



## NEBRASKA AUDITOR OF PUBLIC ACCOUNTS

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February 14, 2013

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) as of and for the year ended June 30, 2012, in accordance with auditing standards generally accepted in the United States of America, and have issued our report thereon dated January 16, 2013. In planning and performing our audit, we considered the State's internal control over financial reporting (internal control) as a basis for designing audit procedures for the purpose of expressing our opinions on the basic financial statements of the State, but not for the purpose of expressing an opinion on the effectiveness of the State's internal control. Accordingly, we do not express an opinion on the effectiveness of the State's internal control.

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.

Our consideration of internal control was for the limited purpose described in the first paragraph and was not designed to identify all deficiencies in internal control that might be material weaknesses or significant deficiencies and, therefore, material weaknesses or significant deficiencies may exist that were not identified. However, as discussed below, we identified a certain deficiency in internal control that we consider to be a significant deficiency.

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. We did not identify any deficiencies in internal control that we consider to be material weaknesses.

A significant deficiency is a deficiency, or combination of 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.

A separate evaluation of the State's significant Information Technology (IT) systems was completed. The 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. 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, 2012.

**1. Review of CAFR Information**

A good internal control plan requires an adequate review of draft financial reports and 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:

- The draft report submitted by the Department of Administrative Services State Accounting Division (State Accounting) was not complete and accurate. The first draft required substantial revisions for formatting and incorrect information, such as hidden rows on the financial statements, incorrect statistical information, etc. According to State Accounting this was the first year they used new report software. State Accounting subsequently submitted six revised draft reports prior to the final draft.
- State Accounting did not have adequate procedures to ensure the amounts submitted by State agencies were correct. The errors ranged from an overstatement of \$5,032,592 to an understatement of \$5,948,143 by the Department of Health and Human Services.

- Errors were also noted in information prepared by State Accounting to support entries made to the financial statements. Errors ranged from an understatement of \$6,480,699 to an overstatement of \$61,040,550.

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 implement procedures to ensure draft reports are complete and accurate prior to submission to the auditors. Furthermore, we recommend State Accounting continue to work with State agency personnel to ensure accrual information is supportable and has a sound accounting base. State Accounting should also have procedures in place to review and verify the information is supportable, reasonable, and accurate. We also recommend State Accounting ensure internally prepared documentation is accurate.

*Agency's Response: State Accounting has and will continue to work extensively with agencies to ensure that the amounts the agencies submit with the accrual questionnaires are correct. State Accounting has met with many of the larger agencies to discuss this issue and to help the agencies implement proper procedures for several years. 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. 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 and State Accounting will again put strong emphasis on making our work papers correct. Significant progress has been made in accrual reporting over the years.*

## **2. Timesheets**

Neb. Rev. Stat. § 84-1001 (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 requires employees that accrue vacation and sick leave have adequate support that the employees “earned” the amounts recorded in the leave records.

During testing of payroll we noted the following:

- The Agency’s exempt employees were not required to maintain a timesheet or other form of documentation to show at least forty hours were worked each week. The Agency used EnterpriseOne for time entry and leave exceptions; exempt employees were only required to record leave used in the system. A similar finding was noted in previous reports.
- Nebraska Records Retention and Disposition Schedule 124, as issued by the Nebraska State Records Administrator, Section 124-86 requires, “Any supporting records received or generated by an agency used to review, correct or adjust and certify agency payroll records” are to be retained for five years. Per this same section, the supporting records may include timesheets and reports. We noted:
  - EnterpriseOne did not retain the timesheet completed by the employee in the system for agencies that used basic time entry. Furthermore, the supervisor and human resource staff within the agencies were able to change the employee’s submitted timesheet without the employee’s knowledge or documentation of the changes made.
  - EnterpriseOne did not track who approved timesheets in the system. Each employee is assigned a supervisor in their master file in the system. For agencies that utilize timesheet entry in EnterpriseOne, the supervisor assigned to an employee approves the timesheet. However, supervisors are allowed to set up delegates in the system to approve timesheets in the supervisors absence. The system does not record who actually approves the timesheet, if a delegate approves an employee timesheet the system will record the supervisor assigned to the employee as the approver.

Without adequate records to support hours worked and approvals in the system, there is an increased risk for fraudulent or inaccurate payment of regular hours worked or accumulation of leave. A failure to retain important documentation risks noncompliance with the Nebraska Records Retention and Disposition Schedule 124.

We recommend the Agency establish a policy requiring all employees maintain adequate supporting documentation, such as timesheets or certifications, in compliance with State statute. Furthermore, we recommend the Agency make the necessary changes to EnterpriseOne for the retention of timesheets, documentation of approvals, and changes to timesheets in compliance with the Nebraska Records Retention and Disposition Schedule.

*Agency’s Response: Exempt employees are required to only enter their leave exceptions into the EnterpriseOne 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: State statute strictly requires employees working full-time to render no less than forty hours each week. In order to adequately document forty hours were worked, a detailed timesheet, log, or other documentation should be kept for evidence of compliance with § 84-1001. Furthermore, in order to receive full-time leave accruals for sick and vacation, forty hours must be documented as worked.**

### **3. Private Purpose Trust**

Governmental Accounting Standards Board (GASB) Statement Number 34, paragraph 72, states, “*Private-purpose trust funds, such as a fund used to report escheat property, should be used to report all other trust arrangements under which principal and income benefit individuals, private organizations, or other governments.*”

Furthermore, Governmental Accounting, Auditing, and Financial Reporting, *Specialized Guidance for Private-Purpose Trust Funds*, states,

*“The term “private-purpose” is best understood as referring to the absence of a public purpose rather than to the presence of a private benefit. The use of private-purpose trust funds normally should be limited to situations where specific benefits accrue to specific individuals, organizations, or governments. For example, it would not be appropriate to use a private-purpose trust fund to account for the revenues of prison pay phones that will provide benefits to inmates generally.”*

The State of Nebraska reports the Canteen and Welfare fund and Vocational Rehabilitation fund as Private Purpose Trust Funds. The Canteen and Welfare fund generates revenues from vending sales, donations, and gifts at State facilities for use of inmates or patients of the Department of Correctional Services and the Department of Health and Human Services. The Vocational Rehabilitation fund revenues are generated through assessments against insurance companies and self-insurers to provide rehabilitation services to outside persons so they can obtain employment. Neither funds’ revenues were designated for the benefit of **specific** individuals and, therefore, should not be reported as Private Purpose Trust Funds but instead as Special Revenue Funds. A similar finding was noted in the previous report.

Without adequate documentation to support fund presentation in the financial statements, there is a risk of financial statement misstatements.

We recommend State Accounting reconsider their classification and present these funds as Special Revenue Funds in accordance with accounting standards.

*Agency’s Response: State Accounting will review these funds again and make adjustments if determined necessary.*

#### **4. Lack of Procedures for the Review of Express Scripts, Inc. Reports**

A good internal control plan requires health insurance claims paid by the State be adequately reviewed to ensure only eligible claims are paid.

During fiscal year 2012, the Agency contracted with Express Scripts, Inc. (ESI) for pharmacy claims and rebate processing. The Agency paid claims totaling \$34,496,316 to ESI during the fiscal year. ESI obtained a Service Organization Control (SOC) report in accordance with Statements on Standards for Attestation Engagements (SSAE) 16. The report tested controls to ensure they were designed and operating effectively. Within the report they also outlined user entity controls that the Agency should implement to achieve certain control objectives included in the report. During our review of the SOC report we noted the following:

- The SOC report stated, “Client organizations are responsible for ensuring that Eligibility Summary and Error reports are reconciled to documentation of transactions sent to Express Scripts to identify input exceptions.” The Agency did not review the reports during the fiscal year to ensure eligibility was proper and errors noted by ESI were properly addressed and corrected.
- The SOC report stated, “Client organizations are responsible for the review and comparison of Claim Billing reports generated from the Anchor system to the invoice to determine that invoices generated by Express Scripts reconcile to the claims adjudicated.” The Agency did not reconcile the ESI invoices to ensure claims paid by the State agreed to detailed support; rather the Agency simply reviewed the invoices for reasonableness and paid the amount requested.

When eligibility and claim reports are not reviewed and reconciled to supporting documentation, there is an increased risk of error in the data supplied to and from ESI and a risk payments will not be proper. A similar finding was noted in the previous report.

We recommend the Agency implement procedures to review and reconcile reports received from ESI to ensure claims are proper and errors noted are corrected.

*Agency’s Response: Benefits initiates, extracts information from the system of record, and sends eligibility files to the vendor. As a result, of the information received by the state, ESI processes member information and in turn sends Benefits detailed processing information. Benefits reviews and sample tests the information received back from the vendor for accuracy to re-review eligibility.*

#### **5. GASB 45 – Actuarial Review**

GASB Statement Number 45, *Accounting and Financial Reporting by Employers for Postemployment Benefits Other Than Pensions*, establishes standards for the measurement, recognition, and display of other postemployment benefits (OPEB), including postemployment healthcare. For financial reporting purposes, an actuarial valuation is required at least biennially for OPEB plans with a total membership of 200 or more.

The State offered early retirees the option of purchasing health insurance through the State until the time they reached the age of eligibility for Medicare. The retiree paid the full premium for the plan selected. State Accounting had not performed a valuation in accordance with GASB Statement 45 since fiscal year 2009. State Accounting had determined in 2009, that the State's OPEB was not material and, therefore, not included in the CAFR. State Accounting needs to update the valuation calculation in order to determine if previous valuations are still reasonable. Noncompliance with GASB Statement 45 increases the risk of misstatement of the financial statements.

We recommend State Accounting obtain an actuarial valuation in accordance with accounting standards.

*Agency's Response: Administrative Services will perform an actuarial valuation as required in fiscal year FY12/13 for OPEB plans. However, based on the number of retirees today being similar to the number of retirees in 2009, and the costs for health insurance today being at a similar level of cost for health insurance as in 2009, we anticipate the amount determined today to be similar to that calculated in 2009, which was not material.*

#### **Other Items – New Accounting 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.

***GASB Statement No. 63, Financial Reporting of Deferred Outflows of Resources, Deferred Inflows of Resources, and Net Position.***

This Statement, effective for financial statements for periods beginning after December 15, 2011, provides financial reporting guidance for deferred outflows of resources and deferred inflows of resources. Concepts Statement No. 4, *Elements of Financial Statements*, introduced and defined those elements as a consumption of net assets by the government that is applicable to a future reporting period, and an acquisition of net assets by the government that is applicable to a future reporting period, respectively. Previous financial reporting standards do not include guidance for reporting those financial statement elements, which are distinct from assets and liabilities.

***GASB Statement No. 65, Items Previously Reported as Assets and Liabilities.***

This Statement, effective for financial statements for periods beginning after December 15, 2012, establishes accounting and financial reporting standards that reclassify, as deferred outflows of resources or deferred inflows of resources, certain items that were previously reported as assets and liabilities and recognizes, as outflows of resources or inflows of resources, certain items that were previously reported as assets and liabilities.

***GASB Statement No. 66, Technical Corrections–2012—an amendment of GASB Statements No. 10 and No. 62.***

This Statement, effective for financial statements for periods beginning after December 15, 2012, is to improve accounting and financial reporting for a governmental financial reporting entity by resolving conflicting guidance that resulted from the issuance of two pronouncements, Statements No. 54, *Fund Balance Reporting and Governmental Fund Type Definitions*, and No. 62, *Codification of Accounting and Financial Reporting Guidance Contained in Pre-November 30, 1989 FASB and AICPA Pronouncements*.

***GASB Statement No. 67, Financial Reporting for Pension Plans—an amendment of GASB Statement No 25.***

This Statement, effective for financial statements for fiscal years beginning after June 15, 2013, is to improve financial reporting by state and local governmental pension plans. This Statement results from a comprehensive review of the effectiveness of existing standards of accounting and financial reporting for pensions with regard to providing decision-useful information, supporting assessments of accountability and inter-period equity, and creating additional transparency. This Statement replaces the requirements of Statements No. 25, *Financial Reporting for Defined Benefit Pension Plans and Note Disclosures for Defined Contribution Plans*, and No. 50, *Pension Disclosures*, as they relate to pension plans that are administered through trusts or equivalent arrangements (hereafter jointly referred to as trusts) that meet certain criteria. The requirements of Statements 25 and 50 remain applicable to pension plans that are not administered through trusts covered by the scope of this Statement and to defined contribution plans that provide postemployment benefits other than pensions.

***GASB Statement No. 68, Accounting and Financial Reporting for Pensions-an amendment of GASB Statement No. 27.***

The primary objective of this Statement, effective for fiscal years beginning after June 15, 2014, is to improve accounting and financial reporting by state and local governments for pensions. It also improves information provided by state and local governmental employers about financial support for pensions that is provided by other entities. This Statement results from a comprehensive review of the effectiveness of existing standards of accounting and financial reporting for pensions with regard to providing decision-useful information, supporting assessments of accountability and inter-period equity, and creating additional transparency.

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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.

**SIGNED ORIGINAL ON FILE**

Pat Reding, CPA, CFE  
Assistant Deputy Auditor