NEBRASKA AUDITOR OF PUBLIC ACCOUNTS

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December 18, 2024

Dr. Brian Maher, Commissioner
Nebraska Department of Education
P.O. Box 94987
Lincoln, Nebraska 68509-4987

Dear Dr. Maher:

We have audited, 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, 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, 2024, and the related notes to the financial statements, which collectively comprise the State's basic financial statements, and have issued our report thereon dated December 18, 2024. In planning and performing our audit of the financial statements, we considered the State's system of 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 audit as described above, we noted certain internal control or compliance matters related to the activities of the Nebraska 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 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 (Multiple Financial Statement Adjustments) 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 (Special Education Program Noncompliance and Accrual) 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 management 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 management letter. *Government Auditing Standards* require the auditor to perform limited procedures on the responses. The responses were not subjected to the other auditing procedures applied in the audit of 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, 2024.

1. <u>Multiple Financial Statement Adjustments</u>

The Department is responsible for accurately recording financial transactions in the State's accounting system and providing additional financial information, including various accounts receivable and payable entries, to the Department of Administrative Services – State Accounting Division (State Accounting) on an accrual response form for preparation of accrual entries for the State's Annual Comprehensive Financial Report (ACFR).

The Auditor of Public Accounts (APA) reviewed these transactions to ensure the proper presentation of the State's financial statements and proposed $234,162,148 in adjustments to the financial statements due to errors made by the Department in its year end reporting. The proposed adjustments were recorded in the accounting system by State Accounting. The errors are summarized in the table below:

Description of Accrual or Error	Amount in Error
Prior Year Expenditures Accrual Error	$ 228,211,790
Department Accrual Errors	$ 5,950,358
Total	**$ 234,162,148**

Many of the current year accruals were inaccurate and not prepared in accordance with governmental accounting standards. Additionally, the Department lacked procedures to ensure a secondary review of the accruals to verify their completeness and accuracy prior to submission to State Accounting or when the entries were recorded in the State's accounting system.

A similar issue was reported in the prior year. However, the APA accumulated only $4,074,000 in proposed adjustments for fiscal year 2023. Therefore, the Department's errors have increased by more than 5,648%.

The following information provides more detail on each of the accrual errors noted in the above table.

<u>Prior Year Expenditures Accrual Error</u>
The State's accounting system allows users to identify transactions made in the prior fiscal year by applying a certain code to the transaction. When transactions processed during the fiscal year are identified as a prior year transaction using this code, State Accounting records an adjustment to the beginning fund balance for these transactions, so that the prior year transactions are not included in the current fiscal year's activity. The APA found the following issues:

Description	Reason	Dollar Error
Prior Year Expenditures Accrual Error	The Department recorded $228,211,790 in various transactions as prior period expenditures, even though they were already recorded as prior period activity through a separate procedure in the prior year. These errors resulted in duplicative prior period activity. The APA proposed an adjustment for these errors, which was posted by State Accounting, to correct the errors.	$ 228,211,790

Department Accrual Errors

The Department's financial statement accruals reported to State Accounting for preparation of the fiscal year 2024 ACFR contained multiple errors. Activity reported to State Accounting is related to various grants administered by the Department that span multiple fiscal years. For these various programs, the Department calculates an original payable amount at fiscal year-end, which is then manually reduced to account for current year payments processed after the fiscal year end.

The APA found the following errors in the Department's calculation of program accruals that required adjustments to the State's financial statements.

Description	Reason	Dollar Error
Early Childhood Education Grant	The Department failed to review the Early Childhood Education grant for current year expenditures recorded after the fiscal year end. As such, $1,600,939 in General Fund activity was incorrectly included as a payable.	$ 1,600,939
General Fund Discretionary Projects Grants	The Department's review of current expenditures recorded after fiscal year end included a $39 error.	$ 39
Total General Fund Payable Adjustment:		**$ 1,600,978**
Nebraska Hands and Voices Grant	The Grant Award Notification (GAN) provided by the Department for one award did not agree to Department's accrual calculation reported to State Accounting. As a result, the Federal Fund included $20,000 that should not have been reported as a payable.	$ (20,000)
Deaf/Blind Program Grant	The Department's calculation included a formula error that resulted in an $88,888 misstatement.	$ (88,888)
Teach Step Up Grant	The Department excluded the Teach Step Up grant in its review for current period expenditures recorded after the fiscal year end. As such, $26,486 in activity was incorrectly recorded as a payable.	$ (26,486)
Quality Enhancement Grant	The Department excluded the Quality Enhancement grant from its review for current period expenditures recorded after the fiscal year end. As such, $92,870 in activity was incorrectly recorded as a payable.	$ (92,870)
Educational Service Unit PreK Grant	The Department excluded the Educational Service Unit PreK grant from its review for current period expenditures recorded after the fiscal year end. As such, $499,228 in activity was incorrectly recorded as a payable.	$ (499,228)
CARES* Act Grant	The Department excluded $690,760 in CARES Act grant activity from its review for current period expenditures recorded after the fiscal year end. As such, $690,760 in activity was incorrectly recorded as a payable.	$ (690,760)
Stronger Connection Grant	The Department omitted completely the Stronger Connection grant, resulting in a $2,023,161 misstatement.	$ 2,023,161
Title I Support Grant	The Department omitted completely the Title I Support grant, resulting in a $338,934 misstatement.	$ 338,934
Rural Low Income School (RLIS) Grant	The Department omitted completely the RLIS grant, resulting in a $7,385 misstatement.	$ 7,385
ESSER**/American Rescue Plan (ARP) Grants	The Department's calculation of the payable related to the ESSER/ARP grants contained multiple formula errors and also excluded certain grants, resulting in $8,176,637 in misstatements to the financials.	$ 8,176,637
Grant Management System (GMS) Grants	The Department's calculation of the payable related to its GMS grants contained errors including the duplication of grant amounts and incorrect percentages, resulting in $6,893,517 in misstatements to the financials.	$ (6,893,517)
Total Federal Fund Payable Adjustment:		**$ 2,234,368**
Nebraska Hands and Voices Grant	Error noted above.	$ (20,000)
Deaf/Blind Program Grant	Error noted above.	$ (88,888)
Educational Service Unit PreK Grant	Error noted above.	$ (499,228)
CARES* Act Grant	Error noted above.	$ (690,760)
Stronger Connection Grant	Error noted above.	$ 2,023,161
Title I Support Grant	Error noted above.	$ 338,934
RLIS Grant	Error noted above.	$ 7,385
ESSER**/ARP Grants	Error noted above.	$ 8,176,637
GMS Grants	Error noted above.	$ (6,893,517)

Description	Reason	Dollar Error
Non-Letter of Credit Grant Activity	Previously identified errors related to the reporting of the Teach Step Up and Quality Enhancement grants required a reduction in the APA's proposed adjustment to the Federal Fund because the activity is reported outside of the State's Federal Letter of Credit Fund. As such, any amounts recorded as liabilities would not require a corresponding receivable from the Federal government – similar to the entries from above.	$ (238,712)
Total Federal Fund Receivable Adjustment:		**$ 2,115,012**
Total Errors		**$ 5,950,358**

*CARES – The Coronavirus Aid, Relief, and Economic Security Act
**ESSER – Elementary and Secondary School Emergency Relief

A proper system of internal controls requires procedures to ensure that accruals reported to State Accounting at year end are complete and accurate. Without such procedures, there is a greater risk of material misstatements occurring and remaining undetected.

A similar finding was noted in the prior management letter.

> We recommend the Department prioritize staff training and implement procedures to ensure its accruals are completely and accurately reported to State Accounting, including the resolution of repeated errors. Furthermore, we recommend the Department implement procedures to ensure a secondary review of all accruals is performed by a knowledgeable individual prior to submission to State Accounting or entry into the State's accounting system.

Department Response: The Department continues to value a proper system of internal controls ensuring that accruals reported to the State's accounting system are complete and accurate. To reduce the risk of material misstatements occurring, the Department will prioritize updating procedures, training/re-training staff, and technology verification by July 1, 2025.

2. <u>Special Education Program Noncompliance and Accrual</u>

The Department is authorized to reimburse school districts from its General Fund appropriations 80% of the total allowable excess costs for all Special Education (SPED) programs and support services. Recent legislation also authorized funding to the program from the Education Futures Fund, which includes appropriations separate from the General Fund, if 80% reimbursement of allowable excess costs is not initially achieved.

The APA identified various instances of noncompliance with the recent legislation, including expenditures that exceeded the appropriated funding and the allowable reimbursement per State statute. Additionally, the Department's SPED accrual reported to State Accounting on the accrual response form was not accurate.

The following information provides further detail on each of the issues.

Description	Reason	Dollar Error
Noncompliant Education Futures Fund Expenditures	At June 30, 2024, the General Fund had unspent Special Education Program appropriations of $37,980,193. Neb. Rev. Stat. § 79-1142(4)(b) (Reissue 2024) required the General Funds to be liquidated prior to using Education Future Funds. Instead, the Department used the Education Futures Fund to pay the Special Education Program expenditures, prior to the liquidation of all General Fund appropriations. As a result, the Education Futures Fund also exceeded its appropriations by $19,507,099.	$ 37,980,193
SPED Program Overpayments	The Department reimbursed school districts an amount that exceeded the 80% of the allowable Special Education excess costs set forth in statute. The Department paid $7,406,803 to school districts that was not authorized by statute.	$ 7,406,803
SPED Payable Calculation	The Department calculated incorrectly the payable for the transportation portion of the SPED program. The Department included unspent appropriations as the basis for its calculation rather than expected expenditures in future reporting periods. As a result, we identified a $543,452 variance between expected expenditures and unspent appropriations reported by the Department.	$ 543,452
	Total	**$ 45,930,448**

Legislative Bill (LB) 583 § 11 [codified at § 79-1142 (Reissue 2024)] provides that school district allowable excess costs to be reimbursed at 80%, as follows:

> *[F]or special education and support services provided in each school fiscal year, the department shall reimburse each school district in the following school fiscal year eighty percent of the total allowable excess costs for all special education programs and support services. Cooperatives of school districts or educational service units shall also be eligible for reimbursement for cooperative programs pursuant to this section if such cooperatives or educational service units have complied with the reporting and approval requirements of section 79-1155 for cooperative programs which were offered the preceding year.*

Further, § 79-1142(4)(b) goes on to state the following in relation to how funding shall be utilized:

> *If the General Fund appropriations for special education approved by the Legislature, minus the amounts set aside pursuant to subsection (5) of this section, are insufficient to reimburse eighty percent of the total allowable excess costs for all special education programs and support services for any school fiscal year:*
>
> > *(i) Such allowable excess costs shall be reimbursed from the General Fund appropriations for special education approved by the Legislature, minus the amounts set aside pursuant to subsection (5) of this section, on a pro rata basis at the maximum rate of reimbursement such appropriations will allow as determined by the department; and*
> >
> > *(ii) The remainder of the eighty percent reimbursement of such allowable excess costs shall be paid from the Education Future Fund.*

The program included appropriations as a result of LB 1412 (2023) as follows:

> *There is included in the amount shown for this program $235,724,424 General Funds and $226,580,280 ~~$199,041,052~~ Cash Funds provided as state aid for FY2023-24 for special education reimbursement. There is included in the amount shown for this program $235,724,424 General Funds and $206,007,489 Cash Funds provided as state aid for FY2024-25 for special education reimbursement.*

A proper system of internal controls requires procedures to ensure that the Department's administration of State programs is in accordance with legislative requirements and that Department accruals reported to State Accounting are calculated accurately. Without such procedures, there is an increased risk of regulatory noncompliance and material misstatement to the financial statements.

> We recommend the Department implement procedures to ensure that Special Education program expenses are funded as required by governing legislation and that accrual calculations are accurate.

Department Response: NDE staff worked with the Governor's office and the Legislature to write the language in LB 583 that changed the reimbursement for Special Education. The intent of LB 583 was to appropriate 80% of the submitted special education reimbursable expenses and have NDE pay out the full amount appropriated as has been the process for many years which is necessary to avoid potential maintenance of effort issues as required by the Individuals with Disabilities Education Act (IDEA). The language NDE proposed which was ultimately included and passed did not clearly identify the continued intent of the bill to require NDE to pay out the entire appropriation. NDE has worked with the Governor's office to correct the language adopted in LB 583 so that it clearly requires the full appropriation to be used for Special Education Reimbursement.

NDE will make the necessary journal entry to move the funds as needed to the Education Future Fund in future years.

3. <u>Other Errors in Financial Reporting</u>

The Department made an additional $1,258,694 in other accounting errors that did not require a formal proposed adjustment to the financial statements due to the insignificance of the dollar amount of the error or to the Department's correction of the error before a formal adjustment was proposed. The details of these errors are contained in the table below:

Reason	Dollar Error
One $578,538 payment was recorded inappropriately as a prior period expense, as the transaction covered expenditures incurred within the current (fiscal year 2024) reporting period.	$ 578,538
There were $596,406 in fiscal year 2024 project expenses recorded incorrectly to operating accounts instead of to a construction in progress (CIP) account. The project expenses were related to the Department's Early Childhood Integrated Data System.	$ 596,406
There were $83,750 in fiscal year 2024 project expenses recorded incorrectly to operating accounts instead of to a construction in progress (CIP) account. These project expenses were related to the Department's Individuals with Disabilities Education Act (IDEA) IT Project.	$ 83,750
Total	**$ 1,258,694**

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 that expenses are classified within the correct fiscal year. 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 for the correct reporting period.

Department Response: The Department continues to value a proper system of internal controls to ensure that expenses are reported properly and for the correct reporting period prior to submission into the State's accounting system. To reduce the risk of material misstatements occurring, the Department will prioritize updating procedures, training/re-training staff, and technology verification by July 1, 2025.

4. <u>QE2 Change Management</u>

The Department used the QE2 application to track all expenses paid to assist physically or mentally disabled persons with locating jobs. For 6 of 20 QE2 system changes tested, the Department lacked documentation to support that the system changes were thoroughly tested prior to being implemented. The change tickets for the six changes had "tested locally" in the "Description" field; however, the change tickets failed to indicate the following: 1) the individual(s) that completed testing; 2) the results of testing; and 3) when testing was performed.

Nebraska Information Technology Commission (NITC) Technical Standards and Guidelines, Information Security Policy 8-202 (July 2023), "Change Control Management," states the following, in relevant part:

> *To protect information systems and services, a formal change management system must be established to enforce strict controls over changes to all information processing facilities, systems, software, or procedures. Agency management must formally authorize all changes before implementation and ensure that accurate documentation is maintained.*
>
> * * * *
>
> *(2)(c) The change management processes will retain a documented history of the change process as it passes through the software development life cycle with documentation securely stored for audit purposes. Documentation should address a review of the following: (1) change summary, justification, and timeline; (2) functionality, regression, customer acceptance, and security test plans; (3) security review and impact analysis; (4) documentation and baseline updates; and (5) implementation timeline and recovery plans . . . .*

A proper system of internal controls requires procedures to ensure the testing of system changes is documented prior to the changes being promoted into the production environment.

Without such procedures, there is an increased risk that not only the system changes fail to work properly, but also noncompliance with NITC Standards and Guidelines.

A similar comment was noted in the prior audit.

> We recommend the Department implement procedures to ensure adequate documentation is maintained to support that testing of system changes is performed prior to the change being promoted into production, and should include 1) the individual(s) that completed testing; 2) the results of testing; and 3) when testing was performed.

Department Response: Nebraska VR development team has implemented a manual process of more explicitly documenting who, what and when the code changes were tested.

Over the coming months Nebraska VR development team will research more automated means of testing documentation, namely via a Docker/Podman CI/CD workflow or using Azure Pipelines, or a combination of both.

* * * * *

It should be noted that this letter is critical in nature, as it contains only our comments and recommendations and does not include our observations on any strengths of the Department.

Our audit procedures were designed primarily to enable us to form an opinion on the Basic Financial Statements. Our audit procedures were also designed to enable us to report on internal control over financial reporting and on compliance and other matters based on an audit of financial statements performed in accordance with *Government Auditing Standards* 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 State's internal control over financial reporting or compliance.

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

Kris Kucera

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