



NEBRASKA AUDITOR OF PUBLIC ACCOUNTS

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State Auditor

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To: Governor's office representatives - Chief of Staff, Matt Miltenberger and to the Speaker of the Legislative Council – Jim Scheer

We have audited the financial statements of the governmental activities, the business-type activities, the aggregate discretely presented component units, each major fund, and the aggregate remaining fund information of the State of Nebraska, as of and for the year ended June 30, 2018, which collectively comprise the State of Nebraska's basic financial statements, and have issued our report thereon dated January 4, 2019.

Professional standards require that we provide you with information about our responsibilities under generally accepted auditing standards and *Government Auditing Standards*, as well as the accompanying information related to the conduct of our audit. We have communicated such information in our letter to you dated June 8, 2018. Professional standards also require that we communicate to you the following information related to our audit.

Significant Audit Matters

Qualitative Aspects of Accounting Practices

Management is responsible for the selection and use of appropriate accounting policies. The significant accounting policies used by the State of Nebraska are described in Note 1 to the financial statements. No new accounting policies were adopted and the application of existing policies we not changed during the fiscal year ended June 30, 2018. The beginning net position was restated as the result of errors detected and the implementation of GASB Statement No. 75, as described in Note 17 to the financial statements. The largest restatement increased net position by \$1,396,676,000 to reflect land held as investment at fair value. The lands were granted by the Federal government in connection with the State being admitted to the United States, and were not previously reported at fair value.

We noted no transactions entered into by the State of Nebraska during the year for which there is a lack of authoritative guidance or consensus. All significant transactions have been recognized in the financial statements in the proper period.

Accounting estimates are an integral part of the financial statements prepared by management and are based on management's knowledge and experience about past and current events and assumptions about future events. Certain accounting estimates are particularly sensitive because of their significance to the financial statements and because of the possibility that future events affecting them may differ significantly from those expected. The most sensitive estimates affecting the State of Nebraska's financial statements were:

Management's estimate of the allowances for doubtful accounts, as disclosed in Note 3, is based on historical revenues, historical loss levels, and an analysis of the collectability of individual accounts.

The fair value of investments, in the absence of actively quoted market prices, is determined through price information from external sources. If pricing information from external sources is not available or if observable pricing is not indicative of fair value, judgment is required to develop the estimates of fair value using discounted cash flows and other income valuation approaches.

Management also uses estimates when calculating self-insurance reserves, and the lives of property and equipment.

We evaluated the key factors and assumptions used in these estimates in determining that the estimates were reasonable in relation to the financial statements taken as a whole.

The financial statement disclosures are neutral, consistent, and clear.

Difficulties Encountered in Performing the Audit

We encountered significant audit difficulties in relation to the numerous errors noted in the financial statements as described in Comment No. 1 (CAFR Preparation) in our separately issued Management Letter dated January 30, 2019. The significant difficulties encountered led to the Department of Administrative Services (DAS) being noncompliant with Neb. Rev. Stat. § 81-1125.01, which required DAS to issue the CAFR at least twenty days before the commencement of the regular session of the Legislature, or December 20, 2018. Instead, DAS issued the report on January 4, 2019, or fifteen days late.

Furthermore, a qualified opinion was issued as noted in the *Basis for Qualified Opinions* paragraph within the Independent Auditor's Report. The Director of DAS declined to make the management representations as required by generally accepted auditing standards.

Corrected and Uncorrected Misstatements

Professional standards require us to accumulate all known and likely misstatements identified during the audit, other than those that are clearly trivial, and communicate them to the appropriate level of management. The following material misstatements, detected as a result of audit procedures, were corrected by management:

- Long-term investments related to State owned land managed by the Board of Educational Lands and Funds was understated by \$1,310,848,849 due to a change in accounting principles effective in fiscal year 2016, but not adopted. The Permanent School Fund beginning balance was understated by \$1,396,676,054 and investment income was overstated by \$83,370,230.
- The Insurance Tax Fund balance included amounts recorded as due to other government; however, \$26,901,295 was due to the General Fund for Department of Education State aid to schools.
- Deposits of \$19,646,806 held in a Department of Health and Human Services Medicaid Holding Fund should have reduced General and Federal Fund expenditures, with amounts relating to prior years reported as beginning fund balance adjustments.
- The Medicaid Drug Rebate Federal Fund receivable was understated by \$13,419,316 due to errors in the calculation.
- Due to errors in reporting investment activity, long-term investments were overstated and accounts receivable were understated by \$7,500,560 in the Health and Social Service Fund.

The attached schedule summarizes uncorrected misstatements of the financial statements. Management has determined that their effects are immaterial, both individually and in the aggregate, to the financial statements taken as a whole.

Disagreements with Management

For purposes of this letter, a disagreement with management is a financial accounting, reporting, or auditing matter, whether or not resolved to our satisfaction, that could be significant to the financial statements or the auditor's report. We are pleased to report that no such disagreements arose during the course of our audit.

Management Representations

We have requested certain representations from management that are included in the management representation letter dated January 4, 2019. We were unable to obtain a management representation letter from the Director of DAS. The Director declined to make such representations as required by generally accepted auditing standards. This is the basis for the qualified opinions in our Independent Auditor's Report dated January 4, 2019.

Management's Consultation with Other Accountants

In some cases, management may decide to consult with other accountants about auditing and accounting matters, similar to obtaining a "second opinion" on certain situations. If a consultation involves application of an accounting principle to the State of Nebraska's financial statements or a determination of the type of auditor's opinion that may be expressed on those statements, our professional standards require the consulting accountant to check with us to determine that the consultant has all the relevant facts. To our knowledge, there were no such consultations with other accountants.

Other Audit Findings or Issues

We generally discuss a variety of matters, including the application of accounting principles and auditing standards, with management each year prior to retention as the State of Nebraska's auditors. However, these discussions occurred in the normal course of our professional relationship and our responses were not a condition to our retention.

We believe the failure of the Nebraska Department of Administrative Services to issue the report in compliance with § 81-1125.01 and the many errors noted throughout the engagement (as noted above), is material noncompliance and a material weakness.

A subsequently discovered fact became known before the report release date and was described in the Notes to the Financial Statements No. 18. The Statement of Net Position – Governmental Activities included construction-in-progress totaling \$17,624,000 for a new Medicaid Enrollment and Eligibility System. The development of that system was discontinued in December 2018. The federal government provided a significant portion of the funding for the project.

We were unable to obtain sufficient appropriate audit evidence in the form of management representations signed by the Director of DAS as noted above.

It was identified that the State had not previously reported the fair value of land held as investments totaling more than \$1.3 billion. This circumstance led to the emphasis-of-matter paragraph in the Independent Auditor's Report.

Other Matters

We applied certain limited procedures to the Management's Discussion and Analysis, the Budgetary Comparison Schedule – General Fund, the Information about Infrastructure Assets Reported using the Modified Approach, the Information about Pension Plans, and Information About Other Postemployment Benefit Plans, which are Required Supplementary Information (RSI) that supplements the basic financial statements. Our procedures consisted of inquiries of management regarding the methods of preparing the information and comparing the information for consistency with management's responses to our inquiries, the basic financial statements, and other knowledge we obtained during our audit of the basic financial statements. We did not audit the RSI and do not express an opinion or provide any assurance on the RSI.

We were engaged to report on the Combining Financial Statements and Budgetary Comparison Schedules included as supplementary information which accompany the financial statements but are not RSI. With respect to this supplementary information, we made certain inquiries of management and evaluated the form, content, and methods of preparing the information to determine that the information complies with accounting principles generally accepted in the United State of America, the method of preparing it has not changed from the prior period, and the information is appropriate and complete in relation to our audit of the financial statements. We compared and reconciled the supplementary information to the underlying accounting records used to prepare the financial statements or to the financial statements themselves.

We were not engaged to report on the introductory and statistical sections, which accompany the financial statements but are not RSI. Such information has not been subjected to the auditing procedures applied in the audit of the basic financial statements, and accordingly, we do not express an opinion or provide any assurance on it.

Restriction on Use

This information is intended solely for the information and use of the Governor and State Legislature, and management of the State of Nebraska 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.

Sincerely,



Philip J. Olsen, CPA, CISA
Assistant Deputy Auditor

Schedule of Uncorrected Financial Statement Misstatements
Fiscal Year Ended June 30, 2018

General Fund Opinion Unit:

Beginning Fund Balance Unadjusted	\$ (1,458,635.23)	Understated
Total Assets Unadjusted	\$ (5,175.05)	Understated
Total Revenues Unadjusted	\$ 2,639,561.12	Overstated
Total Expenditures Unadjusted	\$ 1,283,424.92	Overstated
Transfer Out Unadjusted	\$ (97,323.98)	Understated
Ending Fund Balance Unadjusted	\$ (1,453,460.18)	Understated

Highway Fund:

Beginning Fund Balance Unadjusted	\$ (276,706.81)	Understated
Total Revenues Unadjusted	\$ 276,706.81	Overstated
Total Expenditures Unadjusted	\$ 42,312.72	Overstated
Transfer Out Unadjusted	\$ (42,312.72)	Understated
Ending Fund Balance Unadjusted	\$ 276,706.81	Overstated

Other Funds:

Beginning Fund Balance Unadjusted	\$ (3,401,794.36)	Understated
Total Assets Unadjusted	\$ (4,978,698.60)	Understated
Total Liabilities Unadjusted	\$ 744,345.75	Overstated
Total Revenues Unadjusted	\$ 305,986.42	Overstated
Total Expenditures Unadjusted	\$ 4,266,707.83	Overstated
Transfers In Unadjusted	\$ 1,639,471.42	Overstated
Ending Fund Balance Unadjusted	\$ (2,321,249.99)	Understated

Federal Fund:

Beginning Fund Balance Unadjusted	\$ 3,897,471.11	Overstated
Total Assets Unadjusted	\$ 7,877,365.16	Overstated
Total Liabilities Unadjusted	\$ 2,845,983.87	Overstated
Total Revenues Unadjusted	\$ (2,163,002.81)	Understated
Total Expenditures Unadjusted	\$ (2,382,072.04)	Understated
Transfer Out Unadjusted	\$ (914,840.95)	Understated
Ending Fund Balance Unadjusted	\$ (1,133,910.18)	Understated

HHS Fund:

Total Assets Unadjusted	\$ 187,648.27	Overstated
Total Expenditures Unadjusted	\$ (187,648.27)	Understated
Ending Fund Balance Unadjusted	\$ 187,648.27	Overstated

UI Fund:

Beginning Fund Balance Unadjusted	\$	317,706.84	Overstated
Total Assets Unadjusted	\$	430,330.60	Overstated
Total Revenues Unadjusted	\$	120,659.87	Overstated
Total Expenditures Unadjusted	\$	(125,912.96)	Understated
Transfer Out Unadjusted	\$	133,949.07	Overstated
Ending Fund Balance Unadjusted	\$	112,623.76	Overstated

Pension Fiduciary:

Investments - Private Equity Unadjusted	\$	(21,168,727.83)	Understated
Investments - Private Real Estate Unadjusted	\$	21,168,727.83	Overstated
Ending Fund Balance Unadjusted	\$	-	No effect

Agency Funds:

Total Assets Unadjusted	\$	123,612.90	Overstated
Total Liabilities Unadjusted	\$	123,612.90	Overstated
Ending Fund Balance Unadjusted	\$	-	No effect

Government Activities:

Beginning Net Position Balance Unadjusted	\$	(6,751,128.52)	Understated
Total Assets Unadjusted	\$	(8,363,337.90)	Understated
Total Liabilities Unadjusted	\$	3,713,942.52	Overstated
Total Revenues Unadjusted	\$	3,619,251.54	Overstated
Total Expenditures Unadjusted	\$	9,079,352.51	Overstated
Transfers In Unadjusted	\$	(920,528.58)	Understated
Transfer Out Unadjusted	\$	(1,054,477.65)	Understated
Ending Net Position Balance Unadjusted	\$	(5,326,151.90)	Understated

Business Type Activities:

Beginning Net Position Balance Unadjusted	\$	317,706.84	Overstated
Total Assets Unadjusted	\$	430,330.60	Overstated
Total Revenues Unadjusted	\$	120,659.87	Overstated
Total Expenditures Unadjusted	\$	(125,912.96)	Understated
Transfer Out Unadjusted	\$	133,949.07	Overstated
Ending Net Position Balance Unadjusted	\$	112,623.76	Overstated