

**MANAGEMENT LETTER
OF THE
NEBRASKA DEPARTMENT OF
ENVIRONMENTAL QUALITY
CLEAN WATER
STATE REVOLVING FUND PROGRAM
JULY 1, 1999 THROUGH JUNE 30, 2000**

STATE OF NEBRASKA
Auditor of Public Accounts



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February 2, 2001

Mike Linder, Director
Nebraska Department of Environmental Quality
P.O. Box 98922
Lincoln, Nebraska 68509-8922

Dear Mr. Linder:

We have audited the financial statements of the Nebraska Department of Environmental Quality – Clean Water State Revolving Fund Program (Program) as of and for the year ended June 30, 2000, and have issued our report thereon dated February 2, 2001. We have also issued Report On Compliance And On Internal Control Over Financial Reporting Based On An Audit of Financial Statements Performed In Accordance With Government Auditing Standards dated February 2, 2001.

In planning and performing our audit, we considered the Program's internal control over financial reporting in order to determine our auditing procedures for the purpose of expressing our opinion on the financial statements and not to provide assurance on the internal control over financial reporting, and on the Program's compliance with certain provisions of laws, regulations, contracts, and grants, 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 did not express such an opinion.

We noted certain matters involving the internal control over financial reporting and other operational matters that are presented here. Comments and recommendations are intended to improve the internal control over financial reporting, ensure compliance, or result in operational efficiencies.

Our Summary of Comments, and our Comments and Recommendations for the Program for the fiscal year ended June 30, 2000 are as follows:

SUMMARY OF COMMENTS

1. ***Cash Reconciliation:*** The cash and cash equivalents as recorded on the Nebraska Accounting System (NAS) were \$7,080 more than were reported on the financial statements.
2. ***Financial Statement Documentation:*** The Department did not prepare cash basis financial statements based on information recorded on NAS, and then make accrual adjustments to ensure the financial statements were in conformity with generally accepted accounting principles (GAAP).
3. ***Loan Records:*** The Department accounts for loans using both internal records and NAS instead of using NAS only.

More detailed information on the above items is provided hereafter. It should be noted this report is critical in nature since it contains only our comments and recommendations on the areas noted for improvement.

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

We appreciate the cooperation and courtesy extended to our auditors during the course of the audit.

COMMENTS AND RECOMMENDATIONS

1. **Cash Reconciliation**

The Nebraska Accounting System (NAS) was established by the Nebraska Legislature to be the official accounting system of the State of Nebraska. Sound accounting practices require the assets of the Program to be separately documented in the entity's accounting records.

During our audit of the Clean Water State Revolving Fund Program (Program), we noted the Cash and Cash Equivalents as recorded on NAS were \$7,080 more than were reported on the Program's balance sheet at June 30, 2000. The Department was unable to explain this variance, but it appears this variance is the result of errors made by the Department while posting Program activities since the beginning of the program. This was noted in the prior two audits of the fiscal years ending June 30, 1998 and 1999.

While the variance is small in relation to the entire Program balance, it is important to reconcile Program activity as recorded on NAS in order to ensure all of the Program's activity was properly recorded and accounted for. We did note the Department attempted to reconcile the Program's cash activity to the beginning of the program. However, this reconciliation still indicated the variance as noted above.

We recommend the Department continue to reconcile cash activity as recorded on NAS to actual activity of the Program, and make any adjustments to NAS as required.

Department's Response: The department will continue to work on reconciling cash.

2. Financial Statement Documentation

Sound accounting practices require financial statements be prepared based solely on the entity's accounting records, and then formally adjusted for any relevant accounting issues. For the State of Nebraska, this means preparing cash basis statements based on information recorded on NAS, and then preparing accrual adjusting entries to ensure statements are in conformance with generally accepted accounting principles (GAAP).

Our review of the Program indicated the Department prepared the accompanying financial statements based on information as recorded in NAS and on the Bond Trustee's statements. However, the Department did not prepare cash basis statements and then make accrual adjustments to obtain the GAAP basis information. Instead, the Department selected specific transactions and periods of transactions in order to obtain accrual information. This was also noted in the prior two audits of the fiscal years ending June 30, 1998 and 1999.

While we were able to reconcile the information presented in the Program's financial statements to NAS and the Trustee's statements, the information was not easy to follow. This could make it difficult for other entities to review and understand the information used to prepare the Department's Clean Water State Revolving Fund financial statements.

We recommend the Department improve the documentation they use to prepare the Program's financial statements to include the preparation of cash basis statements, and preparing appropriate adjusting journal entries to adjust the cash basis statements to GAAP basis statements.

Department's Response: The department agrees and will prepare a trial balance and adjusting/accrual entries to ensure that financial statements are in conformity with generally accepted accounting principles (GAAP).

3. Loan Records

A significant part of accounting for the Program's activity is the loan activity. Currently the Department accounts for this activity using both internal records and NAS. The internal records include loan files for each city, and ledger sheets showing loan approvals, loan payments, interest and principle payments on loans, and loan balances. This was also noted in the prior two audits of the fiscal years ending June 30, 1998 and 1999.

While the Department does reconcile their internal records to NAS, we believe it would be more efficient, and controls would be improved, if each loan and its activity were recorded on NAS. Efficiency would be improved because the system would record the transactions, and separate spreadsheets and reconciliations to NAS would not need to be prepared. Control would be improved because there would be a reduced likelihood of posting errors, because the original transaction would be recorded based on approved transactions, and it would not be necessary to again record that transaction on a spreadsheet.

We recommend DEQ request assistance from the Department of Administrative Services – Accounting Division, and work toward getting all loans and activities recorded on NAS.

Department's Response: All payments to communities have been appropriated as aid by the legislature and therefore recorded as aid which is account number 4961 (an expense account). To record the payment to a community as a loans receivable would require that account 1311 (an asset account) be used. The agency will contact the Department of Administrative Services Accounting Division and Budget Division to see if this problem can be resolved.

Sincerely,

A handwritten signature in dark ink, appearing to read "Don Dunlap CPA". The signature is fluid and cursive, with the "CPA" part written in a slightly more formal, blocky style.

Don Dunlap
Assistant Deputy Auditor