ATTESTATION REPORT
OF THE
NEBRASKA STATE ELECTRICAL DIVISION

JULY 1, 2003 THROUGH JUNE 30, 2004

Issued on June 20, 2005

NEBRASKA STATE ELECTRICAL DIVISION

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BACKGROUND

The Nebraska State Electrical Division (Division) includes a State Electrical Board, which directs the Division's Executive Director and sets Division policy. The State Electrical Board (Board), established in 1969, is a seven-member regulatory board which enforces the State Electrical Act. Members are appointed by the Governor to five-year terms. Members include a journeyman electrician, an electrical contractor or master electrician, a certified electrical inspector, a registered professional engineer, a state rural electric system representative, a state municipal electric system representative, and a seventh member who may represent any of the above groups.

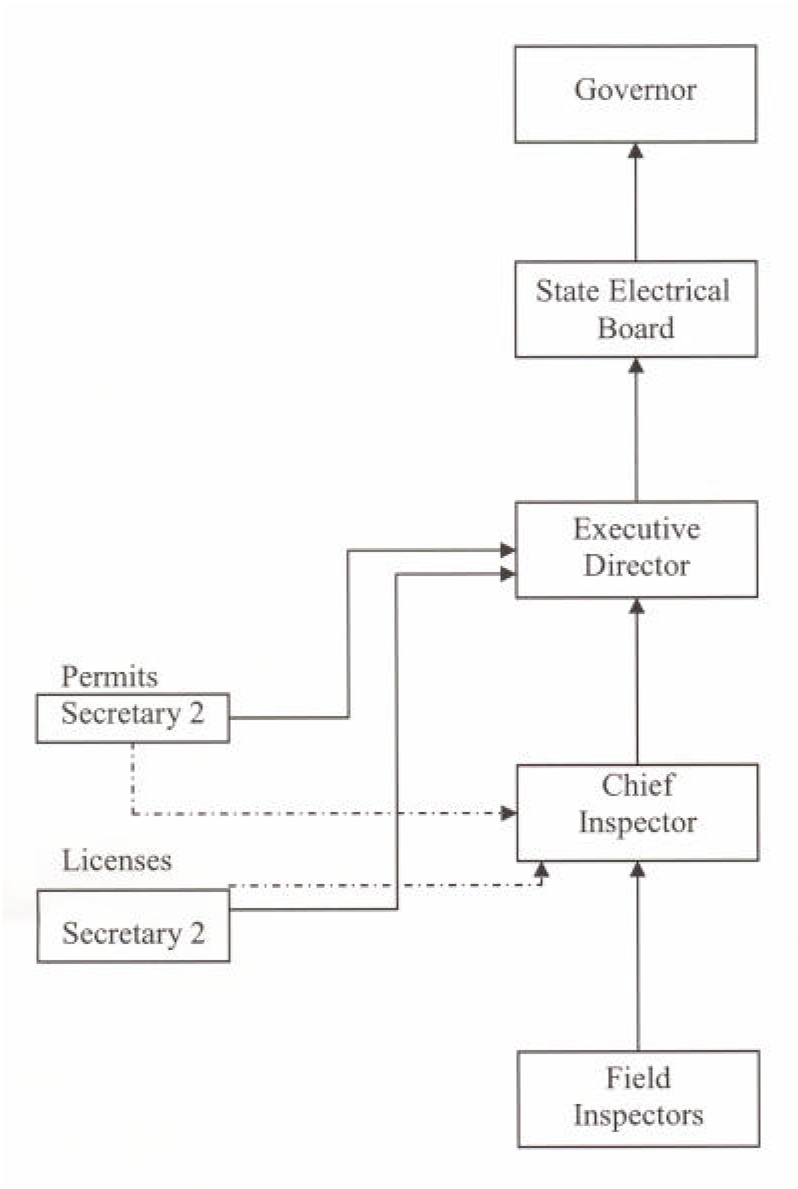
The Division is responsible for the inspection of new electrical wiring and electrical systems installed in buildings for compliance with the adopted electrical code. Existing residential and rural electrical facilities are inspected upon request. Electrical accidents and fatalities are investigated where possible. Practicing electricians and electrical contractors are tested, and, if qualified, are licensed by the Division. The Division is funded with cash funds received from occupational license fees and inspection fees.

MISSION STATEMENT

The mission of the State Electrical Division is to protect the public from hazardous electrical installations by enforcing the electrical licensing and inspection laws created by the Nebraska Legislature.

NEBRASKA STATE ELECTRICAL DIVISION

ORGANIZATIONAL CHART



Notes: Lincoln office personnel are to report independently to the Executive Director.

Lincoln office personnel are to be independently responsible for their assigned duties.

In the absence of the Executive Director, the Chief Electrical Inspector is in charge.

EXIT CONFERENCE

An exit conference was held May 13, 2005 with the Division to discuss the results of our examination. Those in attendance for the Nebraska State Electrical Division were:

NAME	TITLE
Bill Whitmer	Board Member
Ed Bergstraesser	Board Member
Freda Meier	Secretary II Electrical Division
George Morrissey	Board President
Ted Stutheit	Executive Director
Melissa Hamilton	Secretary II Electrical Division
Randy Anderson	Chief Inspector
Scott Danigole	Legislature
Rich Robinson	DAS Budget Division

SUMMARY OF COMMENTS

During our examination of the Nebraska State Electrical Division (Division), we noted certain matters involving the internal control over financial reporting and other operational matters which are presented here.

1. ***Control Environment:*** The control environment was not conducive to fair and complete financial reporting.

2. ***Internal Control Over Receipts:*** The Division recorded $1,092,903 in receipts in the State accounting system, however, due to serious internal control deficiencies and a lack of adequate records we were unable to provide assurance all money received and all money due to the Division was properly deposited in the State Treasury.

3. ***Other Internal Control Issues:*** There was a general lack of segregation of duties and inadequate or lack of monitoring procedures over the accounting functions related to payroll, capital assets, and expenditures.

4. ***Support for Fees Charged:*** The Division did not have documentation on file to support whether the fees for licenses, permits, exams, or other miscellaneous charges were sufficient to cover the costs incurred by the Division or whether they may be excessive. This was also noted in the fiscal year 2001 audit report.

5. ***Contracts:*** The Division entered into a service contract for $45,000. There was no competitive formal bid through the Department of Administrative Services–Materiel Division, there was no legal review of the contract, and the contract was not entered on the Nebraska Information System (NIS). In addition, there was a $5,000 down payment made prior to receiving services.

6. ***Payroll Detail:*** There was a lack of documentation for a salary, required Federal forms (i.e. I-9 and W-4 forms) were not on file, and one payroll deduction was not correct. The Division did not record catastrophic donated leave properly in NIS for one terminated employee. In addition, the Division overpaid the individual $248 for vacation leave and did not withhold retirement and taxes, in the amount of $2,126, on the last paycheck.

7. ***Travel Expenses:*** We noted documents tested did not have meal receipts with detailed receipts or meal logs. Per diem rates were claimed instead of actual expenses for two employees for $208 and $200, a total of $408. Mileage claimed was unreasonable; we calculated an excess of 211 miles. We also noted lodging expenses were not within the Federal General Services Administration (GSA) per diem guideline or the individuals were not over 60 miles from their workplace. Employee expense reimbursements were not properly completed and several documents and trips did not have adequate supporting documentation or were not approved by a supervisor.

SUMMARY OF COMMENTS
(Continued)

8. ***Rental Payments:*** We noted the Division's rental space was not paid from the State Building Revolving Fund. Monthly rental payments were $1,614, or $19,368 annually.

9. ***Fixed Assets:*** We noted a physical inventory was not performed by the Division for fiscal year 2004. In addition, the six assets tested were not properly tagged or marked "Property of State of Nebraska."

10. ***Nebraska Information System and Accounting Procedures:*** Significant concerns or areas where improvement to NIS is needed to ensure NIS integrity and operation efficiency were identified.

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

Draft copies of this report were furnished to the Division 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. Where no response has been included, the Division declined to respond. 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 examination.

We appreciate the cooperation and courtesy extended to our staff during the course of the examination.

COMMENTS AND RECOMMENDATIONS

1. Control Environment

An internal control environment conducive to fair and complete financial reporting includes an adequate segregation of duties to ensure no one individual can process an accounting transaction from beginning to end, effective monitoring and review of processes related to policies, procedures, and accounting functions of the Division, and effective communication between Division personnel and management.

The State Electrical Division is an independent agency under the administrative and operative control of the Executive Director of such division. The Division shall include a seven-member State Electrical Board (Board) appointed by the Governor with the consent of the Legislature. The Board shall direct the efforts of the Executive Director and set policy of the Division. The Executive Director is responsible for all books, records, and transcripts of proceedings of the Board. The control environment was not conducive to fair and complete financial reporting as follows:

- There was an overall lack of monitoring of the accounting activities of the Division by its management. At each meeting the Board reviewed a budget status report of the Division. The Executive Director indicated he also utilized this budget status report for his review of Division operations. The budget status report does not show the detailed transactions of the Division. In fact, there was no review of a detailed report of the accounting transactions by anyone in the Division and, at the time of the audit, no one in the Division was able to generate a detailed report from NIS.

- Based on discussions with management and staff, it did not appear management placed an importance on the accounting functions and controls of the Division. For example, the Executive Director did not review the supporting documentation prior to signing deposit documents. The Executive Director simply signed the deposit document without ensuring the amount on the deposit agreed to the amount received by the Division. Division personnel created logs of monies received and the logs included a place for the signature of the Executive Director; however, we did not observe the signature of the Executive Director on any of the logs we reviewed. The Executive Director also made certain comments to the auditors that conveyed he did not have time to perform all of the control functions.

- Also based on discussions with management and staff, there was a lack of effective communication of policies and procedures between management and some employees. The secretaries perform most of the accounting functions of the Division, and there were few directives or written procedures from management.

COMMENTS AND RECOMMENDATIONS
(Continued)

1. Control Environment (Continued)

- There was lack of organization within the Division. We were unable to obtain supporting documentation for certain documents selected for testing. See Comment Number 2 (Internal Control Over Receipts) and Comment Number 3 (Other Internal Control Issues) for further information.

- There was a lack of segregation of duties in most areas of the Division. There were three individuals who performed the accounting functions of the Division. There were not adequate policies, procedures, and controls in place to ensure a proper segregation of duties exists. See Comment Number 2 (Internal Control Over Receipts) and Comment Number 3 (Other Internal Control Issues) for further information.

Without a control environment conducive to fair and complete financial reporting, there is a significant risk for fraud or mistake to occur and remain undetected.

> The Board has the overall responsibility to establish a strong control environment. A strong control environment should include effective monitoring of the activities of the Division, effective communication between management and staff, and effective segregation of duties or compensating controls. Specifically, we recommend the Division implement a periodic review of all detailed transactions of the Division to ensure all transactions are authorized. We recommend the Division implement procedures to ensure all staff utilizing the accounting system are appropriately trained, appropriate supporting documentation is reviewed, and other controls over processing Division transactions are in place to reduce the risk of fraud in the Division. We also recommend the Division develop adequate policies to ensure an importance is placed on the accounting activities of the Division from management down to the employees. In addition, we recommend the Division ensure a proper segregation of duties is established to ensure no one individual is able to both perpetrate and conceal errors and irregularities.

Division's Response: The State Electrical Division welcomed the opportunity to participate in an audit of FY 03-04. It provided us with very valuable information previously unknown, and gave us numerous good ideas on how to make the division more accountable; we are grateful for the hard work of the auditing team. Our staff learned a lot.

COMMENTS AND RECOMMENDATIONS
(Continued)

1. Control Environment (Concluded)

Division's Response, Concluded:
Following are point by point responses to issues raised in the audit:

- *A detailed review has always been conducted of accounting transactions. However, that review was not conducted in NIS, but rather by hard copy, with data entry into NIS. We will institute procedures to review the data after it's been placed in the NIS system.*

- *Until conditions obtained which caused the executive director to request the audit, trust in the honesty and integrity of division personnel was relied on, and the signature of the director, on deposit documents, for example, was indicative of that trust, although a comparison of hard copy deposit documents vs. NIS has always been conducted. All documents dealing with revenue will be more thoroughly reviewed.*

- *As previously stated, we didn't know there were any egregious errors in our methods, and would not have become aware there were, without the requested audit. Of the three office personnel, the director and one secretary are fairly recent hires. The one secretary who'd been with the division for years was mainly responsible for accounting, and had some year's experience in that field. Her knowledge was the well the rest of us drew from, and we frequently were told, if we encountered a problem, "That's not the way the previous director did it." Directives and written procedures for accounting, it was assumed, were only available from NIS help, as there were none extant.*

- *The overall functioning of accounting practices already in place, filing, maintenance of original documents, payroll processing, and etc., were within the purview of the secretary noted directly above. Training will be instituted, and duties reassigned, the aim being to establish better and more reliable controls.*

- *A plan will be formulated to establish better controls.*

APA's Response: As stated above, it is the responsibility of the Executive Director to ensure all books, records, and transcripts are adequately recorded and maintained at the Division.

2. Internal Control Over Receipts

Good internal control requires a proper segregation of duties to ensure no one individual is able to both perpetrate and conceal errors and irregularities. Good internal control also requires appropriate controls over cash received and the receipting/depositing process, all transactions be documented and explained, all revenues be consistently recorded and reported in the correct accounts, all

2. Internal Control Over Receipts (Continued)

revenues to which the Division is entitled be collected and recorded and are provable by other separately maintained records, all revenues recorded were due to the Division, and all revenues are deposited intact and promptly in accordance with State Statute.

Neb. Rev. Stat. Section 84-710 R.R.S. 1999 states, any money belonging to the State shall be paid into the State Treasury within three business days of receipt when the amount is $500 or more and within seven days of receipt when the amount is less than $500.

For fiscal year 2004, the Division recorded $1,092,903 in receipts in the State accounting system. During our examination of the internal controls and records of the Division's receipt process, we noted serious internal control deficiencies and a lack of adequate records. The internal controls and records were so deficient we were unable to provide assurance that all money received and all money due to the Division was properly deposited in the State Treasury. Following are our findings and recommendations related to the receipt process.

Independence

The individuals handling checks/cash items were not completely independent of the function of processing and approving applications for permits and licenses. One individual created an initial record of money received and also processed permit applications. The money was then given to the other secretary who created the deposit document and also processed the license applications. There is an increased risk for fraud when the individuals that handle the cash received can also issue the permits and licenses.

> We recommend the Board implement procedures to ensure a proper segregation of duties exists between the handling of cash and the issuance of the licenses and permits. If this is not possible due to limited staff, other controls should be implemented to compensate for the lack of segregation of duties such as a detailed review of the initial record of cash received by the Executive Director at the time he signs the deposit and procedures to ensure funds were actually deposited for all licenses and permits issued.

Depositing Procedures

As noted above, the Division created an initial record of monies received on a daily log sheet. The daily log sheet was used to create the deposit document. We noted the following related to the Division's depositing procedures:

COMMENTS AND RECOMMENDATIONS
(Continued)

2. **Internal Control Over Receipts** (Continued)

- Not all monies received by the Division were recorded on the daily log sheets. There was $11,751 more recorded on NIS than was recorded on the daily log sheets for the fiscal year 2004. Additionally, 1 of 25 cash/check items tested, for $25, was not included on the daily log sheets during our cash count procedures. We were also unable to determine all items counted on May 3, 2005, were properly deposited on NIS since the Division did not deposit all monies daily. The deposit was not simply for one day's receipts and there was not an adequate trail from the deposit document back to the daily log sheets.

- The daily log sheets were maintained on the Division's shared computer drive so all individuals in the office had the ability to access and manipulate this daily record of monies received.

- Remittances were held and not deposited with the regular daily deposit. There were 4 of 30 deposits tested which were not made in accordance with State Statute. The deposits were made from two to nine days late. The Division did not deposit monies received for permits and licenses until the applications were approved. This was also noted in the prior report.

- If the application was not approved, the Division sent the original cash or check back to the individual, instead of depositing the money and issuing a refund check. We tested 30 items noted as returned on the daily log sheets and 13 returns, totaling $1,105, were not adequately documented to identify the reason for the return.

- The Division did not restrictively endorse checks or money orders until the application was approved. During the surprise cash count, 1 of 23 checks tested was not restrictively endorsed for deposit.

- Licenses issued from at least July 2002 through August 2003 could not be traced to the deposit document. There was no support to determine whether money was actually deposited for all licenses issued during this timeframe. The Division did not reconcile the licenses issued to the amount deposited for licenses. There were 2 of 6 licenses tested that could not be traced to the deposit document and 4 of 9 deposit documents that could not be traced to the licenses. Therefore, we were unable to verify the accuracy or completeness of the license fees recorded on NIS.

- Inspectors in the field could collect monies for the Division, although it was indicated this rarely occurred.

COMMENTS AND RECOMMENDATIONS
(Continued)

2. Internal Control Over Receipts (Continued)

There is a significant risk for fraud related to the issues noted above.

> We recommend the Division implement procedures to ensure all monies received are properly recorded on the daily log sheets and the daily log sheets agree to the deposit documents. We also recommend the Division ensure the daily log sheets are not accessible to the individual responsible for creating the deposit document to ensure no unauthorized changes are made. We recommend the Division implement procedures to ensure remittances are restrictively endorsed upon receipt and all monies received are deposited with the regular deposit daily. If a return is required, a refund check should be issued through NIS. We also recommend the Division implement procedures to ensure monies have actually been deposited for all licenses and permits issued. Finally, we recommend inspectors be prohibited from collecting money in the field. All funds should be sent to the main office for collection.

Review and Approval Procedures

The following were noted related to the review and approval procedures of the Division:

- There was not a comparison of the deposit documents to supporting detailed documentation during the pre-audit or approval process.

- The Division did not have supporting documentation on file for 1 of 3 documents tested. The Division could not explain the transaction for $53.

- A detailed report of the Division's transactions was not compared to the deposits to ensure accuracy and completeness within NIS.

- The Division did not have procedures established to ensure all monies due to the State were being collected. The Division did not develop expectations regarding the amount of money to be collected from year to year. We were unable to adequately explain variances in the amounts collected for licenses and permits between fiscal year 2003 and fiscal year 2004. The Division could not provide accurate information on the number of permits or licenses issued for each year.

2. Internal Control Over Receipts (Continued)

Without adequate review and approval of individual transactions, adequate supporting documentation, and adequate procedures to ensure all monies due are collected, there is an increased risk for fraudulent activity.

> We recommend the Division implement procedures to ensure the detailed documentation is reviewed by the individuals performing the pre-audit and approval processes, documentation for all transactions is retained by the Division, detailed reports of the Division's transactions are compared to deposits, and all monies due to the State are collected.

License Procedures

We noted the following related to the licensing procedures:

- Licenses were not sequentially numbered within the Division's system. As noted, the Division could not determine the number of licenses issued for the fiscal year from their system. Electricians were required to renew their licenses every two years. Renewed licenses were not assigned a new license number, instead they kept the same number as the original license and there was not a separate control number assigned to numerically account for all licenses issued. In addition, the Division began using the new system in late August 2003. For July and August 2003 the license numbers within the old system were also not sequential.

- The system did not maintain the date the original license was issued once a renewal period was over. When an electrician would renew a license, the original license date or last renewal date would be replaced with the current renewal date. Therefore, the Division was unable to obtain accurate reports for a particular date in time.

- Records deleted were not archived in the system. A record could be deleted with no further trail maintained.

Without adequate procedures related to the license process and system, there is an increased risk for fraud.

COMMENTS AND RECOMMENDATIONS
(Continued)

2. <u>Internal Control Over Receipts</u> (Continued)

> We recommend the Division ensure licenses have sequential control numbers assigned to each license, whether it is an original license or a renewal license, and that all detail pertaining to the licenses in the system, such as initial license dates, all renewal dates, and/or deletions, should be archived in the system for subsequent review and accurate reporting. This would assist management in determining the number of licenses issued for a particular period of time.

<u>Reconciliation Procedures</u>

The Division began utilizing Nebrask@ Online (NOL) for their web-based permit and license renewal application process in May 2004. Homeowners and contractors were able to access the online applications and process a credit card for payment. NOL would then deposit the money into the State's credit card account. The Division was then responsible for ensuring the money was credited properly to their fund by obtaining the deposit information from an NOL report and preparing the deposit document. We noted the following:

- The Division did not reconcile the information obtained from the NOL report and the bank statement for at least two months after the implementation of the web-based application. During these two months, the system had some glitches and subsequently over and under-charged approximately 10 applicants. NOL contacted the Division to inform them of the problem. There was approximately $170 not collected. NOL offered to cover the difference; however, this amount currently remains uncollected.

- Two of five credit card receipts tested could not be traced from the NOL report to the bank statement. The applicant was under-charged $30 for one of the receipts. The NOL report indicated $30 was received; however, this was never recorded on the bank statement. The second receipt was a duplicate permit that could not be traced through the system. If an applicant entered a duplicate permit, the system automatically denied the permit and it was subsequently deleted. There was no documentation to support duplicate permits.

Without adequate controls and documentation over the transactions processed by NOL, there is an increased risk for loss or misuse of State funds.

> We recommend the Division ensure a periodic reconciliation is performed between NOL, the bank statement, and the Division's system to ensure accuracy and completeness.

COMMENTS AND RECOMMENDATIONS
(Continued)

2. Internal Control Over Receipts (Continued)

Division's Response:
Independence: Duties can't be separated, due to limited staffing, however review of records of cash receipts and reconciliation by the director can be accomplished.

Depositing Procedures

- *The daily log should agree with the daily deposit. Changes will be instituted to ensure this happens.*

- *The daily log sheet needs to be accessible to the three office staff, all of whom are charged with accounting duties requiring access, and needs to be editable so entries can be made. Final review of a hard copy will be completed by the director.*

- *In the fiscal year audited, the division believed it was unable to make refunds of monies received in error. Believing it reprehensible to take money and not deliver a service for it, in an effort to be able to make returns, revenues were held to enable contractors to discover their mistakes, and call for a return. An attorney general opinion bore this out, in the opinion of the Electrical Board. That practice ceased, due to advice from state accounting that refunds could be made.*

- *According to the State Electrical Division Act Book, §81-2126, "…licensee or owner making such installation shall submit to the board a request for inspection, on a form prescribed by the board, together with supervisory fee of fifty cents and the inspection fees required for such installation." Also according to the State Electrical Division Act Book, §81-2135 (1) "All state electrical inspection fees shall be due and payable to the board at or before commencement of the installation and shall be forwarded with the request for inspection." Our interpretation of this has been if we cashed the checks, the requester would have a permit. To ameliorate this situation, because we receive applications that must be denied, checks for permits are copied, as well as the application for the permit, and the copies are maintained as documentation. This has not been done with licensing. We will follow the auditor's recommendation with regard for licensing, as copies of checks for denied license renewals were not maintained.*

- *We are working on procedures to restrictively endorse checks in the proper sequence.*

- *This issue was corrected by new permitting and licensing software.*

- *A policy has been instituted precluding inspectors receiving money in the field.*

COMMENTS AND RECOMMENDATIONS
(Continued)

2. <u>Internal Control Over Receipts</u> (Continued)

Division's Response, Concluded:
<u>Review and Approval Procedures</u>

- *There is now a comparison of deposit documents conducted.*
- *(No comment on this. I can't find the document)*
- *Transaction reports are now compared to both deposits and expenses to ensure accuracy and completeness within NIS.*
- *Although the philosophy of the division has been that it's impossible to "develop expectations" of revenue, license renewal, and etc., we will try to come up with a method to do so. Construction, supply of and demand for licensees, with construction being tied to lending rates, which are in turn tied to national confidence, all make for many variables, and our permit and license fees are necessarily tied to construction. Incidents as diverse as 9/11, the incident of swine flu several years ago, severe winter weather, mad cow disease, and even the drop in Lake McConaughy effect division revenue.*

<u>License Procedures</u>

- *The issue of tracking licenses is being resolved by software modification.*
- *This was the way the original system was designed, and again, software modifications are providing resolution. The division previously had relied on individual hard copy files for licensees, separated by type of license, and alphabetized, which served our needs.*
- *Archiving was not a part of the division's policy, again because paper copies for each individual were and are maintained. Software modification has included the ability to archive.*

<u>Reconciliation Procedures</u>

- *After consultation with NOL management, the Electrical Division director determined the $170 would not be collected.*
- *NOL has been made aware of this problem, and has rectified it. Reconciliation of statements is being performed on a daily basis.*

COMMENTS AND RECOMMENDATIONS
(Continued)

2. Internal Control Over Receipts (Concluded)

APA's Response: The Division should ensure all monies received are deposited immediately upon receipt. If the application is not approved, the Division should issue a refund check as necessary.

The Division should also ensure compliance with State Statute 81-8,297(4) R.S.Supp., 2002 to ensure monies determined uncollectible are requested and filed with the State Claims Board prior to write-off.

3. Other Internal Control Issues

Good internal control requires an adequate segregation of duties or compensating controls to ensure no one individual is able to both perpetrate and conceal errors and irregularities. Good internal control also requires adequate monitoring procedures to ensure controls are operating as intended. In addition, good accounting practice and good internal control requires detailed reports of the Division's transactions be reviewed periodically to ensure accuracy of accounting records within the State accounting system.

In addition to the lack of monitoring and control procedures for the receipt process, we also noted a lack of segregation of duties and inadequate or lack of monitoring procedures over the accounting functions related to payroll, expenditures, and capital assets.

Payroll

Four individuals were able to perform all of the payroll functions within NIS, including changes to pay rates and entering of hours worked and leave used. There was no documented review of the payroll register to ensure payroll rates and hours worked were authorized and accurate.

Expenditures

- One individual has access to perform accounting functions on NIS, but is not located in Lincoln, where the supporting documentation for all transactions resides. The Chief Inspector has approved documents on NIS from outside of the Lincoln office. It was noted the office staff provided the detail of the transactions over the phone with the Chief Inspector and the Chief Inspector approved the document online. It does not appear the Chief Inspector has a logical need for access to NIS.

- There was not a review of the detailed reports of the Division's transactions on NIS to ensure all expenditures were authorized.

COMMENTS AND RECOMMENDATIONS
(Continued)

3. Other Internal Control Issues (Continued)

- The Division did not have supporting documentation on file, at the time of the examination, for three of nine documents tested. We were able to determine the transactions for two of the documents were reasonable, but we could not determine the purpose of one transaction for $357.

Fixed Assets

Four employees of the Division have the ability to add and remove assets from the system. There was no review of any of the reports available from the system to ensure all assets are added and removed only as authorized. We noted an overall lack of knowledge by Division personnel related to the fixed asset function on NIS.

There is an increased risk for fraud, abuse, or misuse of State funds and assets without procedures to ensure no one individual is in a position to both perpetrate and conceal errors or irregularities.

> We recommend the Division implement procedures to ensure a proper segregation of duties is established. If a proper segregation of duties is not possible due to limited staff, management should implement review procedures of detailed transactions to ensure all transactions are authorized. Furthermore, we recommend supporting documentation be retained and reviewed prior to approval of all transactions, and no one from outside the Lincoln office should approve documents without detailed support. In addition, we recommend the Division consider further training for employees responsible for fixed assets.

Division's Response:
Payroll

Payroll registers (hard copy) have always been reviewed prior to payroll certification, but that review has not been documented. Hard copy from NIS is being documented now to ensure accuracy.

Expenditures

- *For the purpose of division continuity, in the event of the loss of the director, it was recommended by State Accounting that the Chief Inspector be given NIS access to conduct all business for the division.*

COMMENTS AND RECOMMENDATIONS
(Continued)

3. Other Internal Control Issues (Concluded)

Division's Response, Concluded:
- *Procedures are being put in place to provide for detailed report reviews.*
- *Procedures are being developed to ensure supporting documentation is available.*

Fixed Assets

See comment under Fixed Assets at the end of this response.

APA's Response: As stated above, the Chief Inspector located outside of Lincoln should not be allowed to approve documents without supporting documentation present.

4. Support for Fees Charged

Good business practice requires documentation to support the costs incurred in providing services are adequately covered by the fees charged.

The Division charged fees for licenses, permits, exams, and other miscellaneous charges. The Division did not have documentation on file to support whether the fees charged were sufficient to cover the costs incurred or whether they could be excessive. This finding was also noted in the prior audit.

Without adequate documentation to support the fees charged, there is the risk of charges being set too high or too low to support the operations of the Division.

> We recommend the Division ensure costs incurred are covered by the fees charged and that the comparison is documented.

Division's Response: The State Electrical Board, with aid from its Chief Inspector and budgetary fiscal analyst, determined what fees had to be increased to, to maintain solvency of the division. Fees hadn't been increased for 17 years, and documents do exist indicating an overall increase of 83% revenue was necessary for solvency. Fees will again be reviewed in 2007 for efficacy.

APA's Response: Documentation was not provided to the auditors during the fieldwork of the examination.

COMMENTS AND RECOMMENDATIONS
(Continued)

5. <u>Contracts</u>

Neb. Rev. Stat. Section 81-1118(5) R.S.Supp., 2004 states, "All purchases of and contracts for materials, supplies, or equipment and all leases of personal property shall be made in the following manner except in emergencies approved by the Governor: (a) By a competitive formal sealed bidding process through the materiel division in all cases in which the purchases are of estimated value in the amount of twenty-five thousand dollars or more . . . ."

Neb. Rev. Stat. Section 73-503(1) R.S.Supp., 2003 states, "All state agencies shall process and document all contracts for services through the state accounting system . . . . No later than September 15, 2003, all state agencies shall have entered such information about all contracts for services made prior to April 1, 2003, that are still in effect."

Furthermore, good business practice requires a legal review of all contracts prior to acceptance to ensure the State's interests are fully protected.

The Division entered into a service contract for $45,000. The contract was for information technology and software services related to the Division's permit and licensing system. As part of the contract, the Division paid the contractor $5,000 before any services were performed as a down payment. The Division did not obtain a competitive formal bid through the Department of Administrative Services (DAS) Materiel Division as required by state statute or obtain an exception for a sole source contract. The contract was also not entered onto NIS per statute. There was no legal review of the contract.

Without adequate procedures to ensure laws and regulations related to service contracts are followed, there is an increased risk for misuse of State funds. Additionally, without a legal review of contracts, there is an increased risk the State may not be fully protected in contractual agreements.

> We recommend the Division ensure they obtain a competitive formal bid or an exception from DAS when entering into contracts. We recommend the Division implement procedures to ensure payments on contracts are not made prior to receiving services. Furthermore, the Division should ensure all service contracts are entered onto NIS in compliance with state statute and a legal review should be performed on all contracts prior to acceptance.

Division's Response: If the division ever again has to enter into a contract, it full well intends to adhere to the auditor's recommendations, which were unknown at the time the software contract was consummated. Existing custom software was wildly inaccurate, and it's upkeep cost the

COMMENTS AND RECOMMENDATIONS
(Continued)

5. Contracts (Concluded)

Division's Response, Concluded:
division $1,200 to $1,500 per month. A suite of custom software had been written for a neighboring state, and its director recommended the developer to the board as providing excellent service and an economical product. A second bid was received by the board from State IMS, but was far too costly to pursue.

6. Payroll Detail

Retention of Payroll Records

State of Nebraska, State Agencies General Records Retention, Section 124-1-26, states the original record of board minutes should be microfilmed annually and may not be destroyed after microfilming.

State of Nebraska, State Agencies General Records Retention, Section 124-4-20, states the I-9 form must be retained for 3 years after the date of hire or 1 year after separation/termination from employment, whichever is later.

State of Nebraska, State Agencies General Records Retention, Section 124-4-33, states the W-4 form shall be retained by the agency and may be disposed of 4 years after superseded or 4 years after termination of employment whichever is sooner.

State of Nebraska, State Records Administrator, Electronic Messaging and Electronic Mail Guidelines, 007.03 states, "These records are governed by the retention period for equivalent hard copy records as specified in an approved records retention schedule. The records should be in hard copy or electronic format which can be retrieved . . ."

Good internal control requires procedures to ensure there is adequate supporting documentation of salary rates and employee deductions. Good internal control also requires documentation to ensure the DAS Accounting Division was properly notified by the Division to process payroll.

The Division had 18 employees as of June 30, 2004.

We noted the following:

- One of four employees tested did not have documentation in personnel file or in Board minutes to support salary rate. The Acting Executive Director could not provide the minutes of the meeting from January 2003 in which his original salary was set by the Board.

COMMENTS AND RECOMMENDATIONS
(Continued)

6. **Payroll Detail** (Continued)

- Two of four employees tested did not have an I-9 form on file.

- One of four employees tested had a payroll deduction that could not be traced to an authorization form in the personnel file. The employee did not have a W-4 form on file to support exemptions and additional Federal withholding.

- One of four employees tested had a payroll deduction that was not correct. The employee chose a life insurance coverage that needed underwriting. Once the insurance was approved by DAS – Personnel, the amount withheld from the employee's pay did not change to reflect the correct withholding. The withholding was for two times the employee salary and the employee had elected and been approved for three times the employee salary.

- The Division did not maintain documentation to verify DAS Accounting Division was notified to process payroll for the two bi-weekly pay periods tested, October 15, 2003, and March 17, 2004. Division employees indicated they did not maintain the electronic messages sent to DAS Accounting Division for payroll processing in accordance with the records retention schedules.

Without adequate procedures to ensure the proper forms and documentation is on file in accordance with State Agencies General Records Retention, there is an increased risk for fraud or loss of State funds.

> We recommend the Division implement procedures to ensure proper documentation for salary rates and deductions are on file. We also recommend the Division ensure other forms are appropriately maintained in the employees' personnel file. Finally, we recommend the Division maintain supporting documentation to verify DAS Accounting Division was notified to process payroll.

Termination Payment

DAS Employee Relations Division identifies the process and recording of Catastrophic Leave in NIS and states, "Pay-Type 890 and 891 will be used to record the donated leave for the person RECEIVING the leave . . . Leave transferred will be converted to a dollar value and then converted to hours based on the recipient's hourly rate . . ."

COMMENTS AND RECOMMENDATIONS
(Continued)

6. Payroll Detail (Continued)

Good internal control requires policies and procedures to ensure DAS Accounting Division is properly notified of terminations and documentation is kept on file. In addition, good internal control and sound accounting practice requires the Division ensure all deductions, such as retirement and taxes, are properly withheld.

The Division had one termination during fiscal year 2004. The termination related to the death of the former Executive Director. We noted the following:

- The former Executive Director received donated catastrophic leave totaling 1,197 hours from October 2003 through January 2004. The Division did not properly record on NIS all hours donated to the former director. The incorrect code was used on NIS to record the donated leave and 711 hours of the 1,197 total hours was not recorded on NIS. The Division also utilized manual records to track the hours earned, donated, and used.

- There was no documentation on file to indicate the Division notified DAS Accounting Division of the termination to remove the individual's access to NIS. The individual is identified on NIS as inactive rather than terminated.

- The individual was paid more vacation than was earned, leaving a negative vacation balance on NIS. The overpayment was for 7.91 hours or $248 more than was earned. The Division should contact DAS Accounting Division to determine whether any corrections are needed.

- The proper deductions, such as retirement and taxes, were not withheld from the final paycheck or the check issued for the payment of ¼ of the sick leave, a total of $2,126. Again, the Division should contact DAS Accounting Division to determine whether any corrections are needed.

Without adequate policies and procedures to ensure termination payments are properly calculated and recorded on NIS there is an increased risk of loss or misuse of State funds.

> We recommend the Division implement policies and procedures to ensure all employees are properly paid their vacation and sick leave upon termination. Furthermore, we recommend the Division consider further training for employees responsible for the termination payoff calculation and an independent review of the calculation prior to payment.

COMMENTS AND RECOMMENDATIONS
(Continued)

6. Payroll Detail (Continued)

Division's Response:

- *The minutes could be provided, however, the board acted in executive session, and salary information was not included in the minutes. The board has since taken action to amend the minutes by including their determination of salary.*

- *(Answer for bulleted items 2,3, & 4) The secretary within whose purview it is to see that proper forms are on file has been instructed to include I-9 forms in all personnel files, and to ensure accurate deductions and other personnel information is properly maintained.*

- *Division employees were unaware they needed to save old e-mail to document payroll processing. It seemed prima fascia evidence that if it were a requirement to certify payroll, payroll wouldn't be completed without said certification, and therefore there was evidence of certification in that payrolls were completed. Those e-mails were deleted. They are being saved now.*

Termination Payment

No one in the division had any knowledge of the requirements to properly administer termination payments, and in fact the lack of knowledge of how to handle these payments was universal. Because of this issue, state policy regarding transfer of hours between agencies was ended. Because of the division's lack of expertise on how to proceed, DAS was consulted, and their advice on was followed. It is our intention to follow the recommendations of the auditors in the future.

- *The secretary within whose purview it was to maintain these records consulted with DAS, and her numbers were reviewed by the division director. This issue was both new and unique enough that proper instruction wasn't extant at the time.*

- *The secretary charged with accounting duties for the division was instructed to remove the individual from NIS.*

- *The division will contact DAS accounting to determine what remedies might be available, without demanding repayment by the deceased's widow.*

- *The division acted on advice from DAS, and believed proper amounts were withheld.*

6. Payroll Detail (Concluded)

APA's Response:
Payroll Detail: Documentation of Board minutes were not provided to the auditors during the fieldwork of the examination.

Termination Payment: As stated above, the Division should contact DAS Accounting Division related to the retirement and tax withholdings to determine whether any corrections are needed.

7. Travel Expenses

We selected 11 documents coded as travel expenses to test. Three documents were expense reimbursement documents of Division employees. Eight documents were direct payments to hotels for lodging. We also selected one document that was a monthly DAS Transportation Services Bureau billing for permanently assigned vehicles to the Division. We tested three travel logs for one vehicle (a total of 10 trips) to ensure mileage driven was reasonable and there was adequate support for the purpose of the travel.

Substantiation of Meal Expenses

Nebraska State Accounting Manual, AM-005, Travel Expense Policies, Section 5, states "Under our accountable plan, the Internal Revenue Service requires employees to substantiate the cost for travel, lodging, meals, and other expenses. Adequate accounting generally requires the use of a documentation record such as an account book, expense diary or log, or similar record near the time of incurrence of the expense. Such log should list the date, amount, place (e.g. city) or description, and purpose for each expense or meal/food cost."

Internal Revenue Service (IRS) Publication 463 requires an accountable plan to have adequate accounting. The publication also states, "Documentary evidence ordinarily will be considered adequate if it shows the amount, date, place, and essential character of the expense." A restaurant receipt is enough to prove an expense for a business meal if it has all of the following information: 1) the name and location of the restaurant, 2) the number of people served, 3) the date and amount of expense.

Good internal control requires procedures to ensure requirements of the State's accountable plan are met and that reimbursements are in compliance with guidelines set through the Federal Travel Regulation.

COMMENTS AND RECOMMENDATIONS
(Continued)

7. Travel Expenses (Continued)

Two of three expense reimbursement documents tested did not have meal receipts with adequate detail or an adequate meal log. Both individuals claimed a per diem rate (the exact same amount for each meal) rather than claiming actual expenses incurred. Both employees claimed per diem rates of $6 for breakfast, $7 for lunch, and $12 for dinner each time a meal was claimed for reimbursement. One employee claimed $208 in meals for ten days of travel that were tested. The second employee claimed $200 in meals for eight days of travel that were tested.

Without an adequate accounting of meal expenses from the employee to the employer, the State could lose its accountable plan status. If the State does not have an accountable plan, the amounts reimbursed to employees for meals would be considered taxable income. In addition, there is an increased risk of overpayment and payment for unreasonable travel expenses if the expenses are not supported by adequate documentation.

> We recommend the Division implement procedures to ensure provisions of the State's accountable plan are met and amounts reimbursed are reasonable.

Mileage

Good internal control requires procedures be in place to review mileage on travel logs to ensure the mileage is reasonable based on the most direct travel route.

There were 8 of 10 days of travel tested where the mileage used was not reasonable based on the most direct route of travel and the travel logs were not adequately completed in order to identify all travel destinations. This included a permanently assigned vehicle for an inspector and one personal vehicle mileage reimbursement. We noted 8 of 10 trips tested in which the mileage driven exceeded the most direct route of travel. We were unable to accurately calculate the mileage for two days, as the location of travel on the travel log was not specific; we determined the mileage for the remaining six days was not reasonable. The total miles driven or reimbursed over the calculated mileage was 211 miles.

Without a documented review for reasonableness of mileage used on permanently assigned vehicles, there is an increased risk of misuse of State motor vehicles.

> We recommend the Division implement procedures to ensure mileage on travel logs is reasonable based on the travel destinations indicated. We also recommend the Division ensure employees indicate specific destinations on travel logs and the travel logs are properly reviewed for reasonableness.

COMMENTS AND RECOMMENDATIONS
(Continued)

7. Travel Expenses (Continued)

Lodging

Nebraska State Accounting Manual, AM-005, Travel Expense Policies, Section 4, states "It is State Accounting policy that a person generally must be more than 60 miles from his or her workplace in order to be eligible for lodging. We realize there may be reasons to pay for lodging for distances less than 60 miles. Such reasons include, but are not limited to work requirements, medical conditions or weather; in those instances the reason must be clearly stated on the disbursement document."

Nebraska State Accounting Manual, AM-005, Travel Expense Policies, Section 4, states "Sales to the State of Nebraska and its agencies are exempt from Nebraska sales, use and lodging tax."

We noted four of ten documents with lodging expenses did not have lodging costs within the Federal GSA per diem guideline or the employees were not over 60 miles away from the employee's workplace. In addition, there was one of ten documents tested in which lodging within the State of Nebraska was not direct billed and therefore sales, use, and lodging taxes were paid.

- One employee claimed lodging expenses in Beatrice, Nebraska. The employee's headquarter city was Fairbury, Nebraska, 28 miles from Beatrice. Lodging claimed was for a total of $165.

- Two employees incurred lodging expenses of $55 per night, for 2 nights, for a total of $220, in Grand Island, Nebraska, which was less than 60 miles from both individuals' headquarter cities.

- One Board member exceeded the $55/night per diem guideline in Lincoln, Nebraska, for lodging expenses for two nights. The room rate was $85 per night. In addition, the Division did not have the lodging direct billed and the individual incurred State sales tax and occupancy tax totaling $17.

- Two employees incurred lodging expenses of $58 per night, for 2 nights, for a total of $232, in Kearney, Nebraska. The individuals were both less than 60 miles from their headquarter cities.

There is an increased risk for loss or misuse of State funds without adequate procedures to ensure lodging expenses do not exceed the Federal GSA per diem guideline, or are for unreasonable lodging expenses.

7. Travel Expenses (Continued)

> We recommend the Division implement procedures to ensure lodging expenses are within the Federal GSA per diem guideline and that lodging expenses are only reimbursed for those employees staying overnight who live more than 60 miles away. We further recommend the Division implement procedures to ensure all in-state lodging expenses are direct billed to prevent sales, use, and lodging taxes from being inappropriately paid.

Adequate Supporting Documentation and Expense Reimbursements

Neb. Rev. Stat. Section 81-1174 R.S.Supp. 2004 states, "Each request shall be fully itemized, including when, where, and why the expense was incurred and the actual amount involved."

Nebraska State Accounting Manual, AM-005, Travel Expense Policies, Section 11 a., states "The employee claiming reimbursement of expenses must provide an original signature on the expense document."

Good internal control requires an adequate pre-audit of expense reimbursement documents prior to payment to ensure expenses are supported by adequate documentation, clearly indicate a purpose of the travel, and are a reasonable payment of employee expenses. Good internal control also requires procedures to ensure employees include start and stop times of travel in order to determine which meals should be claimed for reimbursement. In addition, good internal control and sound business practice requires an authorized approver sign the completed expense form to ensure the reimbursement is reasonable, necessary, and allowed.

Good internal control also requires procedures to verify the employee's expense reimbursement agrees to the information on the receipts, expense vouchers, or any agendas related to the expenses incurred to ensure the dates, times, amounts, and locations all agree.

We noted the following:

- The three employee expense reimbursement documents tested did not have expense reimbursements properly completed, including the purpose of travel, points of all destinations, start and stop times, employee signature, authorized signature, and dates of travel.

- There were ten documents and trips tested that did not have adequate documentation, or were not approved by the immediate supervisor, to support the purpose of the travel expense. Therefore, it was difficult to determine the purpose of the travel.

COMMENTS AND RECOMMENDATIONS
(Continued)

7. Travel Expenses (Continued)

- There were four documents and trips tested where the supporting documentation related to the expense could not be agreed to other related supporting expenses such as, vehicle logs, hotel billings, conference agendas, or timesheets for dates, times, locations, etc.

Based on the number of exceptions noted in all sections of this comment, we do not believe the Division has a full understanding of the State's travel requirements and policies and, as such, we do not believe an adequate preaudit was being performed by the Division of travel related documents.

Without adequate supporting documentation and a documented review of travel expenses, there is an increased risk of payments being made for unreasonable and unnecessary expenses. In addition, there is an increased risk of loss or misuse of State funds.

> We recommend the Division implement procedures to ensure all employee expense reimbursement documents go through an adequate preaudit process that includes a review to ensure adequate documentation is attached to the document and all dates, amounts, and times agree to the support, purposes of travel are clearly indicated for each trip and expenses are reasonable. We also recommend the Division implement procedures to ensure travel logs contain the required information. Documentation should include meal receipts or a meal log, hotel bill, receipts for miscellaneous expenses, travel approval form, and the conference registration form or agenda.

Division's Response:

- *In September of 2002, shortly after a field inspector was appointed by the board to be the acting Chief and Director, he called the office of State Accounting to procure guidance on this matter. Both division secretaries and the acting chief attended this meeting. All came away with the following: "You can be reimbursed for any amount you actually spend if you save all your receipts, however if you choose to not save receipts the limit is $6 for breakfast, $7 for lunch, and $12 for dinner, with a limit of $25 per day." All three thought that if the limit was exceeded, the 6/7/12 values were to be recorded. Apparently the information was misunderstood.*

- *We will employ the aid of State Accounting, and create a workable and acceptable plan to replace the one that has always been in use in this agency.*

COMMENTS AND RECOMMENDATIONS
(Continued)

7. <u>Travel Expenses</u> (Continued)

Division's Response, Continued:

<u>Mileage</u>

- *According to the auditor, Mapquest is used from one town to another, and 10% is given for leeway. When on inspections, one can't record every stop one makes in a particular town separately. We tried this once, and abandoned the experiment as completely unwieldy. Further, inspectors don't drive from town to town. They make a route, follow it, and make multiple stops around a destination. In other words, the name of the town is a nominal destination. Our software will now allow us to generate stop by stop reports for any inspector, for any period of time. That report wasn't available during the time period of the audit, FY '03-'04, but it is available now.*

<u>Lodging</u>

- *The inspector who had previously had the district was instructing a new employee. That inspector had to stay in a motel. To maximize the amount of time the inspectors were together for training purposes, the division required the new inspector to stay at the same hotel, even though he lived less than 60 miles distant.*

- *This was a staff meeting all state inspectors were required to attend. Those who were most distant came the evening before, so they'd be present when the meeting began the next day at noon; those closer drove in that morning. Executive staff were there the previous day, to plan the meeting. All staff were required to be there for the meeting's duration, and therefore, even those living within 60 miles were required to stay for the function at the facility.*

- *Until the audit, no one in the division knew that board members were restricted as to where they could stay, and had to comply with the state rate. According to 81-2105, reimbursements are to be made pursuant to 81-1174 to 81-1177. Nothing in those statutes indicates board members are not able to be reimbursed for expenses they choose to incur.*

- *This was the annual conference of the International Association of Electrical Inspectors, Nebraska Chapter, an educational meeting all state inspectors are always required to attend. All staff were required to be there for the meeting's duration, and therefore, even those living within 60 miles were required to stay for the function at the facility.*

COMMENTS AND RECOMMENDATIONS
(Continued)

7. Travel Expenses (Concluded)

Division's Response, Concluded:

Adequate Supporting Documentation and Expense Reimbursements

Although present agency forms have been in use for many years, we concur, and will endeavor to adhere to the tenets of the following statute:

81-1177
Uniform traveling expense account form; prescribed.

The Director of Administrative Services is required to have prepared a uniform traveling expense account form to be used by all state officers and employees when making a request for payment or reimbursement for traveling expenses. No traveling expense request shall be approved for payment unless it is made on the form prescribed and furnished by the director.

- *(Response to the last three bulleted items under Travel Expenses) All staff will be advised via a policy bulletin of the requisites of adequate documentation, and those documents will be reviewed for accuracy and completeness.*

APA's Response:
Mileage: The Division should implement procedures to review these reports periodically in conjunction with the mileage logs to determine appropriateness and reasonableness of mileage claimed. Any reviews performed should be documented.

Lodging: The requirement of individuals to attend all portions of these meetings is a Division requirement. The Division should document the cost comparison each time an individual stays overnight, when they are less than 60 miles from home.

8. Rental Payments

Neb. Rev. Stat. Section 81-1108.22(3)(a) R.S.Supp., 2004 states, "The charges to state agencies, boards, commissions, or departments of state government shall be paid from funds available for the purpose of renting space on a regular basis and placed, as applicable, in the State Building Revolving Fund and the State Building Renewal Assessment Fund. The administrator shall make payments for basic rentals, renovations, and maintenance and operational costs of all leased and owned buildings from the State Building Revolving Fund . . ."

COMMENTS AND RECOMMENDATIONS
(Continued)

8. Rental Payments (Concluded)

We noted the Division's rental space was not paid from the State Building Revolving Fund. The Division did not have rental payments go through DAS as required by statute, instead, entered into and paid the contract directly. Monthly rental payments for the Division were $1,614, or $19,368 annually.

The risk of loss or misuse of State funds increases without adequate procedures to ensure compliance with laws and regulations.

> We recommend the Division comply with State Statute and ensure rental payments are made through the State Building Revolving Fund.

Division's Response: The agency has been paying its rent directly since at least 1992 (DAS has been aware of this situation since then), but no one in the electrical division was aware there existed other requirements. Measures have been put in place to comply with statute requirements, and as of June 1st, 2005, DAS has been responsible for building rental payments.

9. Fixed Assets

Neb. Rev. Stat. Section 81-1118.02(1) R.R.S. 1999 states, "Each executive, department, commission, or other state agency . . . shall annually make or cause to be made an inventory of all property, including furniture and equipment, belonging to the State of Nebraska and in the possession, custody, or control of any executive, department, commission, or other state agency. The inventory shall include property in the possession, custody, or control of each executive, department, commission, or other state agency as of June 30 and shall be completed and filed with the materiel administrator by August 31 of each year." The section goes on to state that all property shall be tagged or marked "Property of State of Nebraska."

In addition, good internal control requires asset items be properly identified for proper tracking of fixed assets.

We noted a physical inventory was not performed by the Division for fiscal year 2004. This was also noted in the prior audit for fiscal year 2001. Furthermore, all six assets tested were not properly tagged or marked "Property of State of Nebraska."

COMMENTS AND RECOMMENDATIONS
(Continued)

9. Fixed Assets (Concluded)

> We recommend the Division ensure proper compliance with State Statute 81-1118. We recommend the Division perform an annual physical inventory. In addition, we recommend the Division ensure all fixed assets are properly tagged "Property of State of Nebraska."

Division's Response: An agency policy will be put in place requiring an inventory of all state property owned by the division, to be maintained at agency level. The policy will require an in-house listing of all property, and will also comply with the following: Fixed assets using the DAS capitalization policy will be considered to be anything over $1500 in value, and computers, regardless of cost.

10. Nebraska Information System and Accounting Procedures

Good internal control requires a plan of organization, procedures, and records designed to safeguard assets and provide reliable financial records. Without adequate training, written procedures, and controls, there is a risk that employees may unintentionally corrupt critical data and that errors could occur and go undetected.

During the fiscal year ended June 30, 2003, the State of Nebraska implemented significant components of a new information system called the Nebraska Information System (NIS). Three major components were the Payroll, Fixed Asset, and Financial components, which went live during the fiscal year ended June 30, 2003. During the fiscal year ended June 30, 2004, the Procurement and Employee Self-Service components were partially implemented. NIS affects all Nebraska State agencies.

A consultant hired by the Auditor of Public Accounts (APA) with expertise in studying large computer systems performed a study of NIS processes and controls prior to June 30, 2003. The APA also performed a preliminary examination of internal controls as of June 30, 2003, at all State agencies in July and August of 2003. In addition, while performing examination procedures the APA obtained a further understanding of NIS.

From these studies and examinations, the APA has identified concerns and areas where improvement to NIS is needed. During the fiscal year ended June 30, 2004, the Department of Administrative Services (DAS) Accounting Division addressed some areas of concern previously reported. However, the following are the more significant concerns or areas where improvement is still needed to ensure NIS integrity and operational efficiency:

COMMENTS AND RECOMMENDATIONS
(Continued)

10. Nebraska Information System and Accounting Procedures (Continued)

a. The reconciliation between the State Treasurer's actual bank statements and records, the Nebraska Accounting System (NAS-the previous accounting system before NIS), NIS accounting records, and the related disposition of reconciling items was not completed for November 2002 through December 2003 in a timely manner. Subsequent to December 2003, the DAS Accounting Division performed some reconciliation procedures. As of July 2004, the June 30, 2003, reconciliation indicates an unknown variance between the bank records and the accounting records of $3,654,783, with the bank being short compared to the accounting records.

   During the fiscal year ended June 30, 2004, DAS Accounting Division began performing a daily reconciliation of activity recorded on NIS compared to the activity recorded in the bank on a limited test basis. For those days tested, the activity recorded on NIS can be reconciled to the activity in the bank. The monthly reconciliations for the months of July 2003 through February 2004 for the fiscal year ended June 30, 2004, have been performed and indicate fluctuations in the variance amounts. The latest monthly reconciliation performed, February 2004, indicates an unknown variance between the bank records and the accounting records of $5,112,201, with the bank being short compared to the accounting records. This variance was provided to us by DAS Accounting Division and its accuracy has not been verified by the APA.

   Although some reconciliation procedures have been performed (daily reconciliation of activity going through NIS to the activity recorded through the bank), the monthly reconciliation for the months March 2004 through June 2004 are still in the preliminary stages and are not complete as of July 2004. Complete and timely reconciliation procedures between bank records and accounting records provide control over cash and accurate financial information. The reconciliation procedures should be completed timely and on at least a monthly basis to ensure all financial information is correct in NIS.

b. During the early implementation months of NIS, DAS Accounting Division did not have a comprehensive written NIS policy and procedures manual available for users. During the fiscal year ended June 30, 2004, DAS Accounting Division made progress in this area and significant policies and procedures can be found by users on the DAS Accounting Division website. However, the APA, after reviewing the old accounting procedures manual, did note some procedures still being performed under those policies that have not been incorporated as NIS policies. We recommend DAS Accounting Division continue to update their NIS policies and procedures to include all policies and procedures in place to help ensure consistent and accurate accounting of the State's financial transactions.

COMMENTS AND RECOMMENDATIONS
(Continued)

10. **Nebraska Information System and Accounting Procedures** (Continued)

c. During the early implementation of NIS it was determined the NIS Payroll application was not allocating salaries and benefits appropriately to salaried employees who incur hours that are distributed across multiple business units. This would apply to many State agencies' funds, programs, and grants. During the fiscal year ended June 30, 2004, agencies developed "work around" solutions to this problem; however, there has been no system change to resolve this problem. The "work around" solutions can be very time consuming. We recommend DAS Accounting Division consider obtaining a system change to allocate salaries and benefits appropriately for salaried employees who incur hours that are distributed across multiple business units.

d. During the first year of NIS implementation an outside consultant noted a detailed analysis had not been performed to determine whether users received adequate training to enable them to appropriately perform their job functions. The APA is not aware of any detailed analysis of user training conducted by the DAS Accounting Division during the fiscal year ended June 30, 2004, but does acknowledge a significant training effort by the DAS Accounting Division during this period. We recommend the DAS Accounting Division continue their training efforts as well as identifying user training needs.

e. Since the implementation of NIS, DAS Accounting Division has not updated their records retention and disposition schedule with the Records Management Division of the Secretary of State. The records retention schedule on file with the Secretary of State covers the records under the old accounting system and was last updated in 1986.

   Neb. Rev. Stat. Section 84-1207 R.R.S. 1999 states the head of any State agency shall make, and submit to the State Records Administrator schedules proposing the length of time each record series warrants retention for administrative, legal, historical or fiscal purposes, after it has been made in or received by the agency, and lists of records in the custody or under the control of the agency which are not needed in the transaction of current business, and do not possess sufficient administrative, legal, historical or fiscal value to warrant their further retention.

   Since many of the records (and their titles) are significantly different under NIS than they were under the old accounting system we do not believe the DAS Accounting Division is in compliance with the above statute with the current retention schedule on file with the Secretary of State. In addition, for legal purposes and for good business practices we believe a comprehensive DAS Accounting Division records retention schedule is imperative. We recommend the DAS Accounting Division work with the Secretary of State to develop a comprehensive records retention schedule for all records they maintain.

COMMENTS AND RECOMMENDATIONS
(Continued)

10. Nebraska Information System and Accounting Procedures (Continued)

f. The payroll component is not designed to promote an effective segregation of duties. We recommend the DAS Accounting Division consider implementing the compensating control as identified in the k. section of this comment.

g. During the first year of NIS implementation an outside consultant noted access to sensitive General Accounting functions had been provided to individuals who may not require such access as a part of their job responsibilities. Based on our inquiries, DAS Accounting Division management noted, "All critical function access rights have been secured down to the appropriate high level matrix codes." We could not verify the accuracy of this statement as requested information and documentation have not been provided to us.

h. During the first year of NIS implementation an outside consultant noted the State had not documented or formalized comprehensive information security procedures for NIS. Based on our inquiries, DAS Accounting Division management noted, "The NIS CNC's and the NIS Security team have developed a comprehensive security policy." We could not verify the accuracy of this statement as requested information and documentation have not been provided to us.

i. During the first year of NIS implementation an outside consultant noted the State had not implemented a formal, comprehensive business continuity or disaster recovery plan that comprehends both NIS and its supporting infrastructure. Based on our inquiries, DAS Accounting Division management noted, "We have now contracted with an outside vendor for business continuity planning." Documentation provided to us by DAS management indicates the State has a disaster recovery plan, however, it is not complete and the business continuity plan is in the draft stage but has not yet been tested. We recommend the State continue to implement formal, comprehensive business continuity and disaster recovery plans.

j. The APA reviewed certain data in the NIS address book in July 2004. We noted the following related vendor information:

1. Duplicate Name and Address – Our review noted a total of 4,435 duplicate records. However, all have different address book numbers.

2. Duplicate Bank Information – 4,118 vendors had duplicate bank information.

COMMENTS AND RECOMMENDATIONS
(Continued)

10. Nebraska Information System and Accounting Procedures (Continued)

3. Vendors with no Federal Tax Identification Number (FTIN) in NIS and Vendors with an FTIN of 000000000 – 3,789 vendors either had no FTIN or an FTIN with all zeros. The vendors with zeros as their FTIN were all PW (welfare) vendor types. Out of the 3,789 records 3,408 had no FTIN at all.

When duplicate records are in the NIS address book database there is a greater risk of duplicate payments being made and not being detected and queries of the database for vendor information may not be complete because the queries may not include all vendor information. In addition, when the database does not include FTIN numbers for all vendors there is a greater risk of payments to a fictitious vendor. DAS Accounting Division should correct the database for duplicate records and ensure all vendors included in the database have an FTIN.

k. DAS Accounting Division payroll procedures require each State agency to certify its payroll for each pay period to ensure payroll is processed accurately and completely. This certification is to be in writing, either through an email or letter to the DAS Accounting Administrator. In our review of the final payroll notification and certification procedures processed in July 2003 and May of 2004 and discussion with DAS Accounting Division personnel, the certification procedures were not always performed. Our review also noted that the DAS Accounting Division did not have a policy on the information that should be included in the written certification. We noted during our testing, when there was a certification, there was no consistency in the information provided by State agencies.

DAS Accounting Division should establish a policy on detailing the information to be included in the certification, should ensure all State agencies consistently follow this policy, and ensure all payroll expenditures are certified.

The issues identified above are the responsibility of the DAS Accounting Division and NIS Functional Team as they relate directly to NIS; however, they directly affect all Nebraska State agencies' financial information and must be disclosed in this report. The results of the consultant's study of NIS were communicated in a separate report to DAS, who is responsible for NIS. Letters to each State agency communicated the results of the APA's preliminary examination of internal controls at the State agency level. Additional concerns identified by the APA were communicated to the appropriate State officials.

Division's Response: This is a global comment, included in all audits. The division has no response to it therefore.

COMMENTS AND RECOMMENDATIONS
(Continued)

10. <u>Nebraska Information System and Accounting Procedures</u> (Concluded)

Division's Overall Response: The division underwent a great upheaval, with the loss of a secretary, death of the executive director, retirement of an inspector, retirement of the Chief Electrical Inspector, and replacement of very inadequate and inaccurate permitting and licensing software. The secretary serving as accountant for the division, although familiar with the NAS/NEIS system, had to begin to learn the new NIS system during this time. The new executive director had no accounting experience, or prior experience with accounting practices; the newly hired secretary had no prior experience with government employ, and the secretary who'd been with the division several years was relied on for knowledge regarding procedures. All Lincoln office staff had to learn a complete new system of computerized permit and license issuance, concurrent with learning NIS. The State Electrical Division is grateful for the input and shared knowledge from the State Auditors, and is instituting methods to improve.

STATE OF NEBRASKA
AUDITOR OF PUBLIC ACCOUNTS

P.O. Box 98917
State Capitol, Suite 2303
Lincoln, NE 68509
402-471-2111, FAX 402-471-3301
www.auditors.state.ne.us

Kate Witek
State Auditor
kwitek@mail.state.ne.us

Deann Haeffner, CPA
Deputy State Auditor
haeffner@mail.state.ne.us

Don Dunlap, CPA
Asst. Deputy Auditor
ddunlap@mail.state.ne.us

Pat Reding, CPA
Asst. Deputy Auditor
reding@mail.state.ne.us

Tim Channer, CPA
Asst. Deputy Auditor
channer@mail.state.ne.us

Mary Avery
SAE/Finance Manager
marya@mail.state.ne.us

Dennis Meyer, CGFM
Subdivision Budget Coordinator
dmeyer@mail.state.ne.us

Mark Avery, CPA
Subdivision Audit Review Coordinator
mavery@mail.state.ne.us

Perry Pirsch, JD, MPA
Legal Counsel
ppirsch@mail.state.ne.us

NEBRASKA STATE ELECTRICAL DIVISION

INDEPENDENT ACCOUNTANT'S REPORT

State Electrical Division
Lincoln, Nebraska

We have examined the accompanying schedule of revenues, expenditures, and changes in fund balances of the Nebraska State Electrical Division (Division) for the fiscal year ended June 30, 2004. The Division's management is responsible for the schedule of revenues, expenditures, and changes in fund balances. Our responsibility is to express an opinion based on our examination.

Except as discussed in the following paragraph, our examination was conducted in accordance with attestation standards established by the American Institute of Certified Public Accountants, and the standards applicable to attestation engagements contained in *Government Auditing Standards* issued by the Comptroller General of the United States, and accordingly, included examining, on a test basis, evidence supporting the schedule of revenues, expenditures, and changes in fund balances and performing such other procedures as we considered necessary in the circumstances. We believe that our examination provides a reasonable basis for our opinion.

We were unable to obtain sufficient documentation supporting the Revenues stated at $1,092,903, which is included on the Schedule of Revenues, Expenditures, and Changes in Fund Balances at fiscal year end June 30, 2004; nor were we able to satisfy ourselves as to the amount of revenues by other auditing procedures.

In our opinion, except for the effects of such adjustments, if any, as might have been determined to be necessary had we been able to examine sufficient evidence regarding the revenues referred to in the above paragraph, the financial schedule referred to in the first paragraph above, presents fairly, in all material respects, the revenues, expenditures, and changes in fund balances of the Nebraska State Electrical Division for the fiscal year ended June 30, 2004, based on the accounting system and procedures prescribed by the State of Nebraska Director of Administrative Services as described in Note 1.

In accordance with *Government Auditing Standards,* we have also issued our report dated May 13, 2005, on our consideration of the Nebraska State Electrical Division's internal control over financial reporting and our tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements and other matters. The purpose of that report is to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing, and not to provide an opinion on the internal control over financial reporting or on compliance. That report is an integral part of an attestation engagement performed in accordance with *Government Auditing Standards* and should be considered in assessing the results of our examination.

This report is intended solely for the information and use of the Division and the appropriate Federal and regulatory agencies. However, this report is a matter of public record and its distribution is not limited.

Don Dunlap CPA

May 13, 2005 Assistant Deputy Auditor

NEBRASKA STATE ELECTRICAL DIVISION

SCHEDULE OF REVENUES, EXPENDITURES, AND CHANGES IN FUND BALANCES

For the Fiscal Year Ended June 30, 2004

	State Electrical Board Cash Fund
REVENUES:	
Sales & Charges	$ 1,079,514
Miscellaneous	13,389
TOTAL REVENUES	1,092,903
EXPENDITURES:	
Personal Services	946,331
Operating	146,941
Travel	106,559
Capital Outlay	193
TOTAL EXPENDITURES	1,200,024
Excess (Deficiency) of Revenues Over (Under) Expenditures	(107,121)
OTHER FINANCING SOURCES (USES):	
Sales of Assets	731
TOTAL OTHER FINANCING SOURCES (USES)	731
Net Change in Fund Balances	(106,390)
FUND BALANCE, JULY 1, 2003	370,686
FUND BALANCE, JUNE 30, 2004	$ 264,296
FUND BALANCE CONSISTS OF:	
General Cash	$ 265,961
Deposits with Vendors	1,549
Accounts Receivable Invoiced	964
Due to Vendors	(4,178)
TOTAL FUND BALANCE	$ 264,296

The accompanying notes are an integral part of the schedule.

NOTES TO THE SCHEDULE

For the Fiscal Year Ended June 30, 2004

1. Criteria

The accounting policies of the Nebraska State Electrical Division are on the basis of accounting as prescribed by the State of Nebraska Department of Administrative Services (DAS).

Per Neb. Rev. Stat. Section 81-1107(2) R.S.Supp., 2004, the State of Nebraska Director of Administrative Services duties include "The keeping of general accounts and the adoption and promulgation of appropriate rules, regulations, and administrative orders designed to assure a uniform and effective system of accounts and accounting, the approval of all vouchers, and the preparation and issuance of warrants for all purposes."

The Nebraska Information System (NIS) is the official accounting system prescribed by DAS for the State of Nebraska. Policies and procedures are detailed in NIS manuals and Nebraska Accounting System Concepts published by DAS and available to the public. The financial information used to prepare the schedule of revenues, expenditures, and changes in fund balances for the Division was obtained directly from the NIS. NIS records accounts receivable and accounts payable as transactions occur. As such certain revenues are recorded when earned and expenditures are recorded when a liability is incurred, regardless of the timing of related cash flows. The accounts payable liability recorded on NIS, and thus recorded as expenditures, as of June 30, 2004, includes only those payables posted to NIS before June 30, 2004, and not yet paid as of that date. The amount recorded as expenditures as of June 30, 2004, **does not** include amounts for goods and services received before June 30, 2004 which had not been posted to NIS as of June 30, 2004.

The NIS system does not include liabilities for accrued payroll and compensated absences.

The fund type established by NIS and used by the Division is:

> **20000 – Cash Funds** – account for revenues generated by specific activities from sources outside of State government and the expenditures directly related to the generation of the revenues. Cash funds are established by State statutes and must be used in accordance with those statutes.

The major revenue object account codes established by NIS used by the Division are:

> **Sales & Charges –** Income derived from sales of merchandise and commodities, compensation for services rendered, and charges for various licenses, permits, and fees.
>
> **Miscellaneous –** Revenue from sources not covered by other major categories, such as investment income and delinquent fees charged for filing late requests for inspection.

NOTES TO THE SCHEDULE
(Continued)

1. Criteria (Concluded)

The major expenditure object account titles established by NIS used by the Division are:

Personal Services – Salaries, wages, and related employee benefits provided for all persons employed by the Division.

Operating – Expenditures directly related to a program's primary service activities.

Travel – All travel expenses for any state officer, employee, or member of any commission, council, committee, or board of the State.

Capital Outlay – Expenditures which result in the acquisition of or an addition to capital assets. Capital assets are resources of a long-term character, owned or held by the government.

Other significant object account codes established by NIS and used by the Division include:

Assets – Resources owned or held by a government that have monetary value. Assets include cash accounts, deposits with vendors, and receivable accounts. Accounts receivable are recorded as an increase to revenues and an increase to fund balance on the schedule. Cash accounts and deposits with vendors are also included in fund balance and are reported as recorded on NIS.

Liabilities – Legal obligations arising out of transactions in the past that must be liquidated, renewed, or refunded at some future date. Accounts payable transactions increase expenditures and decrease fund balance.

Other Financing Sources – Proceeds of fixed asset dispositions.

2. State Agency

The Nebraska State Electrical Division (Division) is a State agency established under and governed by the laws of the State of Nebraska. As such, the Division is exempt from State and Federal income taxes. The schedule includes all funds of the Division.

The Nebraska State Electrical Division is part of the primary government for the State of Nebraska.

NOTES TO THE SCHEDULE
(Continued)

3. Capital Assets

Under NIS, capital assets are not capitalized in the funds used to acquire or construct them. Instead, capital acquisitions are reflected as expenditures. Capital assets, which would include property, plant, equipment, and infrastructure assets (e.g., roads, bridges, sidewalks, and similar items) would be reported for the State of Nebraska in the Comprehensive Annual Financial Report (CAFR). The Division values all capital assets at cost where historical records are available and at estimated historical cost where no historical records exist. Donated capital assets are valued at their estimated fair market value on the date received. Generally, equipment that has a cost of $1,500 at the date of acquisition and has an expected useful life of two or more years is capitalized. Depreciation expenses would be reported in the CAFR in the funds used to acquire or construct them for the State of Nebraska. The cost of normal maintenance and repairs that does not add to the value of the asset or extend asset life is not capitalized.

Equipment is depreciated using the straight-line method with estimated useful lives of three years.

Capital asset activity of the Division for the fiscal year ended June 30, 2004 was as follows:

	Beginning Balance	Increases	Decreases	Ending Balance
Capital assets				
Equipment	$ 42,279	$ -	$ -	$ 42,279
Less accumulated depreciation for:				
Equipment				19,966
Total capital assets, net of depreciation				$ 22,313

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P.O. Box 98917
State Capitol, Suite 2303
Lincoln, NE 68509
402-471-2111, FAX 402-471-3301
www.auditors.state.ne.us

Kate Witek
State Auditor
kwitek@mail.state.ne.us

Deann Haeffner, CPA
Deputy State Auditor
haeffner@mail.state.ne.us

Don Dunlap, CPA
Asst. Deputy Auditor
ddunlap@mail.state.ne.us

Pat Reding, CPA
Asst. Deputy Auditor
reding@mail.state.ne.us

Tim Channer, CPA
Asst. Deputy Auditor
channer@mail.state.ne.us

Mary Avery
SAE/Finance Manager
marya@mail.state.ne.us

Dennis Meyer, CGFM
Subdivision Budget
Coordinator
dmeyer@mail.state.ne.us

Mark Avery, CPA
Subdivision Audit
Review Coordinator
mavery@mail.state.ne.us

Perry Pirsch, JD, MPA
Legal Counsel
ppirsch@mail.state.ne.us

NEBRASKA STATE ELECTRICAL DIVISION

REPORT ON INTERNAL CONTROL OVER FINANCIAL REPORTING AND ON COMPLIANCE AND OTHER MATTERS BASED ON AN EXAMINATION OF THE SCHEDULE OF REVENUES, EXPENDITURES, AND CHANGES IN FUND BALANCES PERFORMED IN ACCORDANCE WITH *GOVERNMENT AUDITING STANDARDS*

State Electrical Division
Lincoln, Nebraska

We have examined the accompanying schedule of revenues, expenditures, and changes in fund balances of the Nebraska State Electrical Division for the fiscal year ended June 30, 2004, and have issued our report thereon dated May 13, 2005. The report was qualified as we were unable to obtain sufficient documentation supporting the revenues stated at $1,092,903. Except as noted above and further discussed in our Independent Accountant's Report, we conducted our examination in accordance with attestation standards established by the American Institute of Certified Public Accountants and the standards applicable to attestation engagements contained in *Government Auditing Standards*, issued by the Comptroller General of the United States.

<u>Internal Control Over Financial Reporting</u>

In planning and performing our examination, we considered the Nebraska State Electrical Division's internal control over financial reporting in order to determine our procedures for the purpose of expressing our opinion on the schedule of revenues, expenditures, and changes in fund balances, and not to provide an opinion on the internal control over financial reporting. However, we noted certain matters involving the internal control over financial reporting and its operation that we consider to be reportable conditions. Reportable conditions involve matters coming to our attention relating to significant deficiencies in the design or operation of the internal control over financial reporting that, in our judgment, could adversely affect the Nebraska State Electrical Division's ability to record, process, summarize, and report financial data consistent with the assertions of management in the financial schedule. Reportable conditions are described in the Comments Section of the report as Comment Number 1 (Control Environment), Comment Number 2 (Internal Control Over Receipts), Comment Number 3 (Other Internal Control Issues), and Comment Number 10 (Nebraska Information System and Accounting Procedures).

A material weakness is a reportable condition in which the design or operation of one or more of the internal control components does not reduce to a relatively low level the risk that misstatements caused by error or fraud in amounts that would be material in relation to the financial schedule being examined may occur and not be detected within a timely period by employees in the normal course of performing their assigned functions. Our consideration of the internal control over financial reporting would not necessarily disclose all matters in the internal control that might be reportable conditions and, accordingly, would not necessarily disclose all reportable conditions that are also considered to be material weaknesses. However, of the reportable conditions described above, we consider Comment Number 1 (Control Environment) and Comment Number 2 (Internal Control Over Receipts) to be material weaknesses.

Compliance and Other Matters

As part of obtaining reasonable assurance about whether the Nebraska State Electrical Division's schedule of revenues, expenditures, and changes in fund balances, is 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 schedule amounts. However, providing an opinion on compliance with those provisions was not an objective of our examination, 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*.

We noted certain additional items that we reported to management of the Nebraska State Electrical Division in the Comments Section of this report as Comment Number 4 (Support for Fees Charged), Comment Number 5 (Contracts), Comment Number 6 (Payroll Detail), Comment Number 7 (Travel Expenses), Comment Number 8 (Rental Payments), and Comment Number 9 (Fixed Assets).

This report is intended solely for the information and use of the Division and the appropriate Federal and regulatory agencies. However, this report is a matter of public record and its distribution is not limited.

Don Dunlap CPA

May 13, 2005 — Assistant Deputy Auditor