



NEBRASKA AUDITOR OF PUBLIC ACCOUNTS

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Tony Fulton, Tax Commissioner
Nebraska Department of Revenue
301 Centennial Mall South
PO Box 94818
Lincoln, Nebraska 68509

Dear Tax Commissioner Fulton:

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, 2020, in accordance with auditing standards generally accepted in the United States of America and the 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 December 17, 2020. 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 Department of Revenue (Department) or other operational matters that are presented below for your consideration. The comment and recommendation, which has been discussed with the appropriate members of the Department management, is intended to improve internal control or result in other operating efficiencies.

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.

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. Given these limitations during our audit, we did not identify any deficiencies in internal control that we consider to be material weaknesses. However, material weaknesses may exist that have not been identified.

Draft copies of this letter were furnished to the Department 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, 2020.

Lack of Procedures for Severance and Conservation Tax

The Department lacked procedures to ensure that severance tax money received (in conjunction with a Nebraska Severance and Conservation Tax Return, Form 61) was accurate. According to Department staff, the Form 61 has supporting schedules that are recalculated to ensure the mathematical accuracy of the tax receipt reports; however, there was no verification of the value of the amounts reported. The Department deposited receipts associated with the severance tax directly into the Severance Tax Distribution Fund (STDF). The conservation tax was also deposited into the STDF, as it was paid on the same form as the severance tax. The Department then performed a journal entry each month to move the conservation tax from the STDF to the Oil & Gas Conservation Fund.

Taxes receipted into the STDF totaled \$2,434,194 – including \$408,362 in conservation taxes – for the fiscal year ended June 30, 2020.

The Auditor of Public Accounts determined also that the value of exemptions reported each month were not verified for accuracy or statutory compliance.

Neb. Rev. Stat. § 57-718(4) (Reissue 2010) allows for examination of the books and records of any person liable for the severance tax, as follows:

The Tax Commissioner or any person authorized in writing by him or her may examine the books, papers, records, and equipment of any person liable for the severance tax and may investigate the character of the business of the person in order to verify the accuracy of any return made, or, if no return is made by the person, to ascertain and determine the amount required to be paid.

Neb. Rev. Stat. § 57-919 (Cum. Supp. 2018) defines the mill levy tax assessed on the value of all oil and gas produced, saved, and sold or transported in Nebraska. Specifically, subsection (2) of that statute provides, in part, the following:

[T]here shall be exempted from the charge levied and assessed in this section the following: (a) The interest of the United States of America and the interest of the State of Nebraska and the political subdivisions thereof in any oil or gas or in the proceeds thereof; (b) the interest of any Indian or Indian tribe in any oil or gas or in the proceeds thereof produced from land subject to the supervision of the United States; and (c) oil and gas used in producing operations or for repressuring or recycling purposes.

Good internal controls require procedures to ensure that the value of the oil and gas severed or the exemptions claimed are correct and proper.

Without such procedures, there is an increased risk for improper tax filings and the attendant loss of State funds.

We recommend the Department implement procedures to ensure the accuracy of the value of oil and gas severed and the exemptions reported by each producer.

Department Response: LB 512, Laws 2019, was introduced on behalf of the Department of Revenue (DOR) for the specific purpose of incorporating the former Motor Fuel Tax Enforcement and Collection Division into DOR's Compliance Division to provide for more effective and efficient use of audit resources in the area of excise tax compliance. DOR has been focused on working toward this goal since the operative date of this legislation.

DOR agrees that Neb. Rev. Stat. § 57-718(4) specifically allows that the Tax Commissioner “may” examine books, papers, and records of any person liable for the severance tax. DOR considers audit selection criteria as a resource decision to be made by the Tax Commissioner for the efficient administration of Chapter 57, article 7, rather than a decision to be made by the Auditor of Public Accounts. The newly created excise tax unit within the Compliance Division of DOR will apply the standard processes and procedures for potential audit selection in the area of severance and conservation taxes. Audit and examination selection criteria, standards, and discovery techniques are confidential under Neb. Rev. Stat. § 77-376(2).

APA Response: As the Department noted, it has the authority to examine the books, papers, records, and equipment of any person liable for severance tax. The Auditor of Public Accounts is not inferring it make the decision on when or whom to examine, rather, that the Department perform a periodic sample of records to ensure the tax receipted is accurate and complete. According to the Department, no verification had been performed.

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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 Department 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 Department.

This communication is intended solely for the information and use of management, the Governor and State Legislature, others within the Department, 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.



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