NEBRASKA AUDITOR OF PUBLIC ACCOUNTS

Mike Foley
State Auditor

Mike.Foley@nebraska.gov
PO Box 98917
State Capitol, Suite 2303
Lincoln, Nebraska 68509
402-471-2111, FAX 402-471-3301
auditors.nebraska.gov

December 13, 2023

Major General Craig Strong, Adjutant General
Nebraska Military Department
2433 NW 24th Street
Lincoln, Nebraska 68524

Dear Major General Strong:

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 Nebraska Military Department (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 management, are 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. 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.

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, we identified a certain deficiency in internal control, Comment Number 1 (Accounting Errors), that we consider 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 Department to provide management with an opportunity to review and to respond to the comments and recommendations contained herein. Where no response had been included, the Department declined to respond.

The following are our comments and recommendations for the year ended June 30, 2023.

1. <u>Accounting Errors</u>

The Department is responsible for the accurate recording of financial transactions in the State's accounting system. The Department of Administrative Services – State Accounting Division (State Accounting) prepared accrual entries for the Annual Comprehensive Financial Report (ACFR) based on the information recorded in the accounting system. The Auditor of Public Accounts (APA) reviewed transactions to ensure the proper presentation of the financial statements, including determining whether the entries were recorded in the proper fiscal year.

During testing of the Department's accrued accounts payable, the Nebraska Emergency Management Agency (NEMA) provided the following email response on October 31, 2023:

> *Please see the attached policy (POL-02-033 Finance Process for Prior Year versus Current year Payments), NEMA determines whether the payment is a P9 or a PV based when the FEMA and NEMA reviews are completed and the documentation is [sic] verified and validated. <u>It is not until this time that it becomes an obligation to the state.</u>*

(Emphasis added.) Raising some concerns with the APA, the above message precipitated discussions with State Accounting regarding whether the Department was recording transactions in the proper fiscal year. Those discussions resulted in the agreement that guidance from the Governmental Accounting Standards Board (GASB) requires the recognition of a payable when reimbursement eligibility requirements are met, not when the costs have been submitted for reimbursement and reviewed and validated.

Because our concerns pertained to the Department's procedures for recording expenses in the proper fiscal year, State Accounting asked the Department whether certain other payments should also be considered prior period expenses. The following transactions were found to be recorded to the wrong fiscal year:

Description of Errors	Amount
Several transactions processed by the Department from October 2022 to June 2023 were recorded as fiscal year 2023 activity, but the transactions were for prior to fiscal year 2023. Therefore, the APA proposed, and State Accounting recorded, an adjustment to correct the Federal Fund activity.	$ 35,094,054
Several transactions processed by the Department from July 2023 to September 2023 were recorded as fiscal year 2024 transactions, but the transactions were for prior to fiscal year 2023. Therefore, the APA proposed, and State Accounting recorded, an adjustment to correct the Federal Fund activity.	$ 17,075,920
Two entries for the reimbursement of expenditures from the Federal Emergency Management Agency (FEMA) and related to the COVID-19 pandemic were not properly recorded in the accounting system. The entries were recorded as fiscal year 2023 activity but were related to fiscal year 2022 activities. The APA proposed, and State Accounting recorded, adjustments of $13,837,681 to the Other Special Revenue Fund and $1,217,780 to the General Fund.	$ 13,837,681 $ 1,217,780
Several transactions processed by the Department from July 2023 to September 2023 were recorded as fiscal year 2024 transactions, but the transactions were for fiscal year 2023. Therefore, the APA proposed, and State Accounting recorded, an adjustment to correct the Federal Fund activity.	$ 1,626,674
One transaction processed by the Department in October 2023 was recorded as a fiscal year 2024 transaction, but it was for a fiscal year 2023 transaction and payable to another State agency. Therefore, the APA proposed, and State Accounting recorded, an adjustment to correct the Federal Fund activity.	$ 351,900

A proper system of internal control requires policies and procedures to ensure transactions are recorded in the proper fiscal year to allow for the accurate presentation of the State's financial statements. Without such procedures, there is an increased risk for a material misstatement of the State's financial statements.

> We recommend the Department review its procedures for recording payments to the proper fiscal year to ensure the accurate presentation of the State's financial statements. If any questions arise, the Department should consult with State Accounting for the proper resolution thereof.

2. Capital Asset Errors

The Department is responsible for recording information regarding capital assets into the State accounting system, as well as reporting construction in progress (CIP) and other capital asset-related information to the Department of Administrative Services – State Accounting Division (State Accounting) for proper financial statement and footnote presentation.

The APA found errors in the capital asset information reported by the Department. Specifically, we noted the following:

Description of Error	Amount
The Department inappropriately recorded two capital assets in the accounting system. Neither asset is owned by the State and should not have been listed as capital assets. These were Federally owned buildings.	$ 4,535,191
The Department recorded three construction projects incorrectly to operating expenditure accounts rather than the correct CIP accounts. CIP is generally used to record construction activity for substantially incomplete projects, including buildings, infrastructure, computer software, etc. While the Department reported this activity properly as CIP on its accrual response form submitted to State Accounting, the improper coding of expenses increases the risk for material misstatement of the financial statements and footnote disclosures and is not in compliance with State Accounting policy.	$ 3,318,307
The Department failed to add the costs to a building asset in the accounting system timely. The asset was completed in June 2021, but the costs had still not been added to the asset as of October 2023.	$ 1,145,933

Despite the errors noted above, State Accounting accounted for these items properly in the financial statements and footnote disclosures.

A proper system of internal control requires procedures to ensure costs are capitalized in a timely manner to allow for the proper presentation of the financial statements and footnote disclosures. Additionally, these internal control procedures should ensure capital asset records, including CIP, are accurate and include only assets owned by the State. When capital asset records and transactions are recorded improperly, there is an increased risk for material misstatement of the financial statements and related disclosures.

> We recommend the Department review its procedures for ensuring costs for completed projects are capitalized properly, and capital asset records are established correctly in the State's accounting system. We also recommend the Department continue its work to remove from the accounting system the non-State assets and implement procedures to ensure that the fixed asset listing is complete and accurate. Finally, we recommend the Department record all expenditures for construction projects of State-owned facilities to the proper CIP account in the accounting system.

3. Payroll Reconciliation

The Department failed to document its reconciliation of the amounts recorded on the payroll register to the amounts on the general ledger to ensure that payroll expenses were recorded properly. The Department's fiscal year 2023 payroll expenses totaled $12,388,980.

A proper system of internal control and sound business procedures require the documented reconciliation of the Department's payroll records to its general ledger to mitigate the risk of errors. Without such procedures, there is an increased risk of errors occurring and going uncorrected.

> We recommend the Department implement procedures for documenting the reconciliation process between the payroll register and the general ledger.

* * * * *

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