



NEBRASKA AUDITOR OF PUBLIC ACCOUNTS

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Kelly Sudbeck, Chief Executive Officer/Executive Secretary
Nebraska Board of Educational Lands and Funds
555 North Cotner Boulevard
Lincoln, Nebraska 68505

Dear Mr. Sudbeck:

In planning and performing our audit of 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 (State) as of and for the year ended June 30, 2018, 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, we have issued our report thereon dated January 4, 2019. 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 that are appropriate in the circumstances for the purpose of expressing our opinions on the 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 Board of Educational Lands and Funds (Board) or other operational matters that are presented below for your consideration. This comment and recommendation, which has been discussed with the appropriate members of the Board's management, is 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 material weakness.

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 consider the comment below (Land Not Reported as an Investment and Unauthorized Bank Account) to be a material weakness.

That comment will also be reported in the State of Nebraska's Statewide Single Audit Report Schedule of Findings and Questioned Costs.

A significant deficiency is a deficiency, or a 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 did not identify any deficiencies in internal control that we consider to be significant deficiencies.

In addition, we noted other matters involving internal control and its operation that we have reported to management of the Board, pursuant to AICPA Auditing Standards AU-C Section 265.A17, in a separate early communication letter dated September 27, 2018.

Draft copies of this letter were furnished to the Board to provide management with an opportunity to review and to respond to the comment and recommendation contained herein. Any formal response received has been incorporated into this letter. Such response has been objectively evaluated and recognized, as appropriate, in the letter. A response that indicates corrective action has been taken was not verified at this time, but it will be verified in the next audit.

The following is our comment and recommendation for the year ended June 30, 2018.

1. Land Not Reported as an Investment and Unauthorized Bank Account

During testing, the Auditor of Public Accounts (APA) noted that the State-owned land managed by the Board for educational purposes was not valued at fair market value on the State's accounting system, as required by the Government Accounting Standards Board (GASB) Codification section I50, Investments, nor was it reported to the Department of Administrative Services (DAS) for inclusion in the State of Nebraska's Comprehensive Annual Financial Report (CAFR). The requirement to report land held for investment purposes at fair market value was to be implemented starting with the fiscal year ended June 30, 2016.

The fair market value of the land held by the Board as of June 30, 2017, was \$1,395,121,093 and as of June 30, 2018, was \$1,310,848,849. During testing of the fair market valuation calculations, the APA found errors that overstated the June 30, 2017, balance by \$758,944 and understated the June 30, 2018, balance by \$514,704, which the Board adjusted once brought to its attention. The APA proposed an adjustment to reflect the investment balances in the CAFR; the adjustment was made by DAS.

We also noted during testing that the Board sold land and, with the sale proceeds, purchased new property to be added to the educational land trust. The Board used a local title company to handle the funds being exchanged during these transactions. Such funds were deposited into, as well as disbursed from, an outside bank account held by the Board under the State's Federal Tax Identification Number (FTIN). The balance in this account at June 30, 2018, was \$2,296,257, with a balance as high as \$7,566,839 during the fiscal year ended June 30, 2018.

The Board's outside bank account was not authorized by the State Treasurer or adequately collateralized, as required by State statute. After taking into account the Federal Deposit Insurance Corporation (FDIC) limit of \$250,000, the Board was lacking \$7,463,176 in collateral in order to be in compliance with the statutory requirement of no less than 102%. Furthermore, the Board did not track the balance or activity in the bank account in the State's accounting system, nor did it report this information to DAS for inclusion in the CAFR. The APA's proposed adjustment was made by DAS to correct the error.

GASB Codification section I50, Investments, paragraph .108, states the following:

[I]nvestments should be measured at fair value Examples of investments that should be measured at fair value include investments in the following:

f. Land and other real estate held as investments by endowments (including permanent and term endowments) or permanent funds.

Neb. Rev. Stat. § 77-2301(1) (Reissue 2018) provides the following:

The State Treasurer shall deposit, and at all times keep on deposit for safekeeping, in the state or national banks, or some of them doing business in this state and of approved standing and responsibility, the amount of money in his or her hands belonging to the several current funds in the state treasury. Any bank may apply for the privilege of keeping on deposit such funds or some part thereof.

Neb. Rev. Stat. § 77-2309 (Reissue 2018) states the following:

It is made the duty of the State Treasurer to use all reasonable and proper means to secure to the state the best terms for the depositing of the money belonging to the state, consistent with the safekeeping and prompt payment of the funds of the state when demanded.

Neb. Rev. Stat. § 77-2395(1) (Reissue 2018) provides, in relevant part, the following:

[T]he custodial official shall not have on deposit in such depository any public money or public funds in excess of the amount insured or guaranteed by the Federal Deposit Insurance Corporation, unless and until the depository has furnished to the custodial official securities, the market value of which are in an amount not less than one hundred two percent of the amount on deposit which is in excess of the amount so insured or guaranteed.

Good internal control requires procedures to ensure the State's accounting system reflects accurately fair market land valuations in accordance with GASB, and the value is properly documented. Without such procedures, there is an increased risk that amounts reported in the CAFR will be materially misstated and noncompliant with GASB.

Furthermore, a good internal control plan requires procedures to ensure that all Board bank activity and balances are reported to DAS for accurate financial statement representation. Without such procedures, there is an increased risk that the State's CAFR will be materially misstated.

When there is not proper authorization by the State Treasurer for outside bank accounts, there is an increased risk for loss or misuse of State funds. Any funds held by a financial institution, whether under the control of the State or otherwise, are at greater risk of loss when the amounts in excess of FDIC coverage are not properly secured. When State funds are involved, moreover, failure to ensure proper collateralization disregards State statute.

We recommend the Board ensure the fair market value of land owned is reported to DAS for inclusion in the CAFR, in accordance with GASB. We also recommend the Board strengthen procedures to ensure the land fair

value calculation is accurate. We recommend the Board work with the State Treasurer to address concerns raised regarding the outside bank account, including properly collateralizing the account in accordance with State statute. Lastly, we recommend the Board work with DAS to ensure activity in the bank account is included in the State's accounting system and the CAFR.

Board Response: The Board was not advised of the recent change to this regulation, and has never before been required to report the value of its property on the State's accounting system. The Board has already met with DAS, and has begun the process of reporting the value of the Board's land onto the State's accounting system.

During the course of the audit, the Board received a letter from the Nebraska State Treasurer demanding that the Board close its escrow account as soon as possible, and transfer those funds into the custody of the State Treasurer. The Board disagrees with the determination of the Auditor and Treasurer. Notwithstanding this; however, the Board immediately applied for an escrow exchange account, and received the approval of the Department of Administrative Services, State Accounting, and the Treasurer. The funds are now in the custody of the Treasurer.

The escrow account was in the custody of one of the largest title companies in Lincoln, Nebraska, which is underwritten by the largest title insurer in the United States. Both the local company, with its errors and omissions insurance policy, and the national underwriter, were fully bonded and insured, and would have been liable to the Board for loss caused by any insufficient collateralization of the account. As stated earlier, this account has already been transferred to the Treasurer's office.

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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 Board 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 Board.

This communication is intended solely for the information and use of the Board, the Governor and State Legislature, others within the Board, 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 communication is a matter of public record, and its distribution is not limited.



Philip J. Olsen, CPA, CISA
Assistant Deputy Auditor