NEBRASKA AUDITOR OF PUBLIC ACCOUNTS

Mike Foley
State Auditor

Mike.Foley@nebraska.gov
P.O. Box 98917
State Capitol, Suite 2303
Lincoln, Nebraska 68509
402-471-2111, FAX 402-471-3301
www.auditors.state.ne.us

February 11, 2011

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, 2010, and have issued our report thereon dated December 28, 2010. 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 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.

A deficiency in internal control exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent, or detect and correct misstatements on a timely basis. A material weakness is a deficiency, or a combination of deficiencies, in internal control such that there is a reasonable possibility that a material misstatement of the entity's financial statements will not be prevented, or detected and corrected on a timely basis. A significant deficiency is a deficiency, or combination of control deficiencies, in internal control that is less severe than a material weakness, yet important enough to merit attention by those charged with governance. We consider Comment Number 1 (Review of CAFR Information) to be a significant deficiency.

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, 2010.

1. <u>Review of CAFR Information</u>

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 an understatement of $11,182,527 to an overstatement of $3,860,610 were noted in amounts reported by the Department of Health and Human Services.

- Errors were also noted on information prepared by State Accounting to support entries made to the financial statements. The errors ranged from $143,555 to $51,680,805.

- State Accounting's worksheet used to accumulate vacation, sick, compensatory time hours, and pay rates for all State employees and then calculate compensated absences accruals, included a pay rate error for one employee tested. The employee's Agency incorrectly entered the employee's address book number as their pay rate in EnterpriseOne. The rate was changed by the employee's Agency; however, the report used by State Accounting used the incorrect rate. As a result, vacation accrual was overstated by $31,156,287, sick accrual was understated by $11,441, and compensatory time accrual was overstated by $43,431.

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.

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 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 APA and the agencies regarding this issue. State Accounting continues to meet with appropriate agencies to improve reporting methods. Significant progress has been made in accrual reporting over the years, and State Accounting will continue to improve this area.*

- *State Accounting has procedures to review work papers before they are given to the APA. 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. Several of the errors noted, including the compensated absences accrual and the largest errors noted, would have been discovered by State Accounting while preparing financial statements. State Accounting has modified working papers and will review timing of providing work papers to the APA to help eliminate many of the errors noted.*

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

A good internal control plan requires documentation to support amounts used in the notes to the financial statements.

The carrying amount of deposits of $62,768,000 was disclosed in the notes to the financial statements and used to reconcile the deposits and investments per the note to the cash and investments on the financial statements. An adjusting figure of $9,649,000 could not be traced to support. This amount appeared to be a plug figure. State Accounting thought the amount related to the State Street Bank statements but were not able to make a specific determination.

A similar finding was noted in our prior audit.

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

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

Management Response: *State Accounting has determined an alternate method to compute the carrying amount of deposits for next year's financial report.*

3. Timesheets

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, a good internal control plan 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.

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

- Approximately 282 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 and the Military Department, who were using EnterpriseOne for timesheets, were not documenting compliance with the above Statute.

A similar finding was noted in our prior audit.

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

> 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 or certifications.

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.

Other Items-New Accounting Standards

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. 59, *Financial Instruments Omnibus*.
This Statement, effective for fiscal years beginning after June 15, 2010, updates and improves existing standards regarding financial reporting and disclosure requirements of certain financial instruments and external investment pools for which significant issues have been identified in practice. The requirements of this Statement will improve financial reporting by providing more complete information, by improving consistency of measurements, and by providing clarifications of existing standards.

GASB Statement No. 60, *Accounting and Financial Reporting for Service Concession Arrangements*.
This Statement, effective for fiscal years beginning after December 15, 2011, establishes recognition, measurement, and disclosure requirements for service concession arrangements (SCAs) for both transferors and governmental operators, requiring governments to account for and report SCAs in the same manner, which improves the comparability of financial statements. As used in the Statement, an SCA is an arrangement between a transferor (a government) and an operator (governmental or nongovernmental entity) in which (1) the transferor conveys to an operator the right and related obligation to provide services through the use of infrastructure or another public asset (a "facility") in exchange for significant consideration and (2) the operator collects and is compensated by fees from third parties.

GASB Statement No. 61, *The Financial Reporting Entity: Omnibus an amendment of GASB Statements No. 14 and No. 34.*
This Statement, effective for fiscal years beginning after June 15, 2012, modifies certain requirements for inclusion of component units in the financial reporting entity. It results in financial reporting entity financial statements being more relevant by improving guidance for including, presenting, and disclosing information about component units and equity interest transactions of a financial reporting entity.

GASB Statement No. 62, *Codification of Accounting and Financial Reporting Guidance Contained in Pre-November 30, 1989 FASB and AICPA Pronouncements.*
This Statement, effective for fiscal years beginning after December 15, 2011, will improve financial reporting by contributing to the GASB's efforts to codify all sources of generally accepted accounting principles for state and local governments so that they derive from a single source. This effort brings the authoritative accounting and financial reporting literature together in one place, with that guidance modified as necessary to appropriately recognize the governmental environment and the needs of governmental financial statement users.

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 recommendations 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