



NEBRASKA AUDITOR OF PUBLIC ACCOUNTS

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February 28, 2008

Mr. Fernando Lecuona III, Commissioner
Nebraska Department of Labor
550 South 16th Street
Lincoln, Nebraska 68509-4600

Dear Mr. Lecuona:

We have audited the basic financial statements of the State of Nebraska (the State) for the year ended June 30, 2007, and have issued our report thereon dated December 28, 2007. We have also audited the State's compliance with requirements applicable to major federal award programs and have issued our report thereon dated February 13, 2008. 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 or compliance matters related to the activities of the Nebraska Department of Labor (the Agency) 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 Agency's management, are intended to improve internal control or result in other operating efficiencies.

Our consideration of internal control included a review of the 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.

Comment Number 1 (Information Technology Controls) relating to the audit of the basic financial statements, is considered a significant deficiency. A significant deficiency is a control deficiency, or combination of control deficiencies, that adversely affects the Agency's ability to initiate, authorize, record, process, or report financial data reliably in accordance with generally accepted accounting principles such that there is more than a remote likelihood that a

misstatement of the financial statements that is more than inconsequential will not be prevented or detected by the Agency's internal control. This comment will also be reported in the State of Nebraska's Statewide Single Audit Report Schedule of Findings and Questioned Costs.

A separate evaluation of the State's significant Information Technology (IT) systems was completed. Some findings, as noted below, were reported as a part of the audit of the Comprehensive Annual Financial Report (CAFR). Additional findings and recommendations were reported to management in a separately issued confidential summary of findings and recommendations.

Draft copies of this letter were furnished to the Agency 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. Where no response has been included, the Agency declined to respond. 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.

The following are our comments and recommendations for the year ended June 30, 2007.

COMMENTS RELATED TO THE AUDIT OF THE BASIC FINANCIAL STATEMENTS

1. Information Technology Controls

Good internal control requires general and application controls for computer systems that support financial data to be in place and working effectively to reduce the risk of financial data being misstated due to error or fraudulent acts. Good internal control requires segregation of duties to ensure application developers cannot manipulate datasets without obtaining management approval for changes.

We noted the following during the testing of the Tax Management and Benefits Payment Systems:

- Sixty-two employees had the ability to prepare and approve claims within the Benefit Payment System. The Agency grants access to the system utilizing roles. During our review of the roles it was noted six roles within the system allowed users to initiate and approve claims.
- Two application developers maintained ALTER access to production datasets in the Tax Management System.

Failure to maintain segregation of duties between claims initiators and claims approvers increases the risk unintended and/or unauthorized unemployment claims may be paid.

Without adequate segregation of duties for access to production datasets there is a risk application developers could manipulate system data by circumventing the application and without creating an audit trail.

We recommend the Agency restrict application developers' access to the production datasets. In the event, access restriction is not feasible; monitoring controls should be implemented and documented to ensure modifications to datasets are approved. We also recommend the Agency separate the functions of initiating and approving unemployment insurance claims. At a minimum reviews and documentation of reviews should be performed on a continuous basis to determine claims prepared and approved by a single individual are in line with management's intentions.

Agency's Response: Though a perceived risk exists, the system controls substantially guard against real risk. The compounding variables present in the BPS system would all have to be aligned for any one individual to take a specific claim at a specific time, assignment to the specific group and specific adjudicator within that group. Management accepts risk of employees maintaining claims taking/adjudicating access, as such risk is mitigated by system processes. On a periodic basis a review of claims prepared and approved for subsequent processing will be implemented as an internal check. Our action plan will consist of quarterly reports of claims adjudicated to be requested on behalf of the Program Integrity (BAM/Internal Security). The Program Integrity personnel will review the results with the UI Benefits Field Manager. The reports will be ran the first business day following each quarter ending and the meeting to discuss the results will occur within five business days of that report.

There is a compensating control in place where application developers will only be in the ETSAPP1 and ETSAPP2 groups for 24 hours or how long it takes to make the change. This compensating control will be adhered to.

2. Unemployment Compensation Outstanding Check Balance

Good internal control and sound accounting practice require accounting records be maintained accurately in order to reflect actual amounts on the financial statements and the accounting records be reconciled on a regular basis.

As part of its bank reconciliation process, the Agency tracked outstanding Unemployment Compensation checks using their monthly ledger (a manually prepared Excel spreadsheet) and their Benefits Payment System (BPS). The Agency performed monthly reconciliations of outstanding checks between these two records. Though the Agency was performing reconciliations, unexplained variances ranging from \$173,227 to \$1,451,321 remained in each month's outstanding checks total. The last reliable reconciliation was performed in January 2003.

The Agency was able to reconcile their bank balances to their manual accounting records.

Without an adequate reconciliation process, there is an increased risk of loss or misuse of State funds.

We recommend the Agency take adequate steps to complete the monthly reconciliation of outstanding checks from the BPS system to the monthly ledger. The reconciliation process should include having adequate explanation of any variances.

Agency's Response: The Agency accepts this finding and agrees the item requires the Agency's attention. We also accept the recommendation made as appropriate. As mentioned during the audit process, the Agency had already begun working to resolve this issue prior to the audit and will continue to do so until an acceptable resolution is achieved. We want to point out that the finding does not allege any misappropriation of funds or any other financial impropriety. Nevertheless, the Agency will work diligently to improve the reconciliation process.

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

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



Pat Reding
Assistant Deputy Auditor



Don Dunlap
Assistant Deputy Auditor