of omitted deposit and investment disclosures required for credit risk and concentration of credit risk because the University disclosed an investment credit risk as not rated.
- \$24.6 million of art and historical collections that were misclassified in the capital assets note disclosure as library books and construction in progress, and further resulting in \$10 million of this amount being misclassified as depreciable capital assets on the statement of net position when they were nondepreciable capital assets.
- \$21 million of omitted deposit and investment disclosures required for concentration of credit risk for an investment that exceeded 5 percent of the University's portfolio.
- \$6.0 million of operating expenses that were omitted by natural classification in the operating expenses note disclosure.

In addition, the University corrected various other disclosure errors we identified.

Effect—The Office corrected the errors that we had identified and recommended it correct before issuing the University’s final financial statements. However, without the Office’s implementing corrective action to improve its financial reporting process, there is an increased risk that the University’s financial statements could contain significant errors and misinform those who are relying on the information.

Cause—The Office did not have sufficiently detailed policies and procedures to follow for preparing the financial statement disclosures and supporting schedules to ensure they were accurate and prepared in accordance with GAAP. Further, the Office had new personnel who were responsible for preparing and completing the detailed supervisory review of the financial statement disclosures to detect errors and correct them prior to providing them for audit, but the new personnel were not aware of all changes to financial information that required new or different classifications and disclosures than previously presented.

Criteria—The Governmental Accounting Standards Board sets the accounting and financial reporting standards that require the University to prepare its financial statements in accordance with GAAP. Accurate financial statements provide valuable information to those charged with the University’s governance and management, and others who rely on the reported financial information to make important decisions about the University’s financial operations. Designing, implementing, and maintaining effective policies and procedures is necessary to achieve the University’s financial reporting objectives and an essential part of internal control standards, such as the *Standards for Internal Control in the Federal Government* issued by the Comptroller General of the United States.¹

Recommendations—The Office should:

1. Update and implement existing policies and procedures to include detailed instructions to:
 - a. Prepare the financial statements and supporting schedules to ensure they are accurate and prepared in accordance with GAAP.
 - b. Evaluate significant changes to financial information to ensure it is properly classified and disclosed.
 - c. Require management to perform detailed supervisory reviews to ensure that the financial statement disclosures are accurate, properly supported, prepared in accordance with the University’s policies and procedures, and presented in accordance with GAAP and to detect and correct errors in the financial statement disclosures before providing them for audit. This review should be performed by an individual who is independent of the financial statements’ preparation and knowledgeable of GAAP reporting requirements to review the financial statements and related note disclosures.
2. Ensure personnel responsible for preparing the financial statements receive adequate training on policies and procedures.

The University’s corrective action plan at the end of this report includes the views and planned corrective action of its responsible officials. We are not required to audit and have not audited these responses and planned corrective actions and therefore provide no assurances as to their accuracy.

¹ U.S. Government Accountability Office (GAO). (2014). *Standards for Internal Control in the Federal Government*. Washington, DC. Retrieved 11/1/2023 from <https://www.gao.gov/assets/670/665712.pdf>.

2023-03

The University's control procedures over IT systems and data were not sufficient, which increases the risk that the University may not adequately protect those systems and data

Condition—The University's control procedures were not sufficiently implemented to respond to risks associated with its IT systems and data. The University lacked sufficient procedures over the following:

- **Restricting access**—Procedures did not consistently help prevent or detect unauthorized or inappropriate access to its IT systems and data.
- **Managing system configurations and changes**—Procedures did not ensure configuration settings were securely maintained and all IT system changes were adequately managed.

Effect—There is an increased risk that the University may not adequately protect its IT systems and data, which could result in unauthorized or inappropriate access and/or the loss of confidentiality or integrity of systems and data.

Cause—According to the University's IT management, they did not have sufficient staffing to fully implement their policies and procedures and as a result, did not follow written policies and procedures for restricting access or making changes to its IT systems and data.

Criteria—Implementing the following effective internal controls that follow a credible industry source, such as the National Institute of Standards and Technology, help the University to protect its IT systems and ensure the integrity and accuracy of the data it maintains:

- **Restrict access through logical access controls**—Help to ensure systems and data are accessed by users who have a need, systems and data access granted is appropriate, and key systems and data access is monitored and reviewed.
- **Manage system configurations and changes through well-defined, documented configuration management process**—Ensures the University's IT system configurations are documented and that changes to the systems are identified, documented, evaluated for security implications, tested, and approved prior to implementation. This helps limit the possibility of an adverse impact on the system's security or operation.

Recommendations—The University should:

1. Fill vacant IT positions to ensure IT policies and procedures are consistently followed.

Restrict access—To restrict access to its IT systems and data, follow established processes to:

2. Remove terminated employees' access to IT systems and data.

Manage system configurations and changes—To configure IT systems securely and manage system changes, implement processes to:

3. Follow the established change management process.

The University's corrective action plan at the end of this report includes the views and planned corrective action of its responsible officials. We are not required to audit and have not audited these responses and planned corrective actions and therefore provide no assurances as to their accuracy.

UNIVERSITY RESPONSE

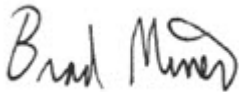
December 15, 2023

Lindsey A. Perry
Arizona Auditor General
2910 N. 44th St. Suite 410
Phoenix, AZ 85018

Dear Ms. Perry,

We have prepared the accompanying corrective action plan as required by the standards applicable to the financial audits contained in *Government Auditing Standards* and by the audit requirements of Title 2 U.S. Code of Federal Regulations Part 200, *Uniform Administrative Requirements, Cost Principles, and Audit Requirements of Federal Awards*. Specifically, for each finding, we are providing you with our responsible officials views, the names of the contact people responsible for corrective action, the corrective action planned, and the anticipated completion date.

Sincerely,



Bradley Miner
Interim Associate Vice President and Comptroller

cc: Bjorn Flugstad, Senior Vice President and Chief Financial Officer

Northern Arizona University

Corrective Action Plan

Year ended June 30, 2023

Financial statement findings

2023-01

Former employee made unallowable purchases totaling \$69,877 and falsely claimed they resulted from their procurement card's information being stolen, which was possible because of the University's lack of effective reviewing and monitoring procurement card activities, resulting in potential misuse of public monies

University contact personnel:

Becky McGaugh, Associate Vice President of Purchasing

Anticipated completion date: July 1, 2023

The University agrees with this finding. Due to the bank's requirement for reporting fraud charges, the University relied upon the issuing bank's process for identifying and managing fraud on purchasing cards. The University has already taken significant corrective action to close the communication loop with the issuing bank. In addition, expanded procedures to proactively monitor and detect fraudulent transactions are now in place.

1. The University has put in to place several additional control measures to improve its procurement card policies and procedures.

In response to this occurrence of fraud, the University's Contracts Purchasing and Risk Management department reviews prior card activity prior to new card issuances when the cardholder claims fraud. Additionally, the new banking provider for purchasing cards, effective July 1, 2023, provides fraud alert emails to the Contracts Purchasing and Risk Management department. Detective measures including transaction review and monthly approval by Local Fiscal Oversight, and review of transactions that fall under high risk for fraud, such as transactions with round numbers, transactions with a weak public purpose and transactions with retailers such as Walmart, Target and Walgreens, and missing documentation by Contracts, Purchasing and Risk Management will aid in identification of potentially fraudulent activity.

2. The University has conducted thorough reviews to identify past fraud and theft, to the extent practicable, and has implemented additional detective controls to deter and identify future fraudulent transactions.

The Contracts Purchasing and Risk Management department investigated all procurement cards for fraud charges going back to March of 2022 to ensure that other unallowable expenses were not being placed on procurement cards. Improved monthly training was implemented December 2021 and is now a requirement for cardholders with recurring purchasing card violations. Additionally, the Contracts Purchasing and Risk Management department will conduct unannounced quarterly reviews of purchasing card transactions and procedures to ensure controls are functioning as intended and purchases are appropriately approved, accurately recorded, properly supported, and serve NAU's business purposes.

Northern Arizona University

Corrective Action Plan

Year ended June 30, 2023

University management believes these preventative and detective controls will reduce the risk of fraud associated with purchasing card use.

2023-02

The University's initial financial statements contained note disclosure omissions and misclassifications, which increased the risk that those relying on the reported financial information could be misinformed

University contact personnel:

Brad Miner, Interim Associate Vice President and University Comptroller

Anticipated completion date: March 31, 2024

The University will expand policies and procedures for preparing the University's financial statements. Personnel responsible for preparing the financial statements will receive adequate training on policies, procedures, and disclosure requirements in accordance with GAAP, as well as continue to seek out expert guidance from GFOA sources. The University will develop written procedures to evaluate significant changes to financial information to ensure supporting schedules include proper classifications in accordance with GAAP. Additionally, management will perform a thorough review to detect and correct errors. This review will be performed by an individual who is not directly involved with financial statements' preparation and is knowledgeable of GAAP reporting requirements.

2023-03

The University's control procedures over IT systems and data were not sufficient, which increases the risk that the University may not adequately protect those systems and data

University contact personnel:

Steve Burrell, Chief Information Officer

Chris Graver, Director of Information Security

Anticipated completion date: December 15, 2023

To reduce risk to its systems and data, the University will further enhance the existing quarterly patch policy with patch implementation dates scheduled in advance for each fiscal year quarter and patch dates documented via established ITIL change process. The University will evaluate patch criticality levels and adhere to established policies based on criticality. The University will conduct a quarterly review of high privilege accounts to ensure retired or terminated users have been removed. Additionally, the University will enhance the Enterprise Resource Planning (ERP) access deprovisioning process by adding safeguards to ensure access is removed appropriately when users are no longer affiliated with the University.

