



## NEBRASKA AUDITOR OF PUBLIC ACCOUNTS

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Dear Sirs and Madam:

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 agencies noted above or other operational matters that are presented below for your consideration. This comment and recommendation, which has been discussed with the appropriate members of agency management, is intended to improve internal control or result in other operating efficiencies.

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 (Capital Asset Accounting Issues) to be a material weakness.

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 agencies 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.

### **Capital Asset Accounting Issues**

The State of Nebraska reported over \$9 billion in capital assets for the primary government at the fiscal year ended June 30, 2020, in the Comprehensive Annual Financial Report (CAFR) audit. In accordance with Neb. Rev. Stat. § 81-1125.01 (Reissue 2014), the Nebraska Department of Administrative Services (DAS), State Accounting Division, prepares the CAFR, which must be completed "at least twenty days before the commencement of each regular session of the legislature[.]" DAS compiled information from the State accounting system and requested State agencies to report accrual items, not contained within the accounting system, for inclusion in the CAFR. As in previous audits, DAS failed to perform adequate procedures to ensure capital assets were recorded properly on the financial statements, causing errors of at least \$276 million. Due to the numerous errors and the inability of DAS to provide sufficient audit evidence for the capital assets financial activity, the Auditor of Public Accounts (APA) issued a disclaimer of opinion on the financial statements.

The APA has reported similar issues since the 2015 audit, with little if any resolution or corrective action taken – such as adequate training of agency staff to ensure assets recorded in the system or reported to DAS are proper and complete – for the errors noted.

In order to ensure the CAFR's timely completion, the APA requested a list of items to be prepared by DAS and submitted to the APA for testing. Though due on November 2, 2020, CIP documentation was not provided until December 1, 2020, nearly one month late. Similar timing issues were noted for the capital asset footnote, journal entries, and construction commitments documentation. All of these items were provided in December, leaving the APA with limited time for adequately reviewing the support, as the CAFR was due December 17, 2020.

To assist in reporting CIP in the financial statements, DAS created a new accrual form for agencies to report CIP still in process and those projects completed during the year. However, upon reviewing the forms submitted and the CIP worksheet, the APA noted that several agencies – one of which had projects in process – did not return the form. Additionally, DAS did not use some of the forms received for financial reporting.

The APA's limited initial review revealed other significant issues with the CIP worksheet. For instance, DAS did not research or compare amounts reported by agencies to information contained in the State's accounting system. Instead, staff merely accepted the forms without requesting any supporting documentation, leaving the APA to contact the agencies for support late in the audit. When the APA questioned why the CIP worksheet had been provided late, with significant errors and no documentation on file to support the amounts from the agencies, DAS could respond only that the new form caused unspecified delays.

Due to the pervasive errors in the CIP worksheet provided – exacerbated by DAS' lack of adequate documentation to support the calculation therein – and the time constraints for completing the CAFR in accordance with State law, the APA was unable to perform a full review of CIP. Nevertheless, limited testing by the APA revealed that at least \$135 million had been reported inaccurately.

The table below details the CIP adjustments required due to the errors found by the APA:

	<b>Beginning Balance</b>	<b>Additions</b>	<b>Deductions, Including Completed CIP</b>	<b>Ending Balance</b>
Reported by DAS	\$ 282,756,562	\$ 91,414,818	\$ 61,445,501	\$ 312,725,879
Adjusted by APA	\$ 275,150,537	\$ 92,201,285	\$ 189,940,709	\$ 177,411,113
<b>Misstatement</b>	<b>\$ (7,606,025)</b>	<b>\$ 786,467</b>	<b>\$ 128,495,208</b>	<b>\$ (135,314,766)</b>

During testing of CIP, we noted these other concerns as well:

- DAS did not run a general ledger detail of CIP accounts in the accounting system to compare to the agency accrual response forms, which resulted in errors being reported. For instance, DAS recorded \$1,124,100 for software licensing subscriptions as CIP; however, the agency recorded the expense appropriately as an operating expenditure in the accounting system. Furthermore, two agencies reported CIP on the accrual response forms, which also agreed to the expenses in the accounting system for \$2.5 million, but DAS did not include the projects on the worksheet.
- DAS did not consider payables recorded for the fiscal year 2020 CAFR for inclusion in CIP.
- DAS stated that there were no projects with retainage; however, during our limited review, the APA noted that at least \$2.5 million in retainage was not recorded.
- DAS did not include \$387,526 in its own agency project's expenses. Furthermore, a project of \$6.7 million included on the worksheet for DAS was completed, but it was not removed from CIP.
- Several agencies reported completion dates of CIP, but the assets were not removed properly from the worksheet. For instance, the Game and Parks Commission provided asset tag numbers for projects completed and capitalized. The APA reviewed the accounting system to determine projects not removed properly from CIP. This procedure was not performed by DAS. One Veterans' Affairs building was open to the public in January 2019, but it still showed on the CIP worksheet for \$98 million. A similar issue was noted for a Department of Corrections building for \$15.8 million.

DAS also prepared several worksheets for capital assets recorded in the State's accounting system. The worksheets included land, buildings, and equipment capitalized for the State. The worksheets were generally prepared using the State's accounting system, with some manual adjustments. There were several substantial spreadsheet errors, including inaccurate beginning balances, amounts not removed properly from CIP and added to capital assets, and incorrect depreciation.

The following table details the spreadsheet errors noted:

	<b>Beginning Balance</b>	<b>Additions</b>	<b>Ending Balance</b>	<b>Ending Balance</b>
<i>Buildings</i>	<i>Capital Asset</i>			<i>Depreciation</i>
Initial Calculation	\$ 709,046,207	\$ 6,450,948	\$ 715,497,155	\$ 371,142,834
Final Calculation	\$ 830,459,954	\$ 8,221,931	\$ 838,681,885	\$ 371,637,409
<b>Total Errors</b>	<b>\$ 121,413,747</b>	<b>\$ 1,770,983</b>	<b>\$ 123,184,730</b>	<b>\$ 494,575</b>
<i>Equipment</i>	<i>Capital Asset</i>			<i>Depreciation</i>
Initial Calculation	\$ 473,791,115	\$ 55,120,760	\$ 514,150,665	\$ 385,406,910
Final Calculation	\$ 474,798,321	\$ 53,407,242	\$ 513,444,353	\$ 383,295,944
<b>Total Errors</b>	<b>\$ 1,007,206</b>	<b>\$ (1,713,518)</b>	<b>\$ (706,312)</b>	<b>\$ (2,110,966)</b>

	<b>Beginning Balance</b>	<b>Additions</b>	<b>Ending Balance</b>	<b>Ending Balance</b>
<i>Equipment-Internal Services-Buildings</i>	<i>Capital Asset</i>			<i>Depreciation</i>
Initial Calculation	\$ 1,632,819	\$ 338,177	\$ 1,949,200	\$ 1,053,785
Final Calculation	\$ 4,758,719	\$ 1,333,032	\$ 6,069,955	\$ 1,043,630
<b>Total Errors</b>	<b>\$ 3,125,900</b>	<b>\$ 994,855</b>	<b>\$ 4,120,755</b>	<b>\$ (10,155)</b>
<i>Equipment-Internal Services-General Services</i>	<i>Capital Asset</i>			<i>Depreciation</i>
Initial Calculation	\$ 7,241,916	\$ 7,266,591	\$ 13,903,326	\$ 5,658,093
Final Calculation	\$ 7,241,916	\$ 584,825	\$ 7,221,560	\$ 4,939,219
<b>Total Errors</b>	<b>\$ -</b>	<b>\$ (6,681,766)</b>	<b>\$ (6,681,766)</b>	<b>\$ (718,874)</b>
<i>Equipment-Internal Services-Office of CIO</i>	<i>Capital Asset</i>			<i>Depreciation</i>
Initial Calculation	\$ 62,635,298	\$ 6,552,242	\$ 67,296,562	\$ 57,493,956
Final Calculation	\$ 62,635,298	\$ 6,552,242	\$ 67,296,562	\$ 55,997,093
<b>Total Errors</b>	<b>\$ -</b>	<b>\$ -</b>	<b>\$ -</b>	<b>\$ (1,496,863)</b>

Other issues noted during testing of capital assets were as follows:

- DAS recorded the internal service fund journal entries improperly, causing a decrease to expenditures that was not incurred during the fiscal year. This required an adjustment of \$6,884,564.
- The construction commitment worksheet used to generate the footnote disclosure was not complete and accurate. The worksheet did not calculate properly the funding sources and contained other issues, resulting in errors of \$9.6 million.
- One DAS asset tested did not have support for the date acquired, which drives the calculation of depreciation expense. The asset totaled \$2,290,642, with costs added in fiscal year 2020, totaling \$1,623,685, yet the date acquired was in 2015.
- DAS did not have a capitalization policy for improvements to land. A similar finding was reported in the previous audit. In order for agencies to record improvements properly, a statewide policy is necessary for uniformity of financial reporting.
- The accumulated depreciation for enterprise funds was understated by \$238,516 due to an error in the calculation.

As noted above, errors were also made by several agencies. Those agencies include the Nebraska Department of Transportation, the Nebraska Department of Veterans' Affairs, the Nebraska Department of Correctional Services, the Nebraska Game and Parks Commission, and the Nebraska Department of Health and Human Services. These errors are explained in more detail below.

Department of Transportation (NDOT)

NDOT provided DAS with infrastructure costs for completed projects and projects still in process to be recorded as CIP. NDOT had several errors in the worksheet used to support the calculations, as follows:

	<b>Beginning Balance</b>	<b>Additions</b>	<b>Deductions – Including Completion of CIP</b>	<b>Ending Balance</b>
<i>Infrastructure</i>				
Initial Calculation	\$ 7,622,534,680	\$ 98,863,737	\$ -	\$ 7,721,398,417
Final Calculation	\$ 7,697,493,583	\$ 22,841,102	\$ -	\$ 7,720,334,685
<b>Total Errors</b>	<b>\$ 74,958,903</b>	<b>\$ (76,022,635)</b>	<b>\$ -</b>	<b>\$ (1,063,732)</b>
<i>CIP</i>				
Initial Calculation	\$ 237,965,232	\$ 37,945,365	\$ 96,672,537	\$ 179,238,060
Final Calculation	\$ 62,953,918	\$ 37,858,297	\$ 20,563,369	\$ 80,248,846
<b>Total Errors</b>	<b>\$ (175,011,314)</b>	<b>\$ (87,068)</b>	<b>\$ (76,109,168)</b>	<b>\$ (98,989,214)</b>

NDOT capitalized assets for the calendar year instead of the fiscal year, causing beginning balance adjustments for both infrastructure and CIP. NDOT determined that the CIP beginning balance was overstated by \$99,869,441 for three projects that should have been removed from CIP in fiscal year 2019. Additionally, NDOT determined that the CIP worksheet did not agree to NDOT's listing of projects still in process, and an additional adjustment of \$75 million was required. However, NDOT was unable to provide sufficient evidence for the difference; therefore, it is unknown if CIP was overstated and the difference needed to be removed due to duplicate entries, or if it should have been reported as infrastructure for completed projects in the current year, as a beginning balance adjustment, or recorded as an expense. Additional errors were noted in the worksheet, including system preservation costs being understated by \$5 million and other computation errors.

Department of Veterans' Affairs (VA)

The VA did not capitalize a building, totaling \$98,292,179, in a timely manner. The asset was completed in January 2019 and, therefore, should have been included as an asset in fiscal year 2019, but it was still in CIP in fiscal year 2020. The VA acknowledged lacking experience with the CIP reporting.

Department of Correctional Services (DCS)

The DCS did not capitalize a building, totaling \$15,826,426, in a timely manner. The asset was completed in April 2019 and, therefore, should have been included as an asset in fiscal year 2019, but it was still in CIP in fiscal year 2020. The DCS stated that it had discussions with DAS regarding the capitalization of the building; therefore, DAS should have been aware that the project was completed for purposes of financial reporting.

Game and Parks Commission (Commission)

The Commission did not capitalize four assets in a timely manner, resulting in \$8,132,608 in errors.

- Two assets, totaling \$232,341, were completed on July 31, 2018, and should have been removed from CIP and included as a capital asset in fiscal year 2019, but they were still included in CIP in fiscal year 2020. The Commission had not recorded them to the capital asset ledger in the accounting system timely.
- One asset, totaling \$6,794,779, opened to the public on May 18, 2019, and should have been added to the capital assets and removed from CIP in fiscal year 2019, but it was still in CIP in fiscal year 2020. The Commission had not recorded it to the capital asset ledger in the accounting system timely.
- One asset, totaling \$1,105,488, was completed on October 1, 2019, in fiscal year 2020, but the Commission entered the completion date in the accounting system as September 21, 2020, fiscal year 2021. Therefore, it was not removed from CIP and added as a capital asset in fiscal year 2020.

Department of Health and Human Services (DHHS)

DHHS did not capitalize three software projects in accordance with GASB 51. Instead, DHHS recorded the expenditures as operating expenses. During discussion with the APA in October, DHHS explained that the three projects involved software capitalization, but DHHS had not analyzed the actual capital costs or submitted these

expenses to DAS with the accrual response form. One system was identified and discussed with DHHS during the previous audit, but no corrective action was taken to record the expenditures properly as CIP. The total expenditures during fiscal year 2020 were \$6,404,762. The contract also had 10% retainage held, totaling \$1,672,089, during the fiscal year, which was also not reported to DAS and, therefore, not recorded as a liability or included in CIP.

The APA notified DAS of the additional systems in October 2020, so they could be included on CIP. DAS did not perform further procedures or inquire with DHHS until December 4, 2020, when the APA inquired as to why the systems were not included on the CIP worksheet. After further inquiry, on December 9, 2020, six business days before the CAFR was statutorily required to be completed, DHHS stated that the two systems should not be capitalized. No further documentation was provided to substantiate this statement. Therefore, it is unknown if costs should have been added to CIP, as neither the follow-up performed by DAS nor the response provided by DHHS was timely. Expenditures for fiscal year 2020 for the two systems totaled \$1,960,529 and \$965,000, respectively.

Good internal controls and sound accounting practice require procedures to ensure that capital asset activity is recorded accurately and supported by adequate documentation.

Without such procedures, there is an increased risk for material misstatements.

We recommend DAS implement procedures to resolve the repeated audit finding and ensure that capital asset activity is accurate and complete before forwarding the information to the APA, and not rely on the APA's examination to identify and correct errors. This includes offering support and training to agencies, as well as reviewing the information that agencies provide. Finally, we recommend DAS ensure that capital asset information is presented to the APA in a timely manner.

*Department of Administrative Services Response: State Accounting agrees that strengthening procedures, agency support, and training around the preparation of capital asset information will increase the completeness, accuracy, and timeliness of the report.*

*State Accounting will partner with agencies and provide training specifically in the areas of preparing capital asset information.*

*Department of Transportation Response: We concur with the Auditor's recommendations as they relate to NDOT. NDOT will coordinate closely with DAS in the future to make improvements to internal processes. The Budget Analyst position that has historically been assigned to take lead on compiling the necessary information has turned over multiple times over the years which has led to a lack of clear and consistent documentation regarding the timing of project substantial completion and as a result reporting was handled differently (i.e. calendar year vs. fiscal year) from year to year. Prior to the beginning of fiscal year 2022, NDOT will develop new Standard Operating Procedures and update other internal financial procedure manuals which make clear the timing of project completion is on a fiscal year basis for CAFR reporting in order to reduce confusion going forward.*

*Current data retrieval tools used by NDOT includes only projects which have cost during the fiscal year. There are instances where a project is put on hold and becomes inactive after the initial study resulting in the cost never being capitalized or expensed. Based on the current process, this resulted in a large work in process balance. Going forward NDOT will generate a list of the projects which make up the work in process. Each year when the data is pulled the projects will be compared to the current work in process listing and any differences will be reviewed and properly accounted. By keeping a listing of the current work in process projects NDOT will be able to use it to determine when a current work in process project should be expensed.*

*Game and Parks Commission Response: We would concur that the 4 assets identified for Game and Parks were not capitalized in a timely fashion. We will continue to work with DAS Accounting to ensure clarification of definitions, processes and timing are improved. We have corrected/posted the items at this point and will ensure they are not included on the CIP report for FY21.*

*We would note that for the first point (two assets – CXT toilet and CXT shower/latrine buildings at Eugene T. Mahoney State Park) the July 31, 2018 date reflected the purchase/receiving of the two prefab buildings. Actual installation completion (payment of final bill) did not occur until 11/15/2018 so that is the date we have utilized to record the Asset in E1. The second point related to the Schramm Education Center, and while the facility had an initial opening on May 18, 2019, final payments and punch lists were not complete until 2/20/2020. That is the date we have utilized to record the Asset in E1. The last point related to the Spray Park feature at Platte River State Park. We have utilized the suggested date of 10/1/2019 for recording the asset in E1.*

**APA Response: For the toilet and shower/latrine buildings, regardless of whether the assets should have been capitalized in July or November 2018, the assets should have been a fiscal year 2019 asset, but were not. As for the Schramm Education Center, it was opened to the public in May 2019, and therefore it appears May 2019, would be the proper date of completion for the asset for financial statement presentation.**

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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 agencies and their 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 agencies.

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