March 7, 2007

Mr. Douglas Ewald, Tax Commissioner
Nebraska Department of Revenue
301 Centennial Mall South, 2nd Floor
Lincoln, Nebraska 68509-4818

Dear Mr. Ewald:

We have audited the basic financial statements of the State of Nebraska (the State) for the year ended June 30, 2006, and have issued our report thereon dated December 21, 2006. We have also audited the State’s compliance with requirements applicable to major federal award programs and have issued our report thereon dated February 6, 2007. In planning and performing our audit, we considered the State’s internal controls in order to determine our auditing procedures for the purpose of expressing our opinions on the basic financial statements of the State and on the State's compliance with requirements applicable to major programs, and to report on internal control in accordance with the Federal Office of Management and Budget (OMB) Circular A-133 (the Single Audit) and not to provide assurance on internal control. We have not considered internal control since the date of our report.

In connection with our audit described above, we noted certain internal control matters related to the activities of the Department of Revenue (Department) or other operational matters that are presented below for your consideration. These comments and recommendations, which have been discussed with the appropriate members of the Department’s management, are intended to improve internal control or result in other operating efficiencies.

Our consideration of internal control included a review of prior year comments and recommendations. To the extent the situations that prompted the recommendations in the prior year still exist, they have been incorporated in the comments presented for the current year. All other prior year comments and recommendations (if applicable) have been satisfactorily resolved.

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

Our comments and recommendations for the year ended June 30, 2006, are shown on the following pages.

- 1 -
COMMENTS RELATED TO THE AUDIT OF THE BASIC FINANCIAL STATEMENTS

1. **Interest on Sales and Use Tax Returns**

Neb. Rev. Stat. Section 77-2708(1)(c) R.S.Supp., 2005 states, “Failure to file the return, filing after the required filing date, failure to remit the net amount of the tax due, or remitting the net amount of the tax due after the required filing date shall be cause for penalty, in addition to interest, …”

Neb. Rev. Stat. Section 77-2711(11) R.S.Supp., 2005 states, “The Tax Commissioner in his or her discretion may waive all or part of any penalties provided by the provisions of such act, but may not waive the minimum interest on delinquent taxes specified in section 45-104.02 …”

For the fiscal year ended June 30, 2006, the penalty for late Sales and Use Tax returns was 10% of the total tax due. The interest rate established by the State Tax Commissioner was an annual rate of 6%.

The Department collected $1.6 billion in receipts for Retailer and Motor Vehicle Sales and Use Tax during the fiscal year ended June 30, 2006. We tested 22 tax returns and noted one tax return was not properly assessed interest. The return was filed on time; however, payment was made seven days after the required filing date. The interest that should have been assessed on the delinquent payment was $466.

The Department did not have procedures to ensure interest was properly assessed on all delinquent tax returns paid through Electronic Funds Transfer (EFT).

Without adequate procedures to ensure the Department is collecting interest on delinquent tax returns, there is an increased risk of loss of revenue and noncompliance with State Statutes.

We recommend the Department implement procedures to ensure interest is being collected on all delinquent tax returns.

*Department’s Response: A review by the Department of Revenue has revealed that the type of occurrence cited above is rare. But, the Department agrees with this recommendation and has implemented procedures for a temporary manual review of specifically identified accounts until programming changes can be made toward the end of this fiscal year to ensure that all interest is properly assessed.*

2. **Homestead Exemption Income Limits**

The Department disbursed $53.7 million to counties for Homestead Exemption during fiscal year 2006. During our review of the Homestead Exemption income limits, we noted some of the income limits for calendar year 2005 were incorrectly rounded. The Department rounded the calculated limit to the next lowest multiple of fifty dollars instead of the next lowest multiple of one hundred dollars as required by State Statute. In addition, amounts listed in the 2004 guide were improperly rounded. The income limits determine the amount of property tax relief an individual will receive.

When income limits are not properly rounded there is an increased risk the individual received additional exemption and the State reimbursed the counties more than the amount allowed by State Statute.

We recommend the Department ensure the income limits are correctly rounded to comply with State Statutes.

Department’s Response: The tables in the 2007 Homestead guide have been corrected.

Our audit procedures are designed primarily on a test basis and, therefore, may not bring to light all weaknesses in policies or procedures that may exist. Our objective is, however, to use our knowledge of the Department and its interaction with other State agencies and administrative departments gained during our work to make comments and suggestions that we hope will be useful to you.

This report is intended solely for the information and use of the Department, the Governor and State Legislature, Federal awarding agencies, pass-through entities, and management of the State of Nebraska. However, this report is a matter of public record and its distribution is not limited.

We appreciate and thank all of the Department employees for the courtesy and cooperation extended to us during our audit.

Pat Reding
Assistant Deputy Auditor

Don Dunlap
Assistant Deputy Auditor