NEBRASKA AUDITOR OF PUBLIC ACCOUNTS

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Jason Jackson, Director
Nebraska Department of Administrative Services
1526 K Street, Suite 190
Lincoln, Nebraska 68508

Dear Mr. Jackson:

We were engaged to audit 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, 2021, 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, and we have issued our report thereon dated April 28, 2022. In connection with our engagement to audit the financial statements, 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, 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 engagement to audit the financial statements as described above, we noted certain internal control or compliance matters related to the activities of the Nebraska Department of Administrative Services (DAS) or other operational matters that are presented below for your consideration. These comments and recommendations, which have been discussed with the appropriate members of DAS's management, are 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 certain deficiencies in internal control that we consider to be material weaknesses and other deficiencies that we consider to be significant deficiencies.

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 Comment Number 1 (ACFR Preparation Issues), Comment Number 2 (Unemployment Insurance Fund Issues), Comment Number 3 (GASB 84 Implementation Failure), and Comment Number 4 (Capital Asset Accounting Errors) to be material weaknesses.

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 consider Comment Number 5 (NOMI Contract Matters) and Comment Number 6 (Lack of Financial Statement Reconciliation) to be significant deficiencies.

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

In addition, we noted other matters involving internal control and its operation that we have reported to management of DAS, pursuant to American Institute of Certified Public Accountants (AICPA) Auditing Standards AU-C Section 265B.A17, in a separate early communication letter dated August 12, 2021.

Draft copies of this letter were furnished to DAS to provide management with an opportunity to review and to respond to the comments and recommendations contained herein. Any formal responses received have been incorporated into this letter. Such responses were not subjected to the auditing procedures applied in the engagement to audit the financial statements; accordingly, we express no opinion on them. Responses that indicate corrective action has been taken were not verified at this time, but they will be verified in the next audit.

The following are our comments and recommendations for the year ended June 30, 2021.

1. ACFR Preparation Issues

The Department of Administrative Services (DAS), State Accounting Division (State Accounting), prepares the State of Nebraska Annual Comprehensive Financial Report (ACFR). Similar to the previous audit, the financial statements were neither accurate nor prepared in accordance with governmental accounting standards. Additionally, adequate controls were not in place, including a secondary review to ensure that entries were accurate prior to being submitted to the Auditor of Public Accounts (APA) to audit. As a result, DAS materially misstated financial statement entries, footnote disclosures, and other supporting documentation, requiring numerous adjustments and revisions.

The table below summarizes over **$4.3 billion** in 115 adjustments for the fiscal year ended June 30, 2021. However, also noted are an additional **$6.2 billion** in errors from items other than the formal adjustments presented below, bringing the total errors to over **$10.5 billion**. These errors would affect multiple line items, funds, and financial statements of the ACFR. The number of errors noted – not to mention their detrimental impact upon the credibility of the financial statements – is particularly concerning because an audit is performed by testing a limited number of transactions; therefore, it is reasonable to assume that additional errors went undetected. The dollar errors noted below include totals for lines necessary for the adjustment.

Type of Error	Dollar Error
GASB 84 Implementation Adjustments – See separate Comment Number 3	$ 950,249,015
Allocation Errors	$ 946,565,186
Incorrect Coding	$ 776,921,497
Improper Eliminations	$ 323,552,452
Unemployment Insurance Fund Issues – See separate Comment Number 2	$ 285,954,675
Duplicated Coronavirus Relief Funds Activity	$ 248,755,293
Capital Asset Accounting Errors – See separate Comment Number 4	$ 233,761,014
DAS Accrual Errors	$ 214,419,147
Unemployment Insurance Fund Issues by the Department of Labor	$ 103,182,097
Errors on Agency Accruals	$ 101,381,663
Beginning Balance Adjustments	$ 73,185,787
Reversing Entry Errors	$ 30,589,737
Ending Balances Not Appropriately Reflected	$ 24,058,023
Errors Made on Adjustments	$ 21,181,711
Security Incorrectly Classified	$ 9,424,258
Duplicated Entries	$ 4,295,724
Errors on Prior Year Adjustments	$ 3,204,551
Total Financial Statement Adjustments	**$ 4,350,681,830**
Total Document Preparation Errors	**$ 5,521,414,995**
Total Footnote Errors	**$ 674,872,663**
Total Errors	**$ 10,546,969,488**

Several adjustments noted above required multiple revisions before the documentation was presented accurately, causing significant time and work by the APA. We also noted several errors in workpapers that did not require adjustments because they were insignificant to the financial statements; however, they also required additional time by the APA to work through and resolve. These errors included, among numerous others, recording entries to the incorrect account code, recording duplicate entries, and not properly eliminating transfers.

During testing, we also pointed out several errors prior to when entries were made or before the audit draft report was prepared, which allowed DAS to make the needed corrections beforehand. Despite being corrected due to the APA's early notification, preventing the need for subsequent formal adjustments, those errors demonstrate further the inability of DAS to provide accurate financial information. Detail is as follows:

- Amounts reported in the Budgetary Comparison Schedules were incorrect. Errors included expenditures overstated by $4,594,046,000; $312,733,000 in transfers not eliminated; $259,064,000 in revenues categorized incorrectly; $15,066,275 not included in the schedule; $930,027 in fund misclassifications; and reconciliation errors up to $1,369,000.

- DAS had to revise these journal entries, which were used to create the government-wide financial statements, in order to rectify errors in the following amounts:

    - Construction in Progress – $149,376,000
    - Deferred Inflows – $2,730,000
    - Elimination of transfers – $592,000
    - Capital lease proceeds – $45,000

- In review of the Governmental Funds trial balance, two journal entries were incorrect, resulting in CARES revenue being overstated by $103,245,000 and expenditures of $461,000 being recorded to the wrong function.

- DAS incorrectly classified $10,088,889 of net position, which was corrected after APA inquiry. Also, during testing, we noted another three funds that were classified incorrectly for net position, totaling $29,872,977.

- DAS incorrectly recorded the component unit's capital assets and accumulated depreciation of $4,136,000 and erroneously eliminated component unit activity of $22,901,000.

- DAS had to revise the donated personal protective equipment journal entry multiple times, which resulted in an understatement of $14,638,827.

- The assigned fund balance for Licensing and Regulation was miscategorized between Conservation of Natural Resources and Other Purposes by $120,000.

- Several errors were noted in the restatements listed in the Management Discussion & Analysis.

- The Statistical Section contained multiple errors due to data entry errors and faulty formatting. A total of seven tables had to be revised, including some that required multiple revisions.

The following errors were noted in our review of the footnotes:

Footnote	Error	Reason
Deposits and Investments Portfolio	$ 519,194,423	Amounts were duplicated; the cash balance was overstated; land was understated; bank loans were erroneously removed; securities were miscategorized; and Federal deposit insurance was overstated.

Footnote	Error	Reason
Noncurrent Liabilities	$ 139,202,000	Capital lease obligation and compensated absences calculations contained errors. Medicaid claims additions and deletions were overstated, and some beginning balances were understated.
Receivables	$ 7,250,297	Amounts were understated.
Lease Commitments	$ 6,255,936	Amounts were incorrect.
Contingencies and Commitments	$ 1,800,000	Two revisions were required due to the settlement amount being understated and the need for wording clarification.
Bonds Payable	$ 578,007	Debt service requirements were missing.
Interfund Balances	$ 592,000	Balances were not updated after adjustment.
Total Errors	**$ 674,872,663**	

Additionally, we noted the following items related to the footnotes:

- Deposits and Investments Portfolio footnote errors resulted in eight versions of the initial securities table and four revisions of the footnotes – caused, in part, by the failure of DAS to update consistently all the tables used in the footnotes after each change to the initial table. Additionally, we noted that the concentration of credit risk calculation did not include 36 securities, totaling $106,235,035, and DAS did not use the correct total to calculate the percentages; however, this did not affect the final percentage used in the footnote.

- For the Receivables footnote, neither DAS nor the Department of Health and Human Services (DHHS) could provide an estimate allowance for the Third-Party Liability receivable. This allowance was approximately $6 million in the previous year.

- The Tax Abatement footnote was not updated to correct, among other things, mistaken names, inaccurate statutory references, missing information, and the improper amount.

We also noted the following procedural and control issues:

- DAS lacked procedures for ensuring that the reclassification of $14,829,558 from due to funds to due to vendor funds was appropriate.

- Two risk management payments tested did not have a secondary review by the Risk Management Division Administrator.

- DAS did not reconcile the imprest payroll liability accounts for employee and employer Social Security portions, resulting in a $943,658 variance.

- Six batches, totaling $141,621,316, were entered between March 2021 and May 2021 but remained unposted in EnterpriseOne (E1), the State's accounting system, after the fiscal year and were not followed up on in a timely manner.

- The June 30, 2021, bank reconciliation performed by DAS had several reconciling items that were incorrect or not followed up on in a timely manner, with some of those reconciling items dating back to 2012. Additionally, $104,838 in unapplied cash transactions was not reviewed and resolved. Lastly, there was no documented review of the bank reconciliation to ensure that it was accurate and complete.

- Funds in E1 are assigned an "ACFR Fund" and "ACFR Function," which DAS uses to prepare the financial statements. During our review of funds, we noted that one fund was assigned the incorrect ACFR Fund, and two funds were assigned the incorrect ACFR Function. Any of these errors could lead to inaccurate financial statements.

- DHHS inventory accounts have contained $102,776 since at least fiscal year 2018 and that amount has not changed during those years. The inventories appear to be for veterans' homes, which are no longer under DHHS. Consequently, the appropriate correction should be made in E1.

Compliance
Per Neb. Rev. Stat. § 81-1125.01 (Reissue 2014), the ACFR must be completed "at least twenty days before the commencement of each regular session of the Legislature[.]" For the fiscal year 2021 audit, the ACFR was due on December 16, 2021. In order to ensure that the ACFR would be completed timely, the APA requested a list of items to be prepared by DAS – State Accounting and submitted to the APA for testing. Of those requested items, 187 were late, with the latest being 154 days overdue. Of the late items, 173 were submitted more than seven days after the due date. The last item received was on April 27, 2022, or 132 days after the date the ACFR was due.

Agency Accruals
DAS required State agencies to report accounts receivable and accounts payable accrual items, which were not contained within E1, for inclusion in the ACFR. DAS lacked procedures, such as obtaining the necessary documentary support, for ensuring the accuracy of the accrual information submitted. As a result, DAS prepared and posted journal entries – based on inaccurate and unverified information provided by agencies – containing material errors. We noted accrual errors by the following State agencies: DHHS, Labor, Transportation, Education, Revenue, Correctional Services, and Supreme Court. Errors at these agencies totaled over $94 million. Due to the continued failure by DAS to implement sufficient corrective action, similar issues have been reported since the 2007 audit.

Good internal controls and sound business practice require the implementation of procedures, including an adequate review and verification of financial information, to ensure the proper and timely preparation of the ACFR by avoiding the reoccurrence of mistakes made in multiple prior years.

Without such procedures, there is an increased risk of not only the ACFR containing material misstatements, which might well remain undetected, but also failure to comply with the statutory timing requirement for completion of the report.

Similar findings related to errors in the preparation of the ACFR have been noted since the fiscal year 2007 audit. DAS – State Accounting did make correcting entries for all material amounts proposed by the APA. However, the number of errors to several financial statement line items and funds, as well as the significant dollar amount of those errors, both individually and collectively, demonstrate that DAS continues to lack controls for ensuring the proper and timely presentation of the financial statements. In addition to the detrimental impact of the many misstatements noted, further misrepresentation of the financial statements due to the likelihood of pervasive undetected misstatements could be material. Therefore, we have issued a disclaimer of opinion.

> We recommend DAS implement procedures, including an adequate review and verification of financial information, including any information provided by different agencies, to ensure the proper and timely preparation of the ACFR by avoiding the reoccurrence of mistakes made in multiple prior years. This includes ensuring that internally prepared information is complete, accurate, and submitted punctually to the auditors. We also recommend DAS utilize resources to work with State agency personnel to ensure accrual information is supported and has a sound accounting base.

DAS Response: key staff turnover coupled with resource demand for administering COVID-19 funding programs undermined State Accountings ability to ensure accurate and timely preparation of the ACFR. State Accounting reduced the reported error amount by 51% over the prior year. Unsatisfied with those results and the opinion received, the following steps are underway for the next reporting period: 1) A systematic budgetary report error, the cause of $5 billion of the noted $10.5 billion in errors, is being corrected, 2) A new Deputy Accounting Administrator position has been created and filled by a teammate with 20 years of State audit experience with significant knowledge of the ACFR process, 3) Conducting onsite pre-audit sessions with State agencies to review accrual calculations, 4) Meeting with key agencies and the Center of Operational Excellence to improve financial reporting where significant errors occurred, and 5) Collecting supporting documentation for agency submitted data to perform additional review procedures.

2. Unemployment Insurance Fund Issues

As noted in previous audits, DAS lacked procedures for ensuring that the Unemployment Insurance (UI) Proprietary Fund financial statements were presented accurately for the ACFR. Both DAS and the Nebraska Department of Labor (NDOL) performed entries within E1 to generate the financial statements. However, those financial statements required material adjustments, as detailed in the table below:

Description	Misstatement Amount	Reason
Duplicate Entry	$ 161,694,358	DAS recorded an entry for a $80,847,179 receivable and revenue that had already been recorded in E1. When attempting to correct this entry, DAS mistakenly recorded it again for another $80,847,179 overstatement.
Erroneous Reversing Entries	$ 98,963,658	The APA proposed adjustments in the prior year's audit, which were inappropriately reversed during FY 2021. However, $889,941 remained and was not proposed, as DAS and NDOL could not determine the correct entry.
Eliminating Transfers	$ 21,408,525	DAS and NDOL were unable to provide documentation to identify the proper accounting to recategorize transfer activity for $4,554,847 of transfers out and $2,066,880 of transfers in. DAS eliminated transfers in/out and reclassified them to benefits payable; however, we noted at least $14,786,798 that should have been recorded as a "Due to Government" and not a transfer in. These were monies received from the Federal government for Federal Emergency Relief funds that had not yet been spent by the agency. The elimination of transfers appeared appropriate; however, the reclassification was not adequately supported for the financial statements. An additional $54,914 was not proposed.
EUISAA (Emergency Unemployment Insurance Stabilization and Access Act) Revenue/Payable	$ 4,832,989	There was $704,155 that should have been recorded as a liability and not a revenue. Additionally, the $704,155 was recognized in the incorrect fund. Finally, $3,424,679 was reclassified as a liability but should have been a revenue.
Total Misstatements	**$ 286,899,530**	

Good internal controls and sound accounting practice require procedures to ensure that accounting entries are made accurately, allowing the financial statements to be reflected properly.

Without such procedures, there is an increased risk for material misstatement of the financial statements.

> We recommend DAS work closely with NDOL to implement procedures for the accurate calculating and reporting of the UI fund for the ACFR, including establishing reconciliation procedures to ensure balances and activity are reported properly at fiscal year-end.

DAS Response: State Accounting agrees with the APA's recommendation. NDOL reduced the reported error amount by 52% over the prior year. DAS is working with NDOL Financial Services to establish procedures for accurately reporting the Unemployment Insurance fund for the ACFR. Furthermore, NDOL is establishing procedures for its staff to review documentation, including the trial balance, and reconcile the separate subsystems to the accounting system to identify issues that need to be remediated. In addition, NDOL Financial Services will establish appropriate support for balances within EnterpriseOne, and adequate controls to ensure financial data was accurate and complete.

3. GASB 84 Implementation Failure

The State was required to implement Governmental Accounting Standards Board Statement No. 84 (GASB 84) by the end of State fiscal year 2021. The Statement provides guidance regarding the identification of fiduciary activities for accounting and financial reporting purposes and how those activities should be reported. The APA inquired several times regarding the procedures that DAS had performed to implement GASB 84. Finally, in January 2022, by which time the ACFR should have already been completed per State statute, the APA and DAS held discussions regarding GASB 84. At that time, it was determined that DAS did not implement GASB 84 correctly, leading to several errors in the presentation of the financial statements. DAS had not analyzed activity or balances contained within previously categorized agency funds found in E1 for compliance with GASB 84. The slow and flawed implementation of GASB 84 contributed to significant adjustments and, ultimately, the delayed issuance of the ACFR.

After the APA's inquiry, DAS made 14 entries, totaling $2,292,000,000, to reclassify several E1 funds to ensure they were reported properly in the fiduciary statements. These entries (which are not included in Comment Number 1) were needed because funds were erroneously categorized as private purpose trust funds and governmental funds but should have been custodial; funds were incorrectly identified as fiduciary but should have been special revenue; transfers in/out were not analyzed; and one fund was not identified appropriately as an investment trust fund. During testing of those 14 journal entries, we noted that four were improper. The APA proposed correcting entries for those errors, as well as additional adjustments, totaling $950 million, after further review of funds. These adjustments are in addition to the $2.3 billion of entries that DAS made after discussion of the GASB 84 implementation with the APA. Details of the adjustments are provided below:

Adjustments	Reason
$ 354,255,897	DAS did not properly reflect additions/deductions for funds and made one of the adjustments erroneously. Additionally, liabilities were recorded incorrectly.
$ 211,600,684	DAS initially recorded both outside trust funds and court activity incorrectly and failed to implement GASB 84, which led to numerous errors.
$ 152,648,834	Corrections were made to the accounting for $55,594,860 that the State received in advanced Federal funding for local governments, which should have been reflected as custodial funds.
$ 110,970,592	One fund needed to be classified as Special Revenue instead of Fiduciary. Additionally, investment income and liabilities were not categorized correctly. Several errors were noted when moving three funds to Special Revenue, as DAS did not properly analyze the activity.
$ 74,422,632	Investment activity for contributions and withdrawals was not recorded properly and the wrong liability account was used.
$ 33,360,248	The APA identified 11 funds in E1 that needed to be reclassified from Fiduciary to Special Revenue funds. Additionally, DAS corrected a previous journal entry that needed revision after implementation of GASB 84.
$ 8,936,183	The incorrect liability account was shown for one fund.
$ 1,791,152	Payables were not stated correctly, and the adjusting entry was made to the wrong custodial fund.
$ 1,002,893	A previous adjustment was corrected.
$ 677,625	A previous adjustment, which had erroneously reclassified activity, was corrected.
$ 582,275	A negative addition should have been shown as a distribution.
$ 950,249,015	**Total Misstatements**

Additionally, as noted, DAS did not perform procedures to implement GASB 84 until January 2022, after the due date for the ACFR and after nearly all procedures had been performed and tested by the APA. The APA would have needed to perform all procedures again to determine if there were any significant or material effects of previously posted entries based on the updated trial balances after review of the fiduciary funds. DAS did not provide adequate support for the APA to determine whether DAS had performed such a review process. This contributed to the modification of the opinion.

When new standards are not implemented correctly and timely, there is a significant increase in risk of material misstatement to the financial statements.

> We recommend DAS implement procedures, including a thorough review of the accounting standard and the financial statement processes, to ensure that GASB statements are implemented timely and properly.

DAS Response: Key staff turnover attributed to the issues experienced in implementing GASB 84. Accounting system updates are being implemented to properly align Custodial Fund activity, and Investment Trust Fund financials for GASB 84 reporting. The ACFR fund designation has been updated for all affected funds in the accounting system.

4. <u>Capital Asset Accounting Errors</u>

For the past seven years, DAS has failed to perform adequate procedures to ensure that capital assets were recorded properly on the financial statements. The APA began reporting this issue in the 2015 audit. This year, it was noted that the ending balances of the capital assets had errors of at least $203 million.

DAS compiled information from E1 and requested State agencies to report accrual items, which were not contained therein, for inclusion in the ACFR. The APA's review of the accrual items reported revealed numerous clerical errors, amounts that did not agree to E1 reports or support, and additions, deletions, beginning balances, and depreciations not accounted for correctly. These errors necessitated revisions to amounts included in capital asset-related items on the financial statements and their footnotes.
The table below details total Construction in Progress (CIP) adjustments required due to the errors found by the APA:

	Beginning Balance	Additions	Deductions, Including Completed CIP	Ending Balance
Initially Reported by DAS	$ 211,282,564	$ 158,017,695	$ 53,477,129	$ 317,519,251
Final After Adjusted by APA	$ 204,058,085	$ 339,411,139	$ 41,747,840	$ 501,721,384
Misstatement	**$ (7,224,479)**	**$ 181,393,444**	**$ (11,729,289)**	**$ 185,898,254***

*This number is the calculation of misstatements and not the difference between ending balances, as DAS spreadsheets contained formula errors.

DAS did not complete the CIP calculation correctly, as there was one beginning balance for $3,092,812, 13 beginning balance adjustments for $10,317,291, and 14 additions, totaling $19,492,813, that did not agree to support. Additionally, there was $157,425,949 in retainage that was not included, and a spreadsheet error that caused $4,474,682 to be omitted. Finally, there were 11 deletions/transfers, totaling $11,729,289, that were not removed properly.

Additionally, DAS duplicated $4,875,460 in retainage, failed to include $10,983,751 in retainage, and had $793,010 in discrepancies between spreadsheet versions, which is not shown in the chart above.

These errors were caused by DAS <u>NOT</u> doing the following:

- Including amounts in CIP that agencies had reported on their accrual response forms.
- Accounting appropriately for prior year transactions.
- Including retainage on its spreadsheet.
- Comparing a general ledger detail of CIP accounts in E1 to amounts that agencies recorded on their accrual response forms.

- Removing assets, including its own, even when agencies had reported them as being complete.
- Recording duplicate retainage in its entry.

The following table details the errors noted in other DAS calculations:

	Beginning Balance	Additions	Ending Balance	Ending Balance
Buildings		*Capital Asset*		*Accumulated Depreciation*
Initial Calculation	$ 851,242,766	$ 7,486,153	$ 845,652,783	$ 384,098,838
Final Calculation	$ 853,586,539	$ 7,486,153	$ 847,996,556	$ 382,774,826
Total Errors	**$ (2,343,773)**	**$ -**	**$ (2,343,773)**	**$ 1,324,012**
Equipment		*Capital Asset*		*Accumulated Depreciation*
Initial Calculation	$ 530,883,655	$ 35,281,986	$ 548,415,032	$ 408,149,777
Final Calculation	$ 519,314,708	$ 35,281,986	$ 536,846,085	$ 405,488,627
Total Errors	**$ 11,568,947**	**$ -**	**$ 11,568,947**	**$ 2,661,150**
Equipment-Internal Services-Office of CIO		*Capital Asset*		*Accumulated Depreciation*
Initial Calculation	$ 22,401,021	$ 91,996	$ 21,214,575	$ 20,376,557
Final Calculation	$ 22,077,578	$ 91,996	$ 20,891,132	$ 20,152,066
Total Errors	**$ 323,443**	**$ -**	**$ 323,443**	**$ 224,491**
Equipment-Internal Services-Other Services		*Capital Asset*		*Accumulated Depreciation*
Initial Calculation	$ 306,415	$ 22,957	$ 329,372	$ 438,900
Final Calculation	$ 438,900	$ -	$ 438,900	$ 329,372
Total Errors	**$ (132,485)**	**$ 22,957**	**$ (109,528)**	**$ 109,528**
Equipment-Correctional Services		*Capital Asset*		*Accumulated Depreciation*
Initial Calculation	$ 5,969,104	$ 917,031	$ 6,790,048	$ 5,227,782
Final Calculation	$ 6,007,484	$ 878,651	$ 6,790,048	$ 5,227,782
Total Errors	**$ (38,380)**	**$ 38,380**	**$ -**	**$ -**
Infrastructure		*Capital Asset*		*Accumulated Depreciation*
Initial Calculation	$ 7,763,489,228	$ 51,487,187	$ 7,814,976,415	$ 472,709
Final Calculation	$ 7,766,521,733	$ 51,487,187	$ 7,818,008,920	$ 666,187
Total Errors	**$ (3,032,505)**	**$ -**	**$ (3,032,505)**	**$ (193,478)**

The following information explains the errors detailed in the above table.

- The errors for "Buildings" were due to erroneous beginning balance adjustments caused by the following: 1) three assets, totaling $8,604,433, that were shown incorrectly as equipment and excluded from buildings; 2) two buildings, totaling $4,535,191, that were included in buildings but were owned by the Federal government and were not State assets; and 3) one asset, costing $1,725,469, that was incorrectly included as a building but should have been included as infrastructure. These errors, when combined with an accumulated depreciation beginning fund balance of $1,162,047, caused variances in the ending balance for accumulated depreciation.

- The beginning and ending balance differences for "Equipment" were due to erroneous beginning balance adjustments caused by the following: 1) three assets, totaling $8,604,433, that were incorrectly shown as equipment but should have been included in buildings; 2) two assets, totaling $1,960,024, that were incorrectly shown as equipment but should have been shown as infrastructure; 3) one software item, costing $1,860,047, that was never completed and was not an asset; 4) two assets, totaling $881,310, that were acquired in prior fiscal years and not included; and 5) two assets, totaling $25,753, that were included twice.

- The errors listed under "Equipment-Internal Services-Office of CIO" were due to DAS double counting $323,443 in assets and $224,491 in accumulated depreciation.

- The errors for "Equipment-Internal Services-Other Services" were due to DAS incorrectly switching the beginning balance for capital assets and accumulated depreciation for a difference of $132,485. Additionally, DAS reported accumulated depreciation of $22,957 as a capital asset addition instead of an addition to accumulated depreciation.

- The errors for "Equipment-Correctional Services" were due to $38,380 that was included as an addition when it should have been a beginning balance adjustment.

- The errors for "Infrastructure" were due to the following: 1) one asset, costing $1,725,469, that was incorrectly included as a building but should have been infrastructure; 2) two assets, totaling $1,960,024, that were incorrectly shown as equipment but should have been shown as infrastructure; 3) one asset, valued at $1,836,223, that was not included on any schedule but should have been included in infrastructure; and 4) beginning balance adjustments that were overstated for the Nebraska Department of Transportation, totaling $2,489,211. There was also a $95,476 error in accumulated depreciation beginning fund balance.

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

- In the footnotes, DAS misstated State construction commitments by $5,321,904 and Federal construction commitments by $375,316.

- Accumulated depreciation for Enterprise funds was not updated from fiscal year 2020, and fixed asset deletions were incorrectly added due to a formula error, causing the ending balance to be overstated by $4,298.

- The capital asset footnote amounts were incorrect and initially could not be traced to supporting documentation, requiring two revisions.

- Two of the four journal entries prepared by DAS to record government-wide capital asset activity were incorrect and required revisions. DAS did not record those expenditures, totaling $8,433,789, by the correct functions.

- DAS did not have a capitalization policy for improvements to land. A similar finding was reported in the previous two audits. In order for agencies to record improvements properly, a statewide policy is necessary for uniformity of financial reporting.

- A geothermal well field project was recorded as operating expenses during its construction and not included on DAS's CIP worksheet. The total project cost was $672,871 and was not capitalized by DAS until after the APA inquired about it.

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 the continued occurrence of the same type of material misstatements that have been identified during the past seven audits.

> We recommend DAS implement procedures to resolve this repeated audit finding by ensuring for itself that capital asset activity is accurate and complete, not relying on the APA's examination to identify and correct errors.

DAS Response: State Accounting reduced the dollar amount of reported errors by 26% over the prior year. The preponderance of the issue, in terms of dollars, relates to retainage and is being addressed with State agencies. State Accounting continues to educate agencies on the importance of recording CIP correctly and capitalizing assets when they are substantially completed. Additional supporting documentation will be requested with agency accrual responses for additional evaluation of capital assets that will lead to improved accuracy of reported amounts.

5. NOMI Contract Matters

On April 21, 2020, the State of Nebraska contracted with Nomi Health (Nomi) to provide a statewide web platform to assist with COVID-19 test scheduling and test kits. Because Nebraska was in a state of emergency at the time, competitive bidding for the contract was not required. Nevertheless, we noted the following issues with both the deliverables and the consistency of documentation associated with the contract.

- The contract with Nomi stated that 1,200,000 test kits were to be received; however, based on available documentation, there was support for the receipt of only 803,240 test kits. DAS did provide a list showing that a total of 1,230,000 test kits were received; however, this listing was not able to be traced to supporting documentation, such as packing slips or inbound receipts. This lack of documentation leads us to question the receipt of 396,760 test kits. The State paid between $25 and $32.50 per test kit, meaning that questioned costs range from $9,919,000 to $12,894,700. Additionally, we were unable to verify that all tests were received by the required dates outlined in the contract.
- A second amendment to the contract, dated October 15, 2020, required the State to pay Nomi for "services its asked to provide associated with the collection sites." Those payments, totaling $2,921,671, were largely retroactive, however, being for services that had been performed already from April 2020 to October 2020.

- Furthermore, the second amendment did not contain clear language to support that the amounts the State was going to pay Nomi would include additional management and service fees. Regardless, those unspecified charges appeared on every direct invoice received by the State during the five months tested. Consequently, during that five-month period, the State paid Nomi $3,489,063 in direct costs and an additional $548,231 for management and service fees.

Agreements by the State or local governments to make retroactive payments are often problematic, if for no other reason than they risk running afoul of Article III, § 19, of the Nebraska Constitution. That constitutional provision prohibits such public entities from making extra payments for past services, as follows:

> *The Legislature shall never grant any extra compensation to any public officer, agent, or servant after the services have been rendered nor to any contractor after the contract has been entered into, except that retirement benefits of retired public officers and employees may be adjusted to reflect changes in the cost of living and wage levels that have occurred subsequent to the date of retirement.*

According to the Nebraska Supreme Court, a payment violates Article III, § 19, "whenever there is no legal obligation to pay such compensation." *Myers v. Nebraska Equal Opportunity Com'n*, 255 Neb. 156, 163, 582 N.W.2d 362, 367 (1998) (quoting *Matter of Mullane v. McKenzie*, 269 N.Y. 369, 377, 199 N.E. 624, 627 (1936)).

The Attorney General has shed additional light on the prohibition in Article III, § 19, as follows:

> *As we stated in Op. Att'y Gen. No. 94064 (August 22, 1994), the purpose of state constitutional provisions such as Art. III, § 19 which prohibit extra compensation to public employees after services are rendered is to prevent payments in the nature of gratuities for past services.*

Att'y Gen. No. 95063 (Aug. 9, 1995). In determining whether a violation of Article III, § 19, has occurred, the Court has emphasized the importance of timing in the decision to pay the compensation at issue:

> *We have said that when the "services" for which compensation is granted are rendered prior to the date on which the terms of compensation are determined, the "benefits awarded are not compensation but are a gratuity." See Wilson v. Marsh, 162 Neb. 237, 252, 75 N.W.2d 723, 732 (1956). It follows that when the "services" for which compensation is paid are rendered after the date on which the terms of compensation are established, the benefits awarded are not a gratuity.*

City of Omaha v. City of Elkhorn, 276 Neb. 70, 83, 752 N.W.2d 137, 147 (2008). Clearly, after-the-fact agreements to pay for services already provided tend to be constitutionally suspect.

A good internal control plan and sound business practices require all State contracts, including those entered into during a state of emergency, to be monitored closely to ensure that deliverables are received and agreement provisions are followed. When practicable, such compliance should be supported with the appropriate documentation, including packing slips and inbound receipts, etc. Furthermore, contractual language should be clear and unambiguous, setting out precisely the future services to be performed and the exact amount to be paid for such prospective performance.

Failure to provide for the tracking and documentation of deliverables received pursuant to a contract or to ensure that agreement provisions are stated clearly and unambiguously increases the risk for loss or misuse of funds, as do commitments to make retroactive payments for service already performed.

> We recommend DAS establish procedures for ensuring the following: 1) deliverables from contracts are accurately tracked and documented; 2) all contractual provisions are stated clearly and unambiguously; and 3) agreements to pay for services are negotiated and entered into prior to the performance of such services.

DAS Response: The Department of Administrative Services provided the auditor with Nomi Health, Inc. records to support that all test kits required under the contract were shipped. DAS' own records indicate that there was a lack of packing slip documentation maintained during the pandemic, particularly in the early months of June, July, and August 2020, however, such test kits were received. Records of the Department of Health and Human Services (DHHS) show that tests were administered at TestNebraska sites in these months.

According to DHHS electronic lab records, a minimum of 789,400 tests were performed. A count of warehouse inventory accounts for an additional 206,500 test kits, providing support for receipt of at least 995,900 test kits. Nomi Health, Inc. provided documentation supporting over 1.2 million test kits, and the contract was fulfilled.

DAS Standard operating procedure requires accurate tracking of received goods. DAS communicated documentation procedures and expectations to the teams receiving the test kits, which included direction to fill out a form, which resolved the documentation issue, detailing receiving information for such orders. DAS will ensure that such performance issue will not occur again in the next pandemic.

Although best practice is to reduce agreements into a writing, there was no violation of the Nebraska Constitution, specifically Article III, § 19. It is well established in law that a writing is not always necessary to legally obligate a party's performance:

> *A binding mutual understanding or meeting of the minds sufficient to establish a contract requires no precise formality or express utterance from the parties about the details of the proposed agreement; it may be implied from the parties' conduct and the surrounding circumstances. Linscott v. Shasteen, 288 Neb. 276, 847 N.W.2d 283 (2014).*

The conduct and surrounding circumstances between April and October 2020, illustrate that the services outlined in Amendment Two (temporary structures, medical professional labor, call center services, security officer personnel, biohazard material removal, and portable bathrooms) were actually provided by the contractor to the State despite not being required by the original contract, which only required the provision of test kits, lab *equipment, and technology associated with testing. When the State accepted and utilized these essential services in responding to the pandemic, the State became legally responsible to compensate the contractor for such costs, whether pursuant to an oral contract, implied contract, or quasi-contract. It does not stand to reason that DAS was not already legally obligated to pay the contractor prior to Amendment Two or that DAS paid the contractor extra compensation for services already received in contravention of the Nebraska constitution when the original contract did not require the services that were actually received by the State.*

DAS agrees that it is a best practice that the agreement of the parties should be reduced to writing to avoid misunderstandings between the parties. Fortunately, in this particular case, there were no misunderstandings or disagreements between the parties, including over the language that the APA identifies as ambiguous. A court would not engage in an ambiguity analysis unless there was such a misunderstanding or disagreement. DAS has procedures in place to ensure that deliverables are accurately tracked and documented, contracts are stated clearly, and agreements are put into writing before payment becomes due. In this circumstance, there were gaps in performance in following these procedures under the stress of a global emergency. DAS will strive to ensure that such gaps do not occur.

6. <u>Lack of Financial Statement Reconciliation</u>

Similar to previous years, DAS failed to reconcile the Schedule of Expenditures of Federal Awards (SEFA) to the financial statements. Expenditures of $4.8 billion were recorded to the Federal fund in the financial statements for the fiscal year ended June 30, 2021, and SEFA expenditures for the fiscal year were $5.9 billion. There are reasons for the differences; however, it is important to reconcile the financial statements to the SEFA to ensure that both are materially accurate. The Summary Schedule of Prior Audit Findings lists the status as complete.

Title 2 CFR § 200.511(a) (January 1, 2021) requires the auditee to prepare a summary schedule of prior audit findings. Per subsection (b)(2) of that same regulation, "When audit findings were not corrected or were only partially corrected, the summary schedule must describe the reasons for the finding's recurrence and planned corrective action, and any partial corrective action taken."

Good internal controls require procedures for reconciling the SEFA to the financial statements to ensure that the SEFA and financial statements are complete and accurate.

Without such procedures, there is an increased risk of the SEFA or the financial statements being inaccurate and those inaccuracies going undetected.

A similar finding was noted in the previous two audits.

> We continue to recommend DAS implement procedures for reconciling the SEFA to the financial statements.

DAS Response: The financial statements and SEFA are both generated from the State's accounting system (E1). The expected differences noted by the APA are reconciling items due to the different basis of accounting. The financial statements are on an accrual basis and the SEFA is on a cash basis. DAS performed a reconciliation for the previous year's reports and noted no issues with the financial statements. This year's reconciliation was performed by the APA and no additional issues or adjustments were necessary for the financial statements as they materially agreed to the SEFA.

7. <u>Postage Deposits</u>

As noted in the previous audit, DAS failed to ensure that the amount of postage deposits held for each agency complies with the requirements of State statute. As of June 30, 2021, a total of $668,982 in postage deposits was recorded in E1.

Neb. Rev. Stat. § 81-167 (Reissue 2014) states the following:

> *Each state officer, department, commission, board, bureau, court or other agency, occupying quarters in the Capitol Building or any state building which may hereafter be located adjacent thereto, shall advance to the materiel division of the Department of Administrative Services, a sum estimated to be sufficient to cover his, her or its postage for at least one month but never to exceed two months' average use as determined by the materiel division. On the first day of each month, the materiel division shall send a statement to each state officer, department, commission, board, bureau, court or other agency of their mailings during the month, and each state officer, department, commission, board, bureau, court or other agency shall remit by warrant to the materiel division the amount of such statement. No overdrafts shall be permitted. If the original amount advanced to the materiel division for postage is not sufficient to cover the postage, additional advances shall be made by the respective state officer, department, commission, board, bureau, court or other agency.*

(Emphasis added.) DAS lacked a formal process for reviewing postage deposits to ensure compliance with the above statute.

To start, DAS performed a partial review of the postage deposits in 2017, relying upon only the January and February 2017 postage billings for comparison. During that review, DAS used the two-month **total** and compared it to the postage balances on hand. However, § 81-167 requires the postage balance to be no more than a two months' **average** usage on hand.

Furthermore, numerous agencies have had the same postage balances for over 15 years. DAS did not perform a calculation to determine the average monthly balance by agency, nor did it analyze postage over an extended period to ensure that the 2017 review was reasonable. Several agencies perform renewals biannually, and reviewing only a two-month period may under- or overstate the analysis. After the 2017 review, DAS made no changes to agency balances, even though – per its own flawed analysis – some agencies had variances of up to approximately $181,000.

Good internal controls require procedures to ensure that agency postage deposits are made as required by § 81-167, and those balances are reviewed periodically.

Without such procedures, there is an increased risk of not only excessive or insufficient postage deposits but also noncompliance with State statute.

> We recommend DAS implement procedures to ensure agency postage deposits comply with State statute and are subject to periodic review. Any excess deposit monies should be returned to the appropriate funds.

DAS Response: Legislative Bill 1012 was approved by the Governor on April 4, 2022. The bill outright repealed Neb. Rev. Stat. § 81-167. The deposits of $668,982 will be returned to each respective agency.

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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 DAS 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 DAS.

This communication is intended solely for the information and use of management, the Governor and State Legislature, others within DAS, Federal awarding agencies, pass-through entities, and management of the State of Nebraska and is not suitable for any other purposes. However, this communication is a matter of public record, and its distribution is not limited.

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