NEBRASKA AUDITOR OF PUBLIC ACCOUNTS

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February 16, 2010

Carlos Castillo, Director
Department of Administrative Services
State Capitol, Room 1315
Lincoln, Nebraska 68509-4664

Dear Mr. Castillo:

We have audited the basic financial statements of the State of Nebraska (the State) for the year ended June 30, 2009, and have issued our report thereon dated December 28, 2009. 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 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 Administrative Services (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 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 (Review of CAFR Information) 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.

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. 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, 2009.

1. Review of CAFR Information

A good internal control plan requires an adequate review of information used to prepare the Comprehensive Annual Financial Report (CAFR), including the information provided by other agencies.

During our audit of the CAFR, we noted the following errors in its preparation:

- The Department of Administrative Services State Accounting Division (State Accounting) did not have adequate procedures to ensure the amounts submitted by State agencies on accrual response forms were correct. Significant errors, ranging from $448,410 to $9,994,831 were noted in amounts reported by the Department of Health and Human Services, State Treasurer, and the Department of Roads. State Accounting did make correcting entries for all material amounts as recommended by the Auditor of Public Accounts (APA). A similar finding was noted in previous reports.

- There were numerous errors noted on information prepared by State Accounting to support entries made to the financial statements. The errors ranged from $11,108 to $13,057,076. State Accounting did make correcting entries for all material amounts as recommended by the APA. A similar finding was noted in previous reports.

Without adequate processes and procedures in place to ensure the accuracy of the CAFR, there is a greater risk material misstatements may occur and remain undetected.

> We recommend State Accounting continue to obtain an understanding of how State agencies prepare key accrual information, and work with and train State agency personnel to ensure accrual information is supportable and has a sound accounting base. Once State agencies submit their information to State Accounting, State Accounting should have procedures in place to review and verify the information is supportable, reasonable, and accurate. We also recommend State Accounting ensure an adequate review of internally prepared documentation is performed to ensure accuracy.

Management Response:

- *State Accounting has and will continue to work with agencies to ensure that the amounts the agencies submit with the accrual questionnaires are correct. Prior to distribution of the financial reporting package, State Accounting met with many of the larger agencies to discuss this issue. Members from State Accounting are continuing to attend each exit conference and be a party to all discussions with the auditors and the agencies regarding this issue. Finally, State Accounting continues to meet with appropriate agencies to improve reporting methods.*

- *State Accounting has procedures to review work papers before they are given to the auditor. This year all work papers were reviewed by State Accounting employees, but some errors were still not discovered. In the future, we will again put strong emphasis on making our work papers correct.*

2. <u>Department of Labor Retirement Plan</u>

Governmental Accounting Standards Board (GASB) Codification Section 1300.102 states "Fiduciary funds should be used to report assets held in a trustee or agency capacity for others and therefore cannot be used to support the government's own programs…The three types of trust funds should be used to report resources held and administered by the reporting government when it is acting in a fiduciary capacity for individuals, private organizations, or other governments." GASB Codification Section P20.117 discusses the information that should be included in the notes to the financial statements for each defined benefit pension plan in which the government participates.

Good internal control and sound business practices require procedures to ensure all resources held and administered by the State of Nebraska are included in the CAFR.

The Department of Labor has a separate retirement plan currently administered by a contract with an insurance company. The plan was completely federally funded, no State contributions have been made. This plan has not been included as a fiduciary fund in the 2009 or past CAFRs and has not been disclosed in the footnotes since the 2001 CAFR. State Accounting should review the plan each year to verify it continues to be appropriate to exclude the plan from the CAFR. The Actuarial Valuation Report for the plan year July 1, 2009, through June 30, 2010, noted the present value of projected benefits exceeds the actuarial value of assets by $6,800,377. For fiscal year 2010, the actuary calculated an annual required contribution of $2,012,577.

Without adequate procedures to review changes in the administrative functions of the State in regards to the Department of Labor Retirement Plan there is an increased risk the financial statements may be understated.

> We recommend State Accounting review the Department of Labor's Retirement Plan each year to verify no changes have been made to the administration of the plan and it is appropriately not included as a fiduciary fund or disclosed in the CAFR.

Management Response: *State Accounting researched the other 5 states that have similar retirement plans. The only state that reported the plan as a fiduciary plan had a statutory change to have the plan administered by the state's retirement system. Two states had footnote disclosures and two states had no mention of the plan. State Accounting will review this plan each year to determine if changes have been made in the administration of the plan.*

3. <u>Carrying Amount of Deposits</u>

A good internal control plan requires adequate documentation to support amounts disclosed in the footnotes.

The carrying amount of deposits of $361,164,000 is shown in the footnotes and used to reconcile the deposits and investments per the footnote to the cash and investments on the financial statements. An adjustment amount of $15,337,000 used in the determination of the carrying amount of deposits could not be traced to support. This amount appeared to be a plug figure.

Without adequate procedures to document the carrying amount of deposits, there is an increased risk the deposits are over or understated.

> We recommend the Agency continue to examine the reconciliation to the financial statements to determine the reason for the variance.

Management Response: *State Accounting identified part of the variance as due to a new account for the operating investment pool. State Accounting will review the applicability of the worksheet used to compute these numbers to determine if a more efficient method can be developed.*

4. <u>Timesheets</u>

Neb. Rev. Stat. § 84-1001(1) (Reissue 2008) states, "All state officers and heads of departments and their deputies, assistants, and employees, except permanent part-time employees, temporary employees, and members of any board or commission not required to render full-time service, shall render not less than forty hours of labor each week except any week in which a paid holiday may occur." In addition, a good internal control plan requires hours actually worked to be adequately documented, for example, via timesheets, time logs, etc. and that such documentation be kept on file to provide evidence of compliance with the requirements of § 84-1001. Furthermore, good internal control also requires that whenever employees accrue vacation and sick leave, adequate documentation should be maintained to support the employees having "earned" the amounts recorded in the leave records. Good internal control requires employee hours worked be approved by a direct supervisor and the approval be documented.

During our testing of payroll, we noted the following in regards to Agency employee timesheets:

- Approximately 150 exempt employees of the Agency were not required to maintain a timesheet or other form of documentation to show at least 40 hours were worked each week.

- The APA also noted other agencies, such as the Department of Motor Vehicles, Historical Society, Abstracters Board of Examiners, and the Military Department, who are using NIS for timesheets, are not documenting compliance with the above Statute.
- For one of ten employees tested, documentation was not available to support their hours were approved within a reasonable amount of time after the pay period ended.

A similar finding was noted in our prior audit.

Without adequate records, or supervisory approval, to support hours worked, there is an increased risk for fraudulent or inaccurate payment of regular hours worked or the accumulation of leave.

> We recommend the Agency obtain supervisor approval prior to processing payroll. Furthermore, it is the APA's position the Agency does not have documentation to support they are in compliance with the above Statute and recommends a policy be established requiring all employees of the Agency maintain adequate supporting documentation, such as timesheets. If the Agency believes timesheets showing daily hours worked for exempt employees is not appropriate, the APA recommends the simple addition of signed certification to their existing leave reporting which states "I certify that I have worked or been on approved leave for at least 40 hours each week of this pay period or in accordance with separate employment contract and/or agreement." Additionally we recommend the Agency consider adding this certification statement to NIS time entry.

Management Response: *Exempt employees are required to only enter their leave exceptions into the NIS time entry time keeping program. If there are no leave exceptions, the approving supervisor does not approve a time record and the system pays them standard hours.*

According to the Fair Labor Standards Act, exempt employees must receive the full salary for any week in which the employee performs any work without regard to the number of days or hours worked, unless certain exceptions are met. These allowable exceptions include certain deductions of one or more full days, but only if there is a bona fide plan, policy, or practice of providing compensation for a loss of salary.

Additionally, exempt employees do not track, earn or receive overtime compensation for extra hours worked. These employees are paid a salary for performing the whole job and not for actual hours worked. However, they are required to record and seek approval for any leave exceptions or if they are in a leave without pay status.

APA Response: We believe additional documentation is required to support compliance with Neb. Rev. Stat. § 84-1001.

Other Items-New Accounting Standards

GASB Statement No. 51, ***Accounting and Financial Reporting for Intangible Assets***.
This statement, effective for fiscal years beginning after June 15, 2009, requires that all intangible assets not specifically excluded by its scope provisions be classified as capital assets. Accordingly, existing authoritative guidance related to the accounting and financial reporting for capital assets should be applied to these intangible assets, as applicable. This Statement requires that an intangible asset be recognized in the statement of net assets only if it is considered identifiable. Additionally, this Statement establishes a specified-conditions approach to recognizing intangible assets that are internally generated.

GASB Statement No. 53, ***Accounting and Financial Reporting for Derivative Instruments***.
This Statement, effective for fiscal years beginning after June 15, 2009, addresses the recognition, measurement, and disclosure of information regarding derivative instruments entered into by state and local governments. A key provision in this Statement is that derivative instruments covered in its scope, with the exception of synthetic guaranteed investment contracts (SGICs) that are fully benefit-responsive, are reported at fair value. The objective of this Statement is to enhance the usefulness and comparability of derivative instrument information reported by state and local governments. This Statement provides a comprehensive framework for the measurement, recognition, and disclosure of derivative instrument transactions.

GASB Statement No. 54, ***Fund Balance Reporting and Government Fund Type Definitions***.
This Statement, effective for fiscal years beginning after June 15, 2010, establishes fund balance classifications that comprise a hierarchy based primarily on the extent to which a government is bound to observe constraints imposed upon the use of the resources reported in governmental funds. The objective of this Statement is to enhance the usefulness of fund balance information by providing clearer fund balance classifications that can be more consistently applied and by clarifying the existing governmental fund type definitions.

GASB Statement No. 57, ***OPEB Measurements by Agent Employers and Agent Multiple-Employer Plans***.
This Statement amends Statement No. 45, *Accounting and Financial Reporting by Employers for Postemployment Benefits Other Than Pensions*, to permit an agent employer that has an individual-employer OPEB plan with fewer than 100 total plan members to use the alternative measurement method, at its option, regardless of the number of total plan members in the agent multiple-employer OPEB plan in which it participates. Consistent with this change to the employer-reporting requirements, this Statement also amends Statement No. 43, *Financial Reporting for Postemployment Benefit Plans Other Than Pension Plans*, requirement that a defined benefit OPEB plan obtain an actuarial valuation. The provisions of this Statement related to the use and reporting of the alternative measurement method are effective immediately. The provisions related to the frequency and timing of measurements are effective for actuarial valuations first used to report funded status information in OPEB plan financial statements for periods beginning after June 15, 2011.

GASB Statement No. 58, *Accounting and Financial Reporting for Chapter 9 Bankruptcies*. This Statement, effective for fiscal years beginning after June 15, 2009, requires governments to remeasure liabilities that are adjusted in bankruptcy when the bankruptcy court confirms (that is, approves) a new payment plan. The objective of this Statement is to provide accounting and financial reporting guidance for governments that have petitioned for protection from creditors by filing for bankruptcy under Chapter 9 of the United States Bankruptcy Code.

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 the Agency.

This report 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 and is not intended to be and should not be used by anyone other than the specified parties. However, this report 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.

Signed Original on File

Pat Reding, CPA, CFE
Assistant Deputy Auditor