NEBRASKA AUDITOR OF PUBLIC ACCOUNTS

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Rob Jeffreys, Director
Nebraska Department of Correctional Services
PO Box 94661
Lincoln, Nebraska 68509

Dear Mr. Jeffreys:

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 Correctional Services (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 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 (Lack of Inventory Valuation Procedures) 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 (Capital Asset Errors) and Comment Number 3 (Missing Fiscal Year 2023 Accrual and Review of Revenues) 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.

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. Lack of Inventory Valuation Procedures

The Department failed to perform certain critical procedures during the year pertaining to the Cornhusker State Industries (CSI) inventory maintained by the Department to ensure the accounting records were complete and accurate for financial reporting for the fiscal year ended June 30, 2024.

The inventory balance reported in the State's accounting system as of June 30, 2024, was $5,974,804. However, due to the lack of critical procedures, as noted below, the Department failed to maintain an internal control process over inventory. It was also determined that the value of the inventory was overstated by $1,449,626.

The Department's procedural failures included the following:

- The Department failed to complete inventory cycle counts for the months of December 2023 through February 2024, which are the primary control procedures over inventory. These cycle counts are routine physical inventory counts and are utilized to safeguard inventory from loss and/or theft. Inventory items are categorized by risk level, with higher risk items counted more frequently. With the lack of performance of these counts, there can be no assurance that inventory was not misappropriated during that period.

- The Department failed to reconcile properly the inventory balances from the inventory ledgers to the balances recorded within the State's accounting system. The Department obtained integrity reports from the State's accounting system; however, those reports were not adequately reviewed, and variances identified on the reports were not resolved. A proper review and resolution of the variances on these reports would have assisted in reconciling inventory ledgers to the accounting system. Such a reconciliation could also assist in identifying possible loss or theft of inventory.

- The Department failed to generate detailed listings of all inventory items at the fiscal year end to allow for an adequate verification of inventory. Such detailed listings can only be generated as of the date the report is run. Without such listings, there is inadequate information to support the inventory valuations included in the financial statements.

The adjustment to inventory included the following:

Error	Amount
The Department failed to reconcile its inventory balances to the accounting system. The review by the Auditor of Public Accounts (APA) revealed the accounting system balances to be overstated.	$ 765,729
During the APA's testing of 20 inventory items, comprising more than $1.9 million, we determined that 8 items included amounts on hand that did not agree to the inventory system, and the balances were overstated.	$ 683,897
Total	**$ 1,449,626**

The APA proposed, and the Department of Administrative Services – State Accounting Division (State Accounting) posted, the $1,449,626 adjustment to the financial statements.

A proper system of internal controls requires procedures to ensure the value of inventory recorded in the accounting system is complete and accurate. This would include procedures to ensure physical counts of all inventories are performed on a periodic basis, detailed listings are generated at the end of the fiscal year, and the listings are verified and reconciled to the accounting system.

Without such procedures, there is an increased risk of not only materially incorrect inventory balances being shown on the financial statements but also the loss or theft of inventory items.

> We recommend the Department ensure physical counts of inventory are performed on a regular basis to determine that the quantities recorded in the accounting system are proper. We also recommend the Department generate detailed inventory listings as of fiscal year end and verify that these amounts reconcile to the accounting system.

Department Response: NDCS agrees physical counts of inventory should be performed. NDCS has scheduled physical count inventories for Cornhusker State Industries, and such will occur on a regular basis. Further, the detailed inventory listing will be generated as of the fiscal year-end and verified that those amounts reconcile to the accounting system.

2. <u>Capital Asset Errors</u>

The Department is responsible for recording information regarding capital assets into the State's accounting system. However, we noted the following shortcomings with the Department's recording procedures: 1) failure to record both timely and properly purchases of land, buildings, and equipment; 2) incorrectly recorded construction-in-progress payments and acquisition dates for multiple assets; 3) lack of documentation to support certain purchases; and 4) failure to pay invoices timely.

The culmination of such recording errors by the Department required an $8 million adjustment to the financial statements, which was proposed by the APA and posted by State Accounting. See below for details of this adjustment:

Project	Department Errors Requiring Adjustment	Amount
New Prison Site - Buildings	The Department recorded the value of five buildings on the property at $1 million each, which was not supported by documentation. Using information from the County Assessor, the APA calculated the value of the buildings to be $781,129, resulting in an overstatement of their value. It was also noted that two of the five buildings had incorrect acquisition dates entered into the system.	$ 4,218,871
New Prison Site - Land	The remaining amount from the APA's calculated asset value (see below) of $17,206,246, less the correct building value calculated above of $781,129, should have resulted in $16,425,117 as the value of land. However, the Department recorded the value of the land as $12,534,346, resulting in an understatement of $3,890,771 of its value.	$ 3,890,771
RTC Construction	The Department failed to include an additional $1,066,187 in costs to the assets related to the construction of the Reception and Treatment Center (RTC). These costs were erroneously recorded as repairs and maintenance. Three of four assets also included incorrect acquisition dates.	$ (1,066,187)
RTC Construction	Because of the errors noted above, adjustments were necessary to the beginning net assets for buildings.	$ 882,486
Prison Buildings and RTC Construction	Because of the errors noted above, adjustments were necessary to the accumulated depreciation for buildings.	$ 94,033
Prison Buildings and RTC Construction	Because of the errors noted above, adjustments were necessary to the current depreciation expense.	$ 89,668
Total Adjustments		**$ 8,109,642**

New Prison Site

During fiscal year 2024, the State paid $17,534,346 for the purchase of land and buildings for the construction of a new prison site near Lincoln. In addition to the errors noted above that resulted in the adjustment, the APA identified other issues related to this land and building purchase, as detailed below:

Additional Departmental Errors
The Department initially recorded the entire $17,534,346 purchase as construction in progress and operating expenses, when it should have been recorded as land and buildings.
The Department recorded the entire $17,534,346 purchase price as a capital asset. However, the APA determined that $328,100 should have been recorded as an expense. These costs included option money paid for real estate that was not purchased (no asset obtained) less title and escrow charges. The total amount that should have been capitalized was $17,206,246.

RTC Construction

The Department had various construction projects related to the RTC. The issues noted above involved one $59,737,472 project and one $36,203,526 project at the RTC.

In addition to the errors above that required adjustments, the following table details other accounting issues and financial statement errors that did not require adjustments to the financial statements due to their relative insignificance; nevertheless, these were errors and are detailed in the table below:

Description of Issue	Dollar Error
The Department failed to capitalize properly equipment purchased and lacked support for the quantities or unit prices thereof.	$ 302,700
The Department inaccurately recorded costs for one project as operating expenditures rather than construction in progress.	$ 155,770
The Department failed to include the costs for 21 assets in the accounting system. For eight of the assets, the following accounts were understated: • Beginning asset cost – $71,909 • Beginning depreciation – $15,656 • Additions – $41,160 • Depreciation additions – $14,236 Two of the assets did not have a cost available but appear to be under the capitalization threshold. Six of the assets were removed and should not have been in the accounting system. Three of the assets were removed because they were surplused before the end of the fiscal year. One asset was not adjusted because the amount was insignificant, and the asset was surplused a month after the fiscal year end. One asset had an acquisition date after the fiscal year.	$ 142,961
The Department failed to pay three invoices related to a capitalized asset within 45 days of receipt of the invoice, as required by State statute. The payments occurred 71, 202, and 230 days after the invoice receipt date.	$ 120,558
Total Unadjusted Errors	**$ 721,989**

Neb. Rev. Stat. § 81-2403(1) (Reissue 2014) states the following:

> *Except as provided in subsection (2) of this section, each agency shall make payment in full for all goods delivered or services rendered on or before the forty-fifth calendar day after (a) the date of receipt by the agency of the goods or services or (b) the date of receipt by the agency of the bill for the goods or services, whichever is later, unless other provisions for payment are agreed to in writing by the creditor and the agency.*

A proper system of internal control requires procedures to ensure that all costs are recorded accurately in the accounting system, acquisition dates are recorded accurately, costs are capitalized promptly upon completion of the project, adequate supporting documentation is maintained, and invoices are paid in a timely manner.

Without such procedures, there is an increased risk for material misstatement of the financial statements and footnote disclosures and noncompliance with State Accounting policy and State law.

> We recommend the Department implement procedures to ensure the following: 1) costs are recorded properly in the accounting system and are capitalized in a timely manner; 2) acquisition dates of the assets are accurate; 3) adequate supporting documentation is maintained by the Department; and 4) invoices are paid in a timely manner.

Department Response: NDCS accounting strives to be as accurate as possible. Procedures have been reviewed with applicable team members to ensure costs are recorded properly and timely, acquisition dates are accurate, adequate supporting documentation is maintained, and invoices are paid in a timely manner.

3. Missing Fiscal Year 2023 Accrual and Review of Revenues

In fiscal year 2024, the Department recorded $4,077,452 incorrectly as revenues for license plate sales. However, these license plates were ordered in fiscal year 2023 and should have been recorded in the prior fiscal year. Therefore, the APA proposed, and State Accounting posted, the $4,077,452 adjustment to correct the financial statements.

We also determined that the Department lacked procedures for reviewing the general ledger detail report to ensure that all revenues were recorded properly in the accounting system.

A proper system of internal controls requires procedures to ensure that not only all financial transactions are reported appropriately in the correct period but also a proper review is performed of accounting reports.

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

> We recommend the Department implement procedures to ensure transactions are reported in the correct fiscal year, and accounting reports are reviewed to determine if all transactions are appropriate.

Department Response: Again, NDCS accounting strives to be as accurate as possible. Procedures have been reviewed with applicable team members and that the accounting reports are reviewed to ensure accuracy.

4. Payroll Issues

The Department used the Kronos system to track work time and duties for personnel, which then interfaced with the State's accounting system. In fiscal year 2024, the Department had payroll expenditures of $236,252,621 for 2,577 separate employees. We noted the following items related to payroll:

- The Department's 338 overtime-exempt employees were required to record only leave used. There was no support, therefore, that all full-time employees rendered at least 40 hours of labor each week, as required by Neb. Rev. Stat. § 84-1001(1) (Reissue 2014), which states the following:

  > *All state officers and heads of departments and their deputies, assistants, and employees, except permanent part-time employees, temporary employees, and members of any board or commission not required to render full-time service, shall render not less than forty hours of labor each week except any week in which a paid holiday may occur.*

- For the paychecks tested of two employees, the Department inaccurately paid a shift differential that was not in accordance with the provisions of the labor contracts between the State of Nebraska and the Fraternal Order of Police (FOP), Nebraska Protective Services, Lodge 88, or the Nebraska Association of Public Employees Local 61 of the American Federation of State, County and Municipal Employees. Both labor contracts require the following:

  > *Bargaining unit members on duty and working fifty percent or more of a shift between the hours of 6:00 p.m. and 6:00 a.m. shall receive sixty cents per hour shift differential for all hours worked on that shift.*

The Kronos system calculates shift differential based on the employee's scheduled hours and not on the hours worked. The APA believes, however, that the labor contracts require payment for all hours actually worked, as opposed to those merely scheduled. The Kronos calculation at issue caused employees to receive incorrectly the shift differential on days that they failed to work more than 50% of their shift between 6:00 p.m. and 6:00 a.m. Similarly, the same flawed calculation methodology caused the employees to miss shift differential payments on days that they worked more than 50% of their shift between 6:00 p.m. and 6:00 a.m. The two employees received overpayments of shift differential totaling $18 and $20 on the paychecks tested.

- For one paycheck tested, the Department paid the employee holiday working out-of-class pay of 2.5%, totaling $5. The APA found no language to support that additional payment in the labor contracts. The FOP labor contract allows 5% additional compensation for working out of class, and the Department's practice has been to pay that when an employee works out of class. However, the Department also paid an additional 2.5% of compensation for employees working out of class on a holiday. Total holiday working out-of-class payroll for the Department in fiscal year 2024 was $617.

A proper system of internal control requires procedures to ensure that employees are paid for time worked in accordance with applicable labor contracts. Those procedures should ensure also that hours worked are supported by timesheets or other documentation, which should be kept on file to provide evidence of compliance with § 84-1001(1).

Without such procedures, there is an increased risk for not only unauthorized pay to employees but also noncompliance with State law.

> We recommend the Department implement procedures to ensure: 1) employees are paid shift differential based on actual time worked and not the scheduled hours; 2) employees are paid in accordance with provisions of the applicable labor contract(s) and do not receive pay unauthorized by those express contractual terms; and 3) hours worked are supported by timesheets or other documentation, which should be kept on file to provide evidence of compliance with § 84-1001(1).

Department Response: As provided to the Auditor's Office in response to the 2024 Attestation Report for the year ended December 31, 2023 (dated August 19, 2024):

> *Based on the Fair Labor standards Act, exempt employees must receive the full salary for any week in which the employee performs any work without regard to the number of days or hours worked, unless exceptions are met. The exception reporting of leave is an appropriate process for exempt employees. They are expected to work 40 hours per week, except when taking leave, and often work more than 40 hours per week.*
>
> *NDCS Payroll strives to be accurate in recording all payroll entries.*

NDCS pays shift differential based on the actual time worked and in accordance with the applicable labor contracts. NDCS payroll strives to be accurate in recording all payroll entries.

APA Response: As noted, Neb. Rev. Stat. § 84-1001(1) requires all state officers and heads of departments and their deputies, assistants, and employees to work no less than forty hours each week. Therefore, documentation should be retained, such as a certification or a detailed timesheet to document compliance with State statute. Additionally, our testing showed that shift differential was not paid on actual hours worked, as indicated; rather, it was paid on the hours of the employee's scheduled shift.

* * * * *

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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