



A REPORT
TO THE
ARIZONA LEGISLATURE

Financial Audit Division

Report on Internal Control and Compliance

Northern Arizona University

Year Ended June 30, 2007



Debra K. Davenport
Auditor General

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Northern Arizona University
Report on Internal Control and Compliance
Year Ended June 30, 2007

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DEBRA K. DAVENPORT, CPA
AUDITOR GENERAL

**STATE OF ARIZONA
OFFICE OF THE
AUDITOR GENERAL**

WILLIAM THOMSON
DEPUTY AUDITOR GENERAL

**Independent Auditors' Report on Internal Control over Financial Reporting
and on Compliance and Other Matters Based on an Audit of Financial
Statements Performed in Accordance with *Government Auditing Standards***

Members of the Arizona State Legislature

The Arizona Board of Regents

We have audited the financial statements of the business-type activities and aggregate discretely presented component units of Northern Arizona University as of and for the year ended June 30, 2007, which collectively comprise the University's financial statements, and have issued our report thereon dated November 20, 2007. Our report was modified to include a reference to our reliance on other auditors. We conducted our audit in accordance with U.S. generally accepted auditing standards and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States. Other auditors audited the financial statements of the aggregate discretely presented component units, the Northern Arizona University Foundation, Inc., and the Northern Arizona Capital Facilities Finance Corporation, as described in our report on the University's financial statements. The financial statements of the aggregate discretely presented component units were not audited by the other auditors in accordance with *Government Auditing Standards*. This report includes our consideration of the results of the other auditors' testing of internal control over financial reporting that are reported separately by those other auditors. However, this report, insofar as it relates to the results of the other auditors, is based solely on the reports of the other auditors.

Internal Control over Financial Reporting

In planning and performing our audit, we considered the University's internal control over financial reporting as a basis for designing our auditing procedures for the purpose of expressing our opinions on the financial statements, but not for the purpose of expressing an opinion on the effectiveness of the University's internal control over financial reporting. Accordingly, we do not express an opinion on the effectiveness of the University's internal control over financial reporting.

Our consideration of internal control over financial reporting was for the limited purpose described in the preceding paragraph and would not necessarily identify all deficiencies in internal control over financial reporting that might be significant deficiencies or material weaknesses. However, as discussed below, we and the other auditors identified certain deficiencies in internal control over financial reporting that we consider to be significant deficiencies.

A control deficiency 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 misstatements on a timely basis. A significant deficiency is a control deficiency, or combination of control deficiencies, that adversely affects the University's ability to initiate, authorize, record, process, or report financial data reliably in accordance with generally accepted accounting principles such that there is more than a remote likelihood that a misstatement of the University's financial statements that is more than inconsequential will not be prevented or detected by the University's internal control. We consider items 07-01 through 07-05 described in the accompanying Schedule of Findings and Recommendations to be significant deficiencies in internal control over financial reporting.

A material weakness is a significant deficiency, or combination of significant deficiencies, that results in more than a remote likelihood that a material misstatement of the financial statements will not be prevented or detected by the University's internal control.

Our consideration of internal control over financial reporting was for the limited purpose described in the first paragraph of this section and would not necessarily identify all deficiencies in internal control that might be significant deficiencies and, accordingly, would not necessarily disclose all significant deficiencies that are also considered to be material weaknesses. However, of the significant deficiencies described above, we consider items 07-03 through 07-05 to be material weaknesses.

Compliance and Other Matters

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

Managements' responses to the findings identified in our audit have been included herein. We did not audit managements' responses and, accordingly, we express no opinion on them.

This report is intended solely for the information and use of the members of the Arizona State Legislature, the Arizona Board of Regents, and the University and is not intended to be and should not be used by anyone other than these specified parties. However, this report is a matter of public record, and its distribution is not limited.

Debbie Davenport
Auditor General

November 20, 2007

Northern Arizona University
Schedule of Findings and Recommendations
Year Ended June 30, 2007

Northern Arizona University Finding

07-01

Northern Arizona University

The University should improve access controls over its financial reporting computer system

System access controls help ensure that only authorized users have access to read, create, or modify data in the University's computer systems. These controls are critical in preventing or detecting unauthorized use, damage, loss, or modification of programs, and misuse of confidential or sensitive information. However, the University did not adequately limit access to its financial reporting system. Specifically, one individual in the comptroller's office has the ability to assign system user rights, including approval rights, and can process financial transactions such as purchase requisitions, purchase orders, journal entries, travel claims, and check disbursements. In addition, the individual's access to the system is not monitored or controlled. Further, approximately 140 office specialists have the ability to initiate a purchase, receive and enter the purchase into the system, and approve the purchase for payment for amounts under \$5,000. As a result, inappropriate or incorrectly classified purchases may not be detected.

To help strengthen controls over its financial reporting computer system, the University should develop and implement written policies and procedures for managing user access rights, including the following:

- Segregate the functions of assigning user access rights and processing daily financial transactions.
- Maintain appropriate system access rights for each employee that are compatible with the employee's job responsibilities.
- Segregate functions of initiating a purchase, receiving and entering the purchase into the system, and approving the purchase for payment.

Discretely Presented Component Unit Findings

The other auditors who audited the Northern Arizona University Foundation, Inc. (NAUF) reported the following significant deficiencies and material weaknesses for that component unit:

07-02

Northern Arizona University Foundation, Inc.

Year-End Preparation of Financial Statements

The Foundation maintains their books on a cash basis of accounting. Adjustments are then posted at the end of the fiscal year to bring the books to an accrual basis of accounting. However, there are not adequate controls in place to ensure that all required entries are made to properly present the financial statements. We recommend establishing policies and procedures for the year-end financial reporting process. Careful consideration should be given to the controls that should be implemented to ensure these year-end procedures are being performed accurately (e.g., reviews by individuals separate from the individuals preparing the adjustments, etc.).

Northern Arizona University
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Foundation management response: With the Controller position filled, NAUF will implement the auditors' suggestion of having a person independent of those making the accrual adjustment review the accrual for accuracy and appropriateness. In addition, NAUF will prepare a procedures document noting the standard adjusting entries to be made at year-end.

07-03

Northern Arizona University Foundation, Inc.

Improper Recording of Gift Income Associated with Irrevocable Trust Agreements

The Foundation has not designed adequate controls to ensure the identification and proper recording of irrevocable trust agreements naming the Foundation as beneficiary. Generally Accepted Accounting Principles require the recognition of gift income at the time the Foundation learns that they are the beneficiary of an irrevocable agreement. There are many situations where the Foundation does not know they are the beneficiary of a donor's estate/trust until the first distribution is received. At this time, the Foundation should contact the trustee to obtain an estimate on what the Foundation will be receiving. This estimate should be recorded as gift income and a receivable on the financial statements. We recommend establishing controls and procedures to ensure this financial reporting objective is achieved in a timely manner.

Foundation management response: NAUF will implement controls and procedures that will ensure proper recording of Irrevocable Trust Gift Income Transactions. Training has and will continue to take place for all parties (gift planning, data entry staff, development officers, and Foundation staff) involved in trust transactions to ensure that the transactions are recorded properly and on a timely basis.

07-04

Northern Arizona University Foundation, Inc.

Net Asset Reporting

Generally Accepted Accounting Principles require the reporting of net assets under three classifications – unrestricted, temporarily restricted, and permanently restricted – which are to be reported in accordance with donor-imposed restrictions. Since the Foundation uses a fund basis of accounting, the Foundation has identified the required net asset classifications based on fund type (e.g., endowed fund, quasi-endowed fund, discretionary fund, etc.). However, the Foundation does not have adequate controls over the creation of funds, the assignment of fund type, and the subsequent recording of gift income in order to ensure that the net asset classification reported in the statement of activities is in accordance with the *donor's* restriction on the gift. For example, during the fiscal year 2007, there was a significant *temporarily restricted* gift that was recorded to an endowed fund type, resulting in a permanently restricted classification in the financial statements.

The Foundation's new accounting system (in use for FY 2008) allows the identification of a fund type (e.g., endowed fund, quasi-endowed fund, discretionary fund, etc.) as well as a separate net asset class identification. Management of the Foundation has determined that this will enable the Foundation to properly record gifts and net assets under the three net asset classifications identified above. However, the Foundation needs to implement controls over the creation of funds to ensure that the funds are set-up

Northern Arizona University
Schedule of Findings and Recommendations
Year Ended June 30, 2007

correctly. In addition, there needs to be controls in place to ensure that the assignment of gifts to funds matches the restriction defined by the donor. We also recommend that a policy (or other documentation) be established that has specific definitions of fund types (generally in line with CASE reporting standards) and the GAAP reporting requirements. Until such controls are in place and operating effectively, material misstatements in the financial statements could continue to occur and not be detected or prevented.

Lastly, we recommend performing a thorough review of all funds to ensure that the set-up of the fund and net asset classifications are in line with the restrictions of the donors who have contributed to those funds. The results of this review should then be reconciled to the net asset balances for each classification reported in the financial statements.

Foundation management response: NAUF will implement appropriate controls to ensure the creation of a fund, the assignment of fund type and the subsequent recording of gift income is done properly and on a timely basis. As the Controller position has now been filled this provides NAUF with an adequate staffing level to provide oversight for the fund creation and classification process. NAUF will perform a thorough review of all funds in FY 2008 to ensure that the existing fund structure corresponds with the net asset classification as established by any donor restrictions.

07-05

Northern Arizona University Foundation, Inc.

Financial Expertise

The Foundation does not have adequate expertise over certain non-profit requirements of Generally Accepted Accounting Principles. Compounding this issue, the board of directors (or designated committee) does not receive regular financial statements for the Foundation as a whole on a regular basis in order to provide adequate oversight of the financial reporting process. To address these issues, we recommend the Foundation accounting staff invest time in conferences and seminars to gain knowledge in accounting issues specific to the Foundation. Also, we recommend reviewing the regular financial reporting process to determine if changes should be made so that the board of directors (or designated committee) can provide proper oversight.

Foundation management response: NAUF will follow the auditor's recommendation of additional training. The Council for Advancement and Support of Education Conference for Institutionally Related Foundations, April 2008, will be attended by the Foundation Director of Finance and Administration and the Foundation Controller. Research will be done to identify additional training opportunities for the NAUF staff, as well as subscriptions that may be obtained for pertinent and relevant periodicals that would allow NAUF staff to be knowledgeable regarding current events/issues. Additionally, NAUF staff will provide the NAUF Board of Directors with quarterly financial reports for review and comment.



NORTHERN ARIZONA UNIVERSITY

COMPTROLLER'S OFFICE

December 16, 2007

Debra K. Davenport, CPA
Auditor General
2910 N. 44th Street, Suite 410
Phoenix, AZ 85018

Re: Schedule of findings and recommendations for the Year Ended June 30,
2007

Dear Ms. Davenport,

Please find attached Northern Arizona University's response to your findings and related recommendations as described in the November 20th, 2007 Independent Auditor's Report on Internal Control over Financial Reporting and on Compliance and Other Matters Based on an Audit of Financial Statements Performed in Accordance with Government Auditing Standards. In the findings and recommendations, you will also see findings for the University component units. The component units are separate legal entities not under the University's management and therefore the University did not respond to those findings.

Sincerely,

Robert Norton
Associate Vice President

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NORTHERN ARIZONA UNIVERSITY

COMPTROLLER'S OFFICE

Northern Arizona University
Corrective Action Plan
Year Ended June 30, 2007

Finding 07-01 - The University should improve access controls over its critical computer systems

Contact Person: Robert Norton, Associate Vice President of Administration and Finance / Comptroller

Anticipated Completion Date: January 2, 2008

Corrective Action Plan – The Advantage Security Administrator's access has been restricted to security functions only. User access rights for employees who have been promoted, demoted, transferred or terminated are reviewed on a monthly basis using the "Terms and Transfers Query" that is generated and distributed by Payroll. Employee access has been updated to be compatible with the employee's job functions. Duties for the initiation and approval of a purchase and the subsequent receipt of goods via the departmental purchase orders have been segregated to no longer allow the self approval of the departmental purchase order.