NEBRASKA AUDITOR OF PUBLIC ACCOUNTS

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December 13, 2023

Brian Maher, Commissioner
Nebraska Department of Education
P.O. Box 94987
Lincoln, Nebraska 68509

Dear Dr. Maher:

We have audited the financial statements of the governmental activities, the business-type activities, the aggregate discretely presented component units, each major fund, and the aggregate remaining fund information of the State of Nebraska (State), as of and for the year ended June 30, 2023, 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 December 13, 2023. 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 Department of Education (Department) or other operational matters that are presented below for your consideration. These comments and recommendations, which have been discussed with the appropriate members of the Department'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 a certain deficiency in internal control that we consider to be a significant deficiency.

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 did not identify any deficiencies in internal control that we consider 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 1 (Incorrect Accounts Payable) to be a significant deficiency.

This comment 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 the Department, pursuant to American Institute of Certified Public Accounts (AICPA) Auditing Standards AU-C Section 265.17, in a separate early communication letter dated September 8, 2023.

Draft copies of this letter were furnished to the Department to provide management with an opportunity to review and to respond to the comments and recommendations contained herein. All formal responses received have been incorporated into this letter. The responses were not subjected to the other auditing procedures applied in the engagement to audit the financial statements and, 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, 2023.

1. <u>Incorrect Accounts Payable</u>

All agencies report accounts payables on an accrual response form submitted to the Department of Administrative Services – State Accounting (State Accounting). The Department's process involves the calculation of an original payable amount at fiscal year-end for its various programs, which is then reduced after the review of payments processed after the fiscal year that were identified as current fiscal year activity.

The Auditor of Public Accounts (APA) found an error in the Department's calculation of a program payable that required an adjustment to the State's financial statements. The table below describes the error.

Description	Fund	Original Amount	Corrected Amount	Variance
Special Education State Aid Program Payable	General Fund	$18,159,257	$22,233,257	$4,074,000

The $4,070,000 error occurred due to a data entry error in the Department's spreadsheet used to calculate the payable. One of the figures used to reduce the original payable, was incorrectly entered into the spreadsheet. An adjustment was proposed by the APA and recorded by State Accounting to ensure the State's financial statements were materially correct.

A proper system of internal controls requires procedures to ensure that accurate accrual activity is reported to State Accounting at year end. Without such procedures, there is an increased risk of material misstatement of the State's financial statements.

> We recommend the Department implement procedures to ensure that accrual activity at year end is accurately reported to State Accounting.

Department Response: The current process for completing the ACFR is a manual process that has resulted in calculation and transposition errors. The Assistant Administrator for Budget & Grants Management and the Director of Central Accounting are reviewing the process and will implement a new process to automate the calculations. The budget management specialists will complete the ACFR utilizing the new procedures and submit the completed report to the Director of Central Accounting for review. Once the Director signs off and approves the report the Assistant Administrator will provide a final review and submit the report to State Accounting. The new process will be documented and in place by July 1, 2024.

2. <u>Other Accounting Errors</u>

The APA noted additional accounting errors on either the Department's calculation of the payables or in the State accounting system that did not require adjustments to the financial statements but are being reported due to the number of errors uncovered. Those errors are described in more detail below:

Description	Original Amount	Correct Amount	Variance
Incorrect Recording of Prior Year Expenses: The State's accounting system allows agencies to identify payments for the prior fiscal year by entering a specific code. The Department incorrectly recorded a $487,125 expense as a prior-period expenditure for fiscal year 2022 using this code; however, the invoice was dated November 30, 2022, making it a fiscal year 2023 expense.	$ -	$487,125	($487,125)
Expanded Learning Opportunity Grant Payable: The APA found an error in the Department's calculation of the payable for this grant. In its spreadsheet used to calculate the payable, an incorrect percentage was used that understated the payable by $104,309.	$414,066	$518,375	($104,039)
Discretionary Projects: The Department reported approximately $3.9 million in payables for the Federal portion of its discretionary project grant obligations – those projects handled through manual applications and payments not made through its Grants Management System (GMS). During testing of 10 grant obligations, the APA determined that two payable amounts were incorrect. Both errors occurred due to data entry errors in the Department's spreadsheet to estimate the accounts payable. One amount was incorrect because of an inaccurate entry of the current year expenses for the grant, which caused the payable to be overstated by $67,887. The second amount was overstated by $27,000 because of the use of an incorrect grant period.	$175,244	$107,357	$67,887
	$106,399	$79,399	$27,000
Individuals with Disabilities in Education Act (IDEA) Payables: The Department reported over $47 million in Federal payables related to IDEA projects recorded in (GMS), which is a web-based system used to process/approve grant applications, budgets, and payments. The APA found that Department staff transposed an amount in its calculation of the IDEA projects, resulting in an overstatement of the payable.	$47,632,742	$47,614,742	$18,000

A proper system of internal control requires procedures to ensure accurate accrual amounts are both reported on the accrual response forms submitted to State Accounting and recorded in the State accounting system. Without such procedures, there is an increased risk for material misstatements of the financial statements.

Most of the errors included above were caused by inaccurate information recorded by Department staff.

> We recommend the Department implement procedures to ensure the accuracy of amounts recorded both on the accrual response forms and in the State accounting system. This includes additional review of the information prior to submission.

Department Response: The current process for completing the ACFR is a manual process that has resulted in calculation and transposition errors. The Assistant Administrator for Budget & Grants Management and the Director of Central Accounting are reviewing the process and will implement a new process to automate the calculations. The budget management specialists will complete the ACFR utilizing the new procedures and submit the completed report to the Director of Central Accounting for review. Once the Director signs off and approves the report the Assistant Administrator will provide a final review and submit the report to State Accounting. The new process will be documented and in place by July 1, 2024.

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

The Department has a contract with Slalom, Inc., for the development and implementation of a cross-agency Early Childhood Integrated Data System (EDICS) with the Nebraska Department of Health and Human Services. The State accounting system has a set of accounts that are to be used for information technology (IT) projects in progress but not completed. The Department failed to record $1,559,475 in expenses for this project to the proper IT projects in progress account codes during fiscal year 2023. Instead, the Department recorded the expenses as operating expenses.

The Department failed not only to record the expenses properly in the accounting system but also to report the ongoing project to State Accounting as part of the year-end financial reporting process. Each year, State Accounting provides agencies with a financial reporting package that includes various spreadsheets and other documents for agencies to submit for their financial activities. By not reporting this project, the Department understated both the Construction in Progress projects by $1,559,475 and the remaining contract amount of $554,445, which is reported as Construction Commitments and is required to be disclosed in the footnotes to the State's Annual Comprehensive Financial Report.

The APA proposed and State Accounting posted an adjustment to report the amounts properly in the State's financial statements and footnotes.

The State Accounting Manual, AM-005, General Policies, Section 28 ("Capital Outlay"), states the following, as is relevant:

> *Computer software that is internally developed, or commercially available software that is modified using more than minimal incremental effort before being put into operation, shall be capitalized as a separate asset if the cost is $100,000 or more and has a life greater than one year. During the application development stage . . . the costs should be accumulated in object account 587550 – IT Projects in Progress. Once the project is complete the costs are moved to 583720 or 583770 – COTS Development or Customized Development.*

A proper system of internal controls requires procedures to ensure expenses are recorded appropriately in the accounting system, and the year-end financial reporting package is returned accurately to State Accounting. Without such procedures, there is an increased risk for material misstatement of the financial statements.

> We recommend the Department implement procedures to ensure that expenses are recorded properly in the State accounting system, and the year-end financial reporting package provided to State Accounting is complete and accurate.

Department Response: The NDE will review process and procedure which identifies contracts created to develop computer software that is internally developed or purchasing commercially available software that is to be modified using more than minimal incremental effort before being placed into operation. The revised process includes the contract originator contacting both the Department's Budget and Central Accounting office's for the appropriate object code(s) to be utilized for proper capital asset expense recording and year-end State Accounting reporting. The Department notes that the sample contract tested with Salalom, Inc. was not recorded under a capital asset object code as the asset was not fully developed or placed into operation. This process will begin immediately on all software projects meeting this requirement regardless of if they are implemented or not.

4. Inadequate Supporting Documentation

The Department failed to perform fiscal monitoring of Lexington Public Schools for the 21st Century Community Learning Centers grant by obtaining documentation to support that payroll costs claimed in a reimbursement request were allowable.

The APA tested a $183,825 payment in January 2023 to Lexington Public Schools. A breakdown of the payment is shown below:

School	Total Payment	Payroll Expenses	% of Total
Lexington Public Schools	$183,825	$180,258	98.06%

The Department performed a desk review at the time of reimbursement, where staff compared the amount claimed to the school-provided accounting records and payroll reports with employee names. The Department's policy then requires further fiscal monitoring on at least a three-year rotation basis for all school districts. As part of this process, a more detailed review of time and effort documentation is completed. However, according to Department staff, fiscal monitoring was scheduled for October 2022; but school district staff stated the timing would not work for them. The Department began their review in December 2022, but it had not yet been completed – more than a year later – due to a lack of responsiveness from the school district.

Fiscal monitoring of Lexington Public Schools was last performed in fiscal year 2020.

A proper system of internal control includes procedures to ensure the Department's fiscal monitoring policies are followed. Without such procedures, there is an increased risk for the payment of unallowable Federal expenses.

> We recommend the Department strengthen its procedures to ensure fiscal monitoring is completed in accordance with Departmental policies, including at least once for every three-year period.

Department Response: Fiscal monitoring of Lexington Public Schools was being performed in 2023 but was not completed as of the time of the ACFR audit. Lexington Public Schools provided reasonable time and effort documentation to support the payroll expenses once requested. The Department will implement procedures to ensure school districts respond to inquiries and requests for documentation within a reasonable timeframe to complete fiscal monitoring in a timely manner.

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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.

The purpose of this letter is solely to describe the scope of our testing of internal control over financial reporting and compliance and the result of that testing, and not to provide an opinion on the effectiveness of the State of Nebraska's internal control over financial reporting or on compliance. This letter is an integral part of an audit performed in accordance with *Government Auditing Standards* in considering the State of Nebraska's internal control over financial reporting and compliance. Accordingly, this communication is not suitable for any other purposes.

Kris Kucera

Kris Kucera, CPA, CFE
Assistant Deputy Auditor