NEBRASKA AUDITOR OF PUBLIC ACCOUNTS

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February 12, 2014

Randall D. Peters, Director
Nebraska Department of Roads
1500 Highway 2
Lincoln, Nebraska 68502

Dear Mr. Peters:

We have audited the basic financial statements of the State of Nebraska (State) as of and for the year ended June 30, 2013, in accordance with auditing standards generally accepted in the United States of America and standards applicable to financial audits contained in *Government Auditing Standards* issued by the Comptroller General of the United States and have issued our report thereon dated December 30, 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 Nebraska Department of Roads (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 (Infrastructure Work In Progress) 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 management with an opportunity to review the letter and to respond to the comments and recommendations included herein. 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, 2013.

1. Infrastructure Work In Progress

Governmental Accounting Standards Board (GASB) Statement 34, paragraph 25, states:

> *If eligible infrastructure assets meet the requirements of paragraphs 23 and 24 and are not depreciated, all expenditures made for those assets (except for additions and improvements) should be expensed in the period incurred. Additions and improvements to eligible infrastructure assets should be capitalized. Additions or improvements increase the capacity or efficiency of infrastructure assets rather than preserve the useful life of the assets.*

The Department of Administrative Services State Accounting Division (State Accounting) prepares the State Comprehensive Annual Financial Report (CAFR) and requires the Agency to report its infrastructure assets. A good internal control plan requires agencies to have procedures for accurately reporting financial information to State Accounting.

The Agency did not report infrastructure work in progress to State Accounting; therefore, the work in progress was not properly capitalized in the State's financial statements. The Agency reported only infrastructure projects that were complete, causing capital assets to be understated. The total amount of work in progress at year ended June 30, 2013, was $351,213,506.

Due to the omission of this information in the prior year, State Accounting was required to restate the beginning balance on the financial statements. When infrastructure work in progress is not properly capitalized in accordance with GASB, financial statements can be materially misstated.

> We recommend the Agency implement policies and procedures to ensure appropriate accounting standards are adhered to, and necessary information is reported to State Accounting for inclusion in the CAFR.

Agency Response: NDOR concurs with this finding. This is a result of a miscommunication between the Department of Roads and DAS Accounting staff. NDOR will be more diligent in the future to ensure this information is recorded as part of the CAFR report.

2. <u>Management Maintenance System Inventory</u>

A good internal control plan requires adequate documentation to support inventory counts and procedures to reconcile inventory balances to system records.

The Agency performed inventory counts of maintenance materials (rock, gravel and shale) in April 2013 at several sites across the State. Each of the seven districts then compiled the site inventories and reported the balances to the Agency's accounting division for reporting in the CAFR.

The Auditor of Public Accounts (APA) observed inventory counts at two sites to ensure their balances agreed to those reported in the CAFR. However, the Agency maintained only the district summaries; therefore, the APA was unable to verify that the site balances agreed to what was reported. The inventory reported totaled $4,717,699 at fiscal year ended June 30, 2013.

Furthermore, the Agency lacked both procedures for reconciling inventory counts to system balances and policies on when to adjust system balances for accuracy. The Agency also reported a negative balance, which could not have existed for supplies. The Agency had to adjust the balance by $248,125 to correct the error. The Agency's performance of the inventory counts in April 2013, instead of fiscal year ended June 30, 2013, also led to difficulties in reconciling balances for the CAFR.

Without adequate policies and procedures for documenting inventory counts and reconciling amounts to system balances, there is an increased risk inventory balances will be misstated on the financial statements.

> We recommend the Agency establish policies and procedures to retain site counts, reconcile counts to system records, and ensure inventory balances reported to State Accounting are reasonable and accurate. We also recommend the Agency consider performing inventory counts at June 30, the State's fiscal year end.

Agency Response: NDOR concurs with this finding and is currently reviewing MMS Inventory procedures and business practices to ensure accurate financial reporting. Inventory counts are currently scheduled for April 1st of each year to accommodate the Districts seasonal work requirements, this practice will also be reviewed.

3. <u>Supporting Documentation for Transit Payments</u>

A good internal control plan requires payments be adequately documented to ensure expenditures are proper and reasonable.

Under the Nebraska Public Transportation Act, which is set out at Neb. Rev. Stat. §§ 13-1201 to 13-1214 (Reissue 2012, Supp. 2013), the Agency is responsible for the Public Transportation Assistance Program (Program), which provides State assistance for the eligible operating costs of a public transportation system. According to § 13-1209, such costs:

> *[I]nclude those expenses incurred in the operation of a public transportation system which exceed the amount of operating revenue and which are not otherwise eligible for reimbursement from any available federal programs other than those administered by the United States Department of the Treasury.*

During fiscal year 2013, the Agency paid the Metro Area Transit (Omaha Transit Authority) $610,290 for expenditures related to the Program. Selecting one payment made during the year to the Metro Area Transit, the APA noted the Agency did not obtain supporting documentation, such as invoices, to support the expenditures claimed for reimbursement.

Per discussions with the Agency, small transit authorities remit invoices with their reimbursement requests; however, the larger transit areas, such as those for Omaha and the City of Lincoln, submit only summary reports. The Agency did not have policies and procedures to ensure the expenditures reimbursed were reasonable, such as selecting expenditures on a test basis and obtaining supporting documentation for them.

Without supporting documentation to ensure expenditures for reimbursement are proper and reasonable, there is an increased risk for fraudulent or improper payments that do not meet Program requirements.

> We recommend the Agency establish policies and procedures to ensure expenditures reimbursed to transit authorities are proper. For larger transit authorities, we recommend the Agency perform procedures, such as selecting a sample of expenditures and requesting supporting documentation, to ascertain whether reimbursements are reasonable and meet Program requirements.

Agency Response: NDOR concurs with this finding and will implement procedures to ensure adequate supporting documentation is provided for all payment requests.

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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 communication is intended solely for the information and use of management, the Governor and State Legislature, and others within the Agency and is not intended to be, and should not be, used by anyone other than these specified parties. However, this communication is a matter of public record, and its distribution is not limited.

SIGNED ORIGINAL ON FILE

Pat Reding, CPA, CFE
Assistant Deputy Auditor