NEBRASKA AUDITOR OF PUBLIC ACCOUNTS

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December 13, 2023

James R. Kamm, Tax Commissioner
Nebraska Department of Revenue
301 Centennial Mall South
PO Box 94818
Lincoln, Nebraska 68509

Dear Mr. Kamm:

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 Department of Revenue (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 material weakness and another deficiency 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 consider Comment Number 1 (Incorrect Coding of Tax Receipts) to be a material weakness.

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 2 (ACFR Preparation Issues) to be a significant deficiency.

These comments 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. 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 was 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. Incorrect Coding of Tax Receipts

The Department failed to record certain taxes properly in the State's accounting system, including lodging taxes, taxes assessed on wind energy farms, also called nameplate capacity taxes, and the prepaid wireless surcharge.

The table below shows the amounts of those improperly recorded taxes, which were collected and distributed in fiscal years 2023 and 2022:

Description of Tax	FY 23	FY 22
Collections		
Lodging Tax	$ 28,634,947	$ 25,856,877
Nameplate Capacity Tax	$ 11,506,331	$ 8,136,069
Prepaid Wireless Surcharge	$ 4,621,468	$ 4,634,354
Refunds/Transfers		
Lodging Tax	$ 27,866,548	$ 25,486,991
Nameplate Capacity Tax	$ 11,503,119	$ 7,670,682
Prepaid Wireless Surcharge	$ 4,249,360	$ 4,636,768

The Department recorded these taxes improperly to the State Highway Fund, which is a fund used to support the State's highway and transportation systems. The taxes included in the table above should not be recorded to that fund.

The following list identifies the funds to which these taxes should have been recorded:

Lodging Taxes: The lodging taxes collected by the Department are distributed to counties and the State's Visitor Promotion Fund. Additionally, a portion is maintained by the Department for an administrative fee. Therefore, those distributions should be recorded to an Other Special Revenue Fund, the Economic Development Fund, and the State General Fund, respectively.

Nameplate Capacity Tax: The purpose of the nameplate capacity tax is to replace property taxes currently imposed on renewable energy infrastructure, and they are distributed completely to the counties in which the taxes were collected. The taxes should be recorded to an Other Special Revenue Fund.

Prepaid Wireless Surcharge: This is a charge that is required to be collected by a seller from a consumer for prepaid wireless services. Most of the surcharges collected are credited to the 911 Service System Fund, the Nebraska Telecommunications Relay System Fund, and the Nebraska Telecommunications Universal Service Fund, and they should be recorded to the Licensing and Regulation Fund in the Annual Comprehensive Financial Report (ACFR). A small portion is retained by the Department as an administrative fee and should be recorded to the General Fund.

The Auditor of Public Accounts (APA) advised the Department of the incorrect coding and requested correcting entries to be provided. The Department provided correcting entries totaling $58 million to the Department of Administrative Services - State Accounting Division (State Accounting), who recorded them into the State accounting system.

Despite being notified of the incorrect amounts, the Department failed to calculate the correcting entries properly, and the APA identified significant additional errors in those calculations. Correcting these additional errors by the Department required considerable work by both the APA and State Accounting.

The following table shows the amount of additional corrections that were needed for each tax type:

Description of Tax	Amount
Lodging Tax	$ 14,185,375
Nameplate Capacity Tax	$ 6,042,973
Prepaid Wireless Surcharge	$ 1,162,009

A proper system of internal control requires procedures to ensure that tax receipts are recorded properly in the accounting system to allow for the accurate presentation of the State's financial statements. Without such procedures, there is an increased risk for material misstatements in the financial statements.

> We recommend the Department work with State Accounting to ensure the proper recording of these tax receipts in the accounting system and, subsequently, the State's financial statements.

Department Response: Department staff have already had preliminary discussions with State Accounting regarding this issue and are looking to establish new distributive funds to track these tax receipts once internal testing and mapping is complete.

2. ACFR Preparation Issues

State Accounting prepares the ACFR and requires all State agencies to determine and to report accurately certain other financial information on accrual response forms to ensure the proper presentation of the financial statements and note disclosures. The other financial information includes the determination of various taxes receivable, construction-in-progress (CIP), and footnote disclosures.

The Department provided inaccurate information to State Accounting, as described in more detail below.

Delinquent Taxes Receivable

The Department is responsible for estimating the amount of its various taxes receivable. Delinquent taxes are those for which a tax return has been filed, but the amount owed has yet to be remitted by the taxpayer. The Department calculated the anticipated collections on these balances as the delinquent taxes receivable.

The Department's calculation procedure is twofold. First, protested audit balances are removed from the original balance due, and an estimated collection is determined for the remaining balances. Protested audit balances are cases in which the taxpayer has been determined to owe taxes, but the amount owed has been protested by the taxpayer. A separate estimate is prepared for the protested balances because the collection percentage for these cases is generally lower than the estimated collections for the regular delinquent balances. The sum of the two estimates is the total expected collections on delinquent tax accounts.

The following table summarizes the total balances due on June 30, 2023, as well as the estimated collection percentages and the amounts due:

Description	Sales and Use Taxes	Withholding Tax	Individual Income Tax	Corporate Income Tax
Total Taxes Owed by Taxpayers	$ 58,400,026	$ 18,422,879	$ 125,118,131	$ 58,442,587
Estimated Collection %	17%	25%	13%	36%
Total Collection without Protested	**$ 9,928,004**	**$ 4,605,720**	**$ 16,265,357**	**$ 21,039,331**
Taxes Owed for Protested Balances	$ 60,820,709	$ 494,720	$ 32,970,586	$ 280,149,943
Estimate Collection %	41%	4%	2%	1%
Total Collection on Protested Balances	**$ 24,936,491**	**$ 19,789**	**$ 659,412**	**$ 2,801,499**
Total Delinquent Taxes Receivable	**$ 34,864,495**	**$ 4,625,509**	**$ 16,924,769**	**$ 23,840,831**

The APA found more than $10 million in errors related to the Department's calculation of the delinquent taxes receivable, as detailed in the table below:

Description	Reason	Dollar Error
Delinquent Individual Income Taxes	The Department's amount of taxes owed for protested balances was incorrect, as it included amounts that had yet to be assessed, which also made the total taxes owed by taxpayers to be incorrect. Additionally, the Department had not analyzed its collections history to determine an actual collection percentage. Instead, it had calculated a five-year average based on the change in balances from year to year. After working with the Department's collections division, the estimated collection percentage was revised from 8% to 13%, increasing the total receivable by $6,259,852. The total receivable is then classified as short-term and long-term receivable amounts. The Department's original calculation of short-term and long-term receivables was understated by $1,043,309 and $5,216,543, respectively.	$ 6,259,852
Delinquent Corporate Income Taxes	The Department's amount of taxes owed by taxpayers was overstated by approximately $2.9 million, as it included a protested balance due. Additionally, the Department's calculation of the estimated collections of delinquent corporate income tax balances was inaccurate because the Department had used the same collection rate for the past seven years. As noted previously, the Department's collection percentage was based on the change in balances from year to year. When the balances increased, or when the collection percentage was determined to be reasonable, the Department reverted to a collection percentage from what it considered the last year with good data. In this case, that was for tax year 2016. After working with the Department's collections division, the estimated collection percentage was revised from 40% to 36%, decreasing the total receivable by $3,513,799. Therefore, the Department's calculation of the short-term and long-term receivable amounts was overstated by $585,633 and $2,928,166, respectively.	$ 3,513,799
Delinquent Withholding Taxes	The Department's calculation of the protested withholding balances contained duplicate entries and was overstated by $1.2 million; therefore, the total taxes owed by taxpayers was also incorrect. Additionally, the Department had not analyzed its collections history to determine an actual collection percentage. Instead, it had calculated a five-year average based on the change in balances from year to year. After working with the Department's collections division, the estimated collection percentage was revised from 28% to 25% for the total balance and from 1% to 4% for the protested balances. These changes increased the total receivable by $683,442. The Department's original calculation of short-term and long-term receivables was understated by $113,907 and $569,535, respectively.	$ 683,442
Total		**$ 10,457,093**

As a result of the errors noted above, the APA proposed, and State Accounting posted, an adjusting entry to reflect properly the Department's delinquent taxes receivables.

Taxes Receivable

The Department performed separate calculations to determine the amount of taxes receivable at fiscal year-end. The calculation included a review of the subsequent July or August tax receipts to determine the amount attributed to tax months during fiscal year 2023. The APA found more than $4.5 million in errors related to the Department's calculation of these taxes receivable, as detailed in the table below:

Description	Reason	Dollar Error
Corporate Income Tax Receivable	The Department's calculation failed to include significant receipts in July and August 2023 from certain corporate tax categories. The most significant tax category excluded was related to corporation income tax returns filed on Form 1120N. The APA also found an error related to one estimated corporate income tax receipt of $99,500, which was related to September 2023 and should not have been in the Department's receivable calculation. Finally, the Department failed to review adequately the receipts for estimated taxes in which the tax year is not known to ensure those receipts are included or excluded appropriately as taxes receivable.	$ 2,820,876
Individual Income Tax Receivable	The Department's calculation failed to include significant receipts in July and August of 2023 from one tax category for tax periods prior to January 2023. The Department also failed to review adequately the receipts for individual estimated and withholding taxes received in which the tax year is not known to ensure those receipts are included or excluded appropriately as taxes receivable.	$ 1,822,610
Total		**$ 4,643,483**

As a result of the errors noted above, the APA proposed, and State Accounting posted, an adjusting entry to reflect properly the Department's taxes receivables.

CIP Reporting Errors
The Department failed to report properly two information technology (IT) projects to DAS; therefore, the project expenses were not included as CIP in the financial statements and related footnote disclosures.

Description	Amount
Project expenses related to the conversion of the partnership tax processing system to the mainframe system were not reported to State Accounting.	$ 128,257
Project expenses related to the update of the NebFile system for individual income tax filings were not reported to State Accounting.	$ 122,052
Total	**$ 250,309**

As a result of the errors noted above, the APA proposed, and State Accounting posted, an adjusting entry to reflect properly CIP.

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

> *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.*

Tax Abatement Footnote
Statement No. 77 of the Governmental Accounting Standards Board (GASB 77) requires the State to disclose specific information about tax abatement agreements to which it is a party. Tax abatement is defined as follows:

> *[a] reduction in tax revenues that results from an agreement between one or more governments and an individual or entity in which (a) one or more governments promise to forgo tax revenues to which they are otherwise entitled and (b) the individual or entity promises to take a specific action after the agreement has been entered into that contributes to economic development or otherwise benefits the governments or the citizens of those governments.*

The Department is responsible for determining the information included in the tax abatement footnote. The APA found errors in the reported amounts for two tax abatement programs, as shown in the table below:

Program	Originally Reported	Correct Amount	Variance
Nebraska Advantage Act	$ 222,801,778	$ 222,394,134	$ 407,644
Affordable Housing Tax Credit Act	$ 10,695,148	$ 10,669,414	$ 25,734
Total			**$ 433,378**

The APA also found other errors in the footnote, including incorrect statutory citations, missing municipalities, and grammatical errors.

A proper system of internal control requires procedures to ensure the complete and accurate reporting of financial information to State Accounting for the proper presentation of the State's financial statements and footnote disclosures. Without such procedures, there is an increased risk that material misstatements will go undetected.

> We recommend the Department implement procedures to improve its procedures for calculating and reporting significant accounting information to State Accounting at fiscal year-end to help ensure the proper presentation of the financial statements and footnote disclosures. The Department should ensure all information reported to State Accounting is subject to a secondary review to ensure its accuracy.

Department Response: For the items noted above, the Department acknowledges the updated collection receivable calculation proposed by the APA and recognizes that information that is more accurate helps in the preparation of better financial statements for the ACFR.

3. Unused Property Tax Credit

Annually, the Department distributes property tax credits in two installments to Nebraska counties. Before July 1 of each year, the counties are required to return the unused portion back to the Department. In fiscal year 2023, the Department received $2,905,470 as repayment from Nebraska counties of the unused property tax credits. The Department recorded the receipt improperly as a miscellaneous adjustment in the State accounting system instead of recording it as a reduction to the account where the original expenditure was posted.

Because of the APA's questions regarding the coding of these receipts, State Accounting made an entry to correct the classification and to ensure proper presentation of the financial statements.

A proper system of internal control and sound accounting policies require procedures to ensure that reimbursement transactions are recorded to the proper accounts in the State accounting system. Without such procedures, there is an increased risk that a material misstatement of the financial statements will go undetected.

> We recommend the Department implement procedures to ensure unused property tax credits are recorded correctly.

Department Response: The Department concurs that the repayment receipts were miscoded and for future repayment transactions, will work to properly classify the receipts to the appropriate accounts.

4. Homestead Exemption Disbursements

The Department paid $119,230,317 in homestead exemption property tax credits to counties. The State's Homestead Exemption property tax credit program is authorized under Neb. Rev. Stat. §§ 77-3501 through 77-3529 (Reissue 2018, Cum. Supp. 2022) and provides full or partial property tax exemption on a homestead's value to property owners.

Qualified applicants fall into one of six categories: (1) Owner occupants age 65 and over; (2) Veterans totally disabled by a non-service accident or illness; (3) Disabled individuals; (4) Veterans who are 100% disabled because of a service related incident drawing compensation from the Department of Veterans Affairs (VA), or the un-remarried surviving spouse of a veteran; (5) Paraplegic or multiple amputee veteran whose home was substantially contributed to by the VA; and (6) Individuals who have a developmental disability.

These property owners file the Nebraska Homestead Exemption Application between February 1 and June 30 with the county assessor, who verifies ownership, occupancy, age, disability certification, veteran service dates, timeliness of filing, property value, etc. Once the county assessor approves the application it is submitted to the Department.

After all applicable reviews and verifications, the county assessor and county treasurer certify the total amount of their exemptions on a Homestead Exemption Summary Certificate Form 458S, which includes the number of exemptions, total exempt homestead property value, and the total tax loss to the county. These certificates are provided to the Department prior to November 30. The Department reimburses the counties based on the information contained on this form.

The Department lacked adequate procedures to verify the accuracy of the tax loss reported by the counties on the Form 458S. A comparison to individual applications on a test basis was not performed; instead, the Department verified the totals on the Form to the total on the Certificate of Taxes Levied (CTL) for each county and compared the total amounts reported from year to year.

A proper system of internal control includes procedures to verify the accuracy of the total tax loss reported by counties to ensure amounts paid to the counties are accurate. Such procedures might include a comparison, on a test basis, of records maintained by the county assessors that show which individual properties were approved for the reported tax loss, to ensure an approved application is on file at the Department. Without such procedures, there is an increased risk for inaccurate homestead exemption payments to counties.

> We recommend the Department implement procedures to review, on a test basis, individual properties included on the CTL reports to ensure a valid application is on file for those properties. We also recommend the Department continue its comparison of the totals from the Form 458S to the CTL reports and set thresholds for changes that should be reviewed further.

Department Response: The Department will continue to review the Homestead Exemption totals and agrees that establishing testing procedures on the individual property data is warranted.

5. Timeliness of Responses to Audit Requests

The Department failed to provide timely responses to the APA's requests for information and, therefore, failed to comply with Neb. Rev. Stat. § 84-305(2) (Cum. Supp. 2022), which requires a response to the auditor's written requests for audit information within three business days.

The improperly delayed responses not only violated State statute but also hindered the timing and completion of the APA's testing.

The following table contains examples of the Department's failure to respond expeditiously – in clear violation of State law – to the APA's requests for information throughout the audit period:

Initial Request	Department Response	Request Fulfilled	Days Until Response	Days Until Fulfillment	Description
6/5/2023	6/15/2023	6/22/2023	8	12	Initial incentive testing documentation request
7/25/2023	8/10/2023	8/10/2023	12	12	Technical Directive question
7/26/2023	8/2/2023	8/3/2023	5	6	Form 312N question
6/21/2023	6/28/2023	6/28/2023	5	5	Severance & Conservation Tax question
8/1/2023	8/8/2023	8/8/2023	5	5	Homestead Exemption question

It is important to note that the above table is far from comprehensive, containing merely a sample listing of delayed responses. Other examples of untimely responses by the Department could also be included.

Section 84-305 states, in relevant part, the following:

> *(1) The Auditor of Public Accounts shall have access to any and all information and records, confidential or otherwise, of any public entity, in whatever form or mode the records may be, unless the auditor is denied such access by federal law or explicitly named and denied such access by state law. If such a law exists, the public entity shall provide the auditor with a written explanation of its inability to produce such information and records and, after reasonable accommodations are made, shall grant the auditor access to all information and records or portions thereof that can legally be reviewed.*

(2) Upon receipt of a written request by the Auditor of Public Accounts for access to any information or records, the public entity shall provide to the auditor as soon as is practicable and without delay, but not more than three business days after actual receipt of the request, either (a) the requested materials or (b)(i) if there is a legal basis for refusal to comply with the request, a written denial of the request together with the information specified in subsection (1) of this section or (ii) if the entire request cannot with reasonable good faith efforts be fulfilled within three business days after actual receipt of the request due to the significant difficulty or the extensiveness of the request, a written explanation, including the earliest practicable date for fulfilling the request, and an opportunity for the auditor to modify or prioritize the items within the request. . . . The three business days shall be computed by excluding the day the request is received, after which the designated period of time begins to run. Business day does not include a Saturday, a Sunday, or a day during which the offices of the custodian of the public records are closed.

(Emphasis added.) Additionally, Neb. Rev. Stat. § 84-305.02 (Cum. Supp. 2022) provides a criminal penalty for failure to comply with the above statutory mandate, as follows:

Any person who willfully fails to comply with section 84-305 or 84-305.01, who otherwise willfully obstructs or hinders the conduct of an audit, examination, or related activity by the Auditor of Public Accounts, or who willfully misleads or attempts to mislead any person charged with the duty of conducting such audit, examination, or related activity shall be guilty of a Class II misdemeanor.

We recommend the Department implement procedures to ensure compliance with § 84-305.

Department Response: The Department will look to strengthen the communication process regarding the fulfillment of requested information by APA audit team members.

* * * * *

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
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