ATTESTATION REPORT
OF THE
STATE OF NEBRASKA
OFFICE OF THE SECRETARY OF STATE

JULY 1, 2003 THROUGH JUNE 30, 2004

Issued on October 8, 2004

STATE OF NEBRASKA OFFICE OF THE SECRETARY OF STATE

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BACKGROUND

The authority and responsibilities of the Secretary of State, an elected official, are derived from the State Constitution and Nebraska Statutes. The Office of Secretary of State, created in 1867, administers laws in the areas of elections, business and farm corporations, trademarks and trade names, debt management, and State records management. The Office issues licenses to private detectives, notaries, debt managers, truth and deception examiners, and collection agencies. Official filings are maintained in a variety of areas including official bonds and uniform commercial code documents. The Secretary of State is the keeper of the Great Seal of the State of Nebraska and is the repository for the State Constitution, legislative bills, State agency rules and regulations, and other official documents of the State.

The programs established to administer the requirements of the Office are:

- Program 9 Salary-Secretary of State - to provide compensation for the Secretary of State. The Secretary of State is administrator or serves as a member of various boards and commissions including: Nebraska Brand Committee, State Real Estate Commission, State Canvassing Board, Board of Pardons, and Nebraska Accountability and Disclosure Commission.

- Program 22 Departmental Administration - provides the overall coordination of Office operations. This program administers and processes all documentation pertinent to the implementation and monitoring of the Elective process, Notary Publics, Rules and Regulations filings, Private Investigators, and fiscal and personnel management of the Office.

- Program 45 Election Administration - responsible with the assistance of local election officials, for the conduct of elections within the State. This includes overall responsibility for the registration of voters, candidate filings, ballot design, and compilation of results as well as ensuring compliance with various Federal mandates such as the Voting Rights Act, Americans with Disabilities Act (as it applies to polling places), the National Voter Registration Act, and the recently passed (2003) "Help America Vote Act."

- Program 51 Enforcement of Standards - Corporations - administers, processes, and is the repository for all Articles of Incorporation, Certificates of Authority, Amendments, Trade Names, Trade Marks, Service Marks, Limited Partnerships, Limited Liability Partnerships, and Limited Liability Companies.

- Program 53 Enforcement of Standards - Collection Agencies - regulates, licenses, and administers bonding requirements for collection agencies and solicitors. Receives and investigates applicants and complaints regarding collection agencies.

- Program 86 Records Management - provides comprehensive records management to all agencies of State government, including higher education, and advises and assists local political subdivisions in implementing records management programs, policies, and procedures. As of June 1997, this program also administers the receipts and disbursements of the State Records Board related to Nebrask@ Online.

BACKGROUND
(Continued)

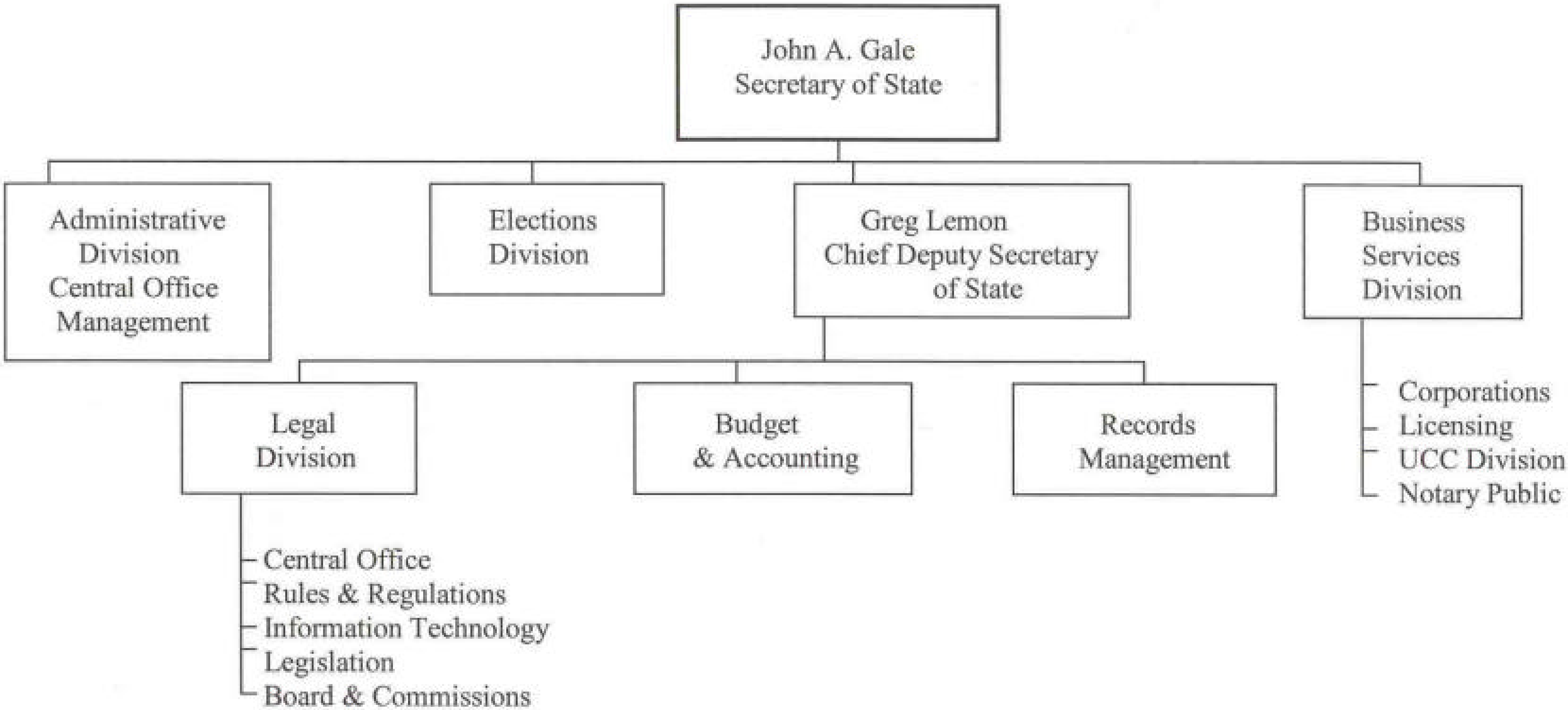
Program 89 Uniform Commercial Code Central Filing - receives, records, and files Uniform Commercial Code (UCC) financing statements to make a public record of secured financial transactions between a debtor and a secured party.

MISSION STATEMENT

The mission of the Secretary of State is to continue to provide the commitment and service to the Citizens of the State of Nebraska.

STATE OF NEBRASKA OFFICE OF THE SECRETARY OF STATE

ORGANIZATIONAL CHART



EXIT CONFERENCE

An exit conference was held September 9, 2004 with the Office to discuss the results of our examination. Those in attendance for the State of Nebraska Office of the Secretary of State were:

NAME	TITLE
John Gale	Secretary of State
Greg Lemon	Chief Deputy Secretary of State
Richard Kohel	Controller

SUMMARY OF COMMENTS

During our examination of the State of Nebraska Office of the Secretary of State, we noted certain matters involving the internal control over financial reporting and other operational matters which are presented here.

1. ***Nebraska Information System and Accounting Procedures:*** Significant areas of concern where improvement to the Nebraska Information System (NIS) is needed to ensure NIS integrity and operational efficiency were identified.

2. ***Pre-Billing of Services:*** The Records Management Division billed two agencies for services well in advance of the service actually being provided.

3. ***Contractual Services***: We noted the Secretary of State entered into a contract with a consultant. The following exceptions related to the contract were noted: Open competition was not used to enter into the contract, adequate public notice was not given, the contract was not pre-reviewed by DAS Materiel Division, the basis for selecting the vendor was not on file, and documentation of a request for potential vendor was not filed with DAS Materiel Division for access to potential vendors.

4. ***Billings and Payments Were Not Made in a Timely Manner:*** On the ten receipts tested for the Records Management Division, the invoice date was over one month after the requisition date. Two of seven expenditures tested were not made within the statutory time requirements.

5. ***Internal Control Over Payroll:*** There was a lack of segregation of duties over the payroll process. The allocation of payroll costs to business units was based on budget amounts, not on actual time worked. Vacation leave balances were still recorded on NIS for two terminated employees tested. The Secretary of State had sick and vacation leave balances recorded on NIS. Supporting documentation was not on file for two employees tested, who used more than ten consecutive days of sick leave. One terminated employee received a severance package. The adjusted service date recorded in NIS was incorrect for two employees.

6. ***Segregation of Duties Over Revenues and Related Receivables:*** There was a lack of segregation of duties over revenues and related receivables in the Business Services Division, Licensing and Administration Division, and Records Management Division.

7. ***Fixed Assets:*** There was a lack of segregation of duties over fixed assets and items were incorrectly coded to fixed asset object account codes. No physical inventory was performed for assets under the control of the Records Management Division. There was no review of NIS Fixed Asset Integrity Reports.

SUMMARY OF COMMENTS
(Continued)

8. ***Travel Expenses:*** Two employees had three days and one employee had one day of meal reimbursement that was over the General Services Administration Federal meal reimbursement guidelines. Two of the employees did not have receipts to support their expense reimbursements, therefore creating taxable income when over the guidelines. One of seven expense reimbursements did not include the name of the restaurants where the meals were purchased. An employee was reimbursed for the double occupancy room rate when their spouse traveled with them on a trip.

9. ***Federal Funds Were Not Posted Timely:*** $5,000,000 in Federal Funds were not posted to NIS until over 4 months after they were received.

10. ***Accounts Receivable Functional Matrix Code 36:*** There were six individuals with an accounts receivable functional matrix code 36 in NIS, which is to be used only by agencies that are not able to segregate their duties.

More detailed information on the above items is provided hereafter. It should be noted this report is critical in nature since it contains only our comments and recommendations on the areas noted for improvement.

Draft copies of this report were furnished to the Office to provide them an opportunity to review the report and to respond to the comments and recommendations included in this report. All formal responses received have been incorporated into this report. Where no response has been included, the Office declined to respond. Responses have been objectively evaluated and recognized, as appropriate, in the report. Responses that indicate corrective action has been taken were not verified at this time but will be verified in the next examination.

We appreciate the cooperation and courtesy extended to our staff during the course of the examination.

COMMENTS AND RECOMMENDATIONS

1. Nebraska Information System and Accounting Procedures

Good internal control requires a plan of organization, procedures, and records designed to safeguard assets and provide reliable financial records. Without adequate training, written procedures, and controls, there is a risk that employees may unintentionally corrupt critical data and that errors could occur and go undetected.

During the fiscal year ended June 30, 2003, the State of Nebraska implemented significant components of a new information system called the Nebraska Information System (NIS). Three major components were the Payroll, Fixed Asset, and Financial components, which went live during the fiscal year ended June 30, 2003. During the fiscal year ended June 30, 2004 the Procurement and Employee Self-Service components were partially implemented. NIS affects all Nebraska State agencies.

A consultant hired by the Auditor of Public Accounts (APA) with expertise in studying large computer systems performed a study of NIS processes and controls prior to June 30, 2003. The APA also performed a preliminary examination of internal controls as of June 30, 2003 at all State agencies in July and August of 2003. In addition, while performing examination procedures the APA obtained a further understanding of NIS.

From these studies and examinations, the APA has identified concerns and areas where improvement to NIS is needed. During the fiscal year ended June 30, 2004, the Department of Administrative Services (DAS) Accounting Division addressed some areas of concern previously reported. However, the following are the more significant concerns or areas where improvement is still needed to ensure NIS integrity and operational efficiency:

a. The reconciliation between the State Treasurer's actual bank statements and records, the Nebraska Accounting System (NAS-the previous accounting system before NIS), NIS accounting records, and the related disposition of reconciling items was not completed for November 2002 through December 2003 in a timely manner. Subsequent to December 2003, the DAS Accounting Division performed some reconciliation procedures. As of July 2004, the June 30, 2003 reconciliation indicates an unknown variance between the bank records and the accounting records of $3,654,783, with the bank being short compared to the accounting records.

   During the fiscal year ended June 30, 2004, DAS Accounting Division began performing a daily reconciliation of activity recorded on NIS compared to the activity recorded in the bank on a limited test basis. For those days tested, the activity recorded on NIS can be reconciled to the activity in the bank. The monthly reconciliations for the months of July 2003 through February 2004 for the fiscal year ended June 30, 2004 have been performed and indicate fluctuations in the variance amounts. The latest monthly reconciliation performed, February 2004, indicates an unknown variance between the bank records and the accounting records of $5,112,201,

COMMENTS AND RECOMMENDATIONS
(Continued)

1. Nebraska Information System and Accounting Procedures (Continued)

with the bank being short compared to the accounting records. This variance was provided to us by DAS Accounting Division and its accuracy has not been verified by the APA.

Although some reconciliation procedures have been performed (daily reconciliation of activity going through NIS to the activity recorded through the bank), the monthly reconciliation for the months March 2004 through June 2004 are still in the preliminary stages and are not complete as of July 2004. Complete and timely reconciliation procedures between bank records and accounting records provide control over cash and accurate financial information. The reconciliation procedures should be completed timely and on at least a monthly basis to ensure all financial information is correct in NIS.

b. During the early implementation months of NIS, DAS Accounting Division did not have a comprehensive written NIS policy and procedures manual available for users. During the fiscal year ended June 30, 2004, DAS Accounting Division made progress in this area and significant policies and procedures can be found by users on the DAS Accounting Division website. However, the APA, after reviewing the old accounting procedures manual, did note some procedures still being performed under those policies that have not been incorporated as NIS policies. We recommend DAS Accounting Division continue to update their NIS policies and procedures to include all policies and procedures in place to help ensure consistent and accurate accounting of the State's financial transactions.

c. During the early implementation of NIS it was determined the NIS Payroll application was not allocating salaries and benefits appropriately to salaried employees who incur hours that are distributed across multiple business units. This would apply to many State agencies' funds, programs, and grants. During the fiscal year ended June 30, 2004, agencies developed "work around" solutions to this problem; however, there has been no system change to resolve this problem. The "work around" solutions can be very time consuming. We recommend DAS Accounting Division consider obtaining a system change to allocate salaries and benefits appropriately for salaried employees who incur hours that are distributed across multiple business units.

d. During the first year of NIS implementation an outside consultant noted a detailed analysis had not been performed to determine whether users received adequate training to enable them to appropriately perform their job functions. The APA is not aware of any detailed analysis of user training conducted by the DAS Accounting Division during the fiscal year ended June 30, 2004, but does acknowledge a significant training effort by the DAS Accounting Division during this period. We recommend the DAS Accounting Division continue their training efforts as well as identifying user training needs.

COMMENTS AND RECOMMENDATIONS
(Continued)

1. Nebraska Information System and Accounting Procedures (Continued)

e. Since the implementation of NIS, DAS Accounting Division has not updated their records retention and disposition schedule with the Records Management Division of the Secretary of State (Secretary of State). The records retention schedule on file with the Secretary of State covers the records under the old accounting system and was last updated in 1986.

Neb. Rev. Stat. Section 84-1207 R.R.S. 1999 states the head of any State agency shall make, and submit to the administrator, (administrator means the State Records Administrator) schedules proposing the length of time each record series warrants retention for administrative, legal, historical or fiscal purposes, after it has been made in or received by the agency, and lists of records in the custody or under the control of the agency which are not needed in the transaction of current business, and do not possess sufficient administrative, legal, historical or fiscal value to warrant their further retention.

Since many of the records (and their titles) are significantly different under NIS than they were under the old accounting system we do not believe the DAS Accounting Division is in compliance with the above statute with the current retention schedule on file with the Secretary of State. In addition, for legal purposes and for good business practices we believe a comprehensive DAS Accounting Division records retention schedule is imperative. We recommend the DAS Accounting Division work with the Secretary of State to develop a comprehensive records retention schedule for all records they maintain.

f. The payroll component is not designed to promote an effective segregation of duties. We recommend the DAS Accounting Division consider implementing the compensating control as identified in the k. section of this comment.

g. During the first year of NIS implementation an outside consultant noted access to sensitive General Accounting functions had been provided to individuals who may not require such access as a part of their job responsibilities. Based on our inquiries, DAS Accounting Division management noted, "All critical function access rights have been secured down to the appropriate high level matrix codes." We could not verify the accuracy of this statement as requested information and documentation has not been provided to us.

h. During the first year of NIS implementation an outside consultant noted the State had not documented or formalized comprehensive information security procedures for NIS. Based on our inquiries, DAS Accounting Division management noted, "The NIS CNC's and the NIS Security team have developed a comprehensive security policy." We could not verify the accuracy of this statement as requested information and documentation has not been provided to us.

COMMENTS AND RECOMMENDATIONS
(Continued)

1. Nebraska Information System and Accounting Procedures (Continued)

i. During the first year of NIS implementation an outside consultant noted the State had not implemented a formal, comprehensive business continuity or disaster recovery plan that comprehends both NIS and its supporting infrastructure. Based on our inquiries, DAS Accounting Division management noted, "We have now contracted with an outside vendor for business continuity planning." Documentation provided to us by DAS management indicates the State has a disaster recovery plan, however, it is not complete and the business continuity plan is in the draft stage but has not yet been tested. We recommend the State continue to implement formal, comprehensive business continuity and disaster recovery plans.

j. The APA reviewed certain data in the NIS address book in July 2004. We noted the following related vendor information:

1. Duplicate Name and Address – Our review noted a total of 4,435 duplicate records. However, all have different address book numbers.

2. Duplicate Bank Information – 4,118 vendors had duplicate bank information.

3. Vendors with no Federal Tax Identification Number (FTIN) in NIS and Vendors with an FTIN of 000000000 – 3,789 vendors either had no FTIN or an FTIN with all zeros. The vendors with zeros as their FTIN were all PW (welfare) vendor types. Out of the 3,789 records 3,408 had no FTIN at all.

When duplicate records are in the NIS address book database there is a greater risk of duplicate payments being made and not being detected and queries of the database for vendor information may not be complete because the queries may not include all vendor information. In addition, when the database does not include FTIN numbers for all vendors there is a greater risk of payments to a fictitious vendor. DAS Accounting Division should correct the database for duplicate records and ensure all vendors included in the database have an FTIN.

k. DAS Accounting Division payroll procedures require each State agency to certify its payroll for each pay period to ensure payroll is processed accurately and completely. This certification is to be in writing, either through an email or letter to the DAS Accounting Administrator. In our review of the final payroll notification and certification procedures processed in July 2003 and May of 2004 and discussion with DAS Accounting Division personnel, the certification procedures were not always performed. Our review also noted that the DAS Accounting Division did not have a policy on the information that should be included in the written certification. We noted during our testing, when there was a certification, there was no consistency in the information provided by State agencies.

COMMENTS AND RECOMMENDATIONS
(Continued)

1. Nebraska Information System and Accounting Procedures (Concluded)

DAS Accounting Division should establish a policy on detailing the information to be included in the certification, should ensure all State agencies consistently follow this policy, and ensure all payroll expenditures are certified.

The issues identified above are the responsibility of the DAS Accounting Division and NIS Functional Team as they relate directly to NIS; however, they directly affect all Nebraska State agencies' financial information and must be disclosed in this report. The results of the consultant's study of NIS were communicated in a separate report to DAS, who is responsible for NIS. Letters to each State agency communicated the results of the APA's preliminary examination of internal controls at the State agency level. Additional concerns identified by the APA were communicated to the appropriate State officials.

2. Pre-Billing of Services

Nebraska State Accounting Manual, AM-005, General Policies, Section 4, states, "Though prepayments are not illegal, per se, they are in conflict with the normal claims process since the State has given up assets in anticipation of goods or services being rendered at a later date . . . . Since the potential for loss to the State is greater under prepayment situations, extreme care should be exercised and a conscious effort should be undertaken to minimize prepayments at the agency level."

We noted the Records Management Division billed two agencies for services well in advance of the service actually being provided. On April 28, 2003, Records Management pre-billed the Tax Equalization and Review Commission $30,000 and the Military Department $2,000 for scanning and storage services. The Military Department was also pre-billed for $25,000 on June 19, 2001. The Records Management Division pre-billed these agencies at their request. As of June 30, 2003, the Commission had a credit balance of $27,633 and the Military Department had a credit balance of $2,608. Prepayments are a possible method of circumventing the legislative appropriation process.

We recommend the Secretary of State not bill agencies in advance for services or accept prepayments for services.

Secretary of State's Response: The Records Management Division has notified those state agencies which have in the past requested to be pre-billed for services to be rendered, that once any existing credit balances are used, pre-billing will not be available and prepayments for services will not be accepted. The Secretary of State will not bill agencies in advance or accept pre-payment in the future.

COMMENTS AND RECOMMENDATIONS
(Continued)

3. Contractual Services

Sound business practice requires procedures be in place to ensure a standardized, open, and fair process for the selection of contractual services even if not specifically required by State Statute. These procedures would include following 2003 Neb. Law LB 626 which requires service procurements in excess of $50,000 to be bid in the manner prescribed in the DAS Materiel Division Procurement Manual. Agencies can complete the bid process at the agency level in accordance with the DAS Materiel Division's Procurement Manual or request the DAS Director to approve an alternate process for the procurement of services. The alternate process needs to be agency or program wide and approved before the competitive bid process. LB 626 also requires adequate public notice, the basis for selection of vendor be on file, and the agency's request for contract be filed with the DAS Materiel Division for access to potential vendors.

The Secretary of State entered into a contract with a consultant to provide technical consulting services for the implementation of the Voter Registration system to meet new Federal standards. During our review of the contract we noted the following:

- Open competition was not used to enter into the contract.
- Adequate public notice was not given.
- The contract was not pre-reviewed by DAS Materiel Division.
- The basis for selecting the vendor was not on file.
- Documentation of a request for potential vendor was not filed with the DAS Materiel Division for access to potential vendors.

During the fiscal year ended June 30, 2004, a total of $142,451 was paid to the consultant. When an open competitive process is not used to award contracts there is an increased risk the Secretary of State may enter into contracts which are not financially in their best interest.

> We recommend the Secretary of State implement procedures to ensure a standardized, open, and fair process for the selection of contractual services is followed. These procedures would include following 2003 Neb. Laws LB 626 and the guidelines established by the DAS Materiel Division.

Secretary of State's Response: LB 626 Specifically provides that "For purposes of sections 73-501 to 73-509 . . . State agency or agency means any state agency, board, or commission ***other than*** *the University of Nebraska, the Nebraska state colleges, the courts, the Legislature, or any other officer or agency established by the Constitution of Nebraska" (Neb. Rev. Stat. §73-502, emphasis added)*

COMMENTS AND RECOMMENDATIONS
(Continued)

3. <u>Contractual Services</u> (Concluded)

Secretary of State's Response, Concluded:
The office of the Secretary of State is created by the Constitution of Nebraska, Article IV, Sec. 1.

§73-504, competitive bidding requirements, apply to state agencies as defined in the act and above, this does not include the Secretary of State's Office as clearly illustrated by #1 and #2 above.

§73-507, the sole source exemption and other provisions are exemptions to the bidding requirement. You cannot logically apply an exemption to a provision that does not apply in the first place. Or stated more clearly, if the bidding requirements do not apply, the exceptions to the bidding requirements do not apply.

Therefore the Secretary of State does not agree with the Auditor's comment "Contract Not in Accordance with LB 626" and suggests that this comment is inappropriate.

The Secretary of State's Office is cognizant of the need to ensure efficient use of state resources through the use of appropriate vendor selection processes.

In selecting Gregoire Consulting the Secretary of State made an evaluation of the expertise needed in the elections and information technology area in order to provide effective services under this contract, it was determined that Ms. Gregoire's work in developing consulting with Secretary of State's Office on Election related IT project in the past made her uniquely qualified to provide assistance in writing the voter registration RFP.

The contract was for assistance in writing and developing an RFP for a larger project, which was to secure a contractor to implement a statewide voter registration system consistent with Help America Vote Act (federal) election mandates. In order to meet the timelines in the mandates we did not have time to write an RFP to select someone to write an RFP. Timely implementation required timely development of the larger RFP which did follow and go through State Purchasing Policies and Procedures.

APA's Response: While we agree that 2003 Neb. Law LB 626 does not specifically include officers or agencies established by the Constitution of Nebraska, procedures established by this legislation are sound business practices and if followed would ensure a standardized, open, and fair process for the selection of contractual service providers. There was no documentation on file to support the basis for the Secretary of State's selection of this particular consultant. When timeliness or other factors make it difficult to follow an open competitive process we recommend documentation be maintained to support the reason a particular vendor is selected.

COMMENTS AND RECOMMENDATIONS
(Continued)

4. Billings and Payments Were Not Made in a Timely Manner

Good internal control requires procedures to be in place to ensure billings for services performed are made in a timely manner. Neb. Rev. Stat. Section 81-2403(1) R.R.S. 1999 states that payment is required within 45 calendar days after (1) receipt of goods or services or (2) the date of receipt of the bill, whichever is later, unless there is a written agreement to the contrary.

During our review of revenues and expenditures for the Records Management Division we noted the following:

- On all ten receipts tested the invoice date was over one month after the requisition date. On three of the ten receipts tested, the invoice date was over three months after the requisition date. In addition, as of August 30, 2004, the Division had not yet billed for May, June, and July, 2004.

- Payments were not made within statutory requirements on two of seven expenditures tested. One payment for $5,830 was not made for 86 days and another for $4,892 was not made for 56 days.

When billings are not made in a timely manner the monies are not available for Secretary of State use and interest earnings are reduced. When payments are not made within statutory timeframes the Secretary of State may be responsible to pay interest to the vendor.

> We recommend the Records Management Division implement procedures to ensure billings are made in a timely manner and expenditures are in accordance with State Statute.

Secretary of State's Response: The Records Management Division acknowledges that billings and expenditures have not been made in a timely manner due to work backlogs. The division is implementing procedures to ensure billings and expenditures are made in a timely manner. In addition, new accounts receivable software which would interface with the NIS system is being investigated to replace the manual paper-based system now in place.

5. Internal Control Over Payroll

Good internal controls require an adequate segregation of duties to ensure no one individual is capable of handling all phases of a transaction from the beginning to end. Good internal controls require a method of allocating time worked by business unit and preparing and maintaining detailed timesheets to document and support actual time worked by business unit.

COMMENTS AND RECOMMENDATIONS
(Continued)

5. Internal Control Over Payroll (Continued)

Good internal control and sound accounting practice require vacation and sick leave balances to be reduced to zero when an employee is terminated. Attorney General's Opinion Number 03021 explains that elected officials are not considered State employees and are not eligible to earn vacation or sick leave. Secretary of State Personnel Policies state "Substantiating evidence will be required if the sick leave absence is ten workdays or longer." In order to follow personnel rules and regulations, documentation is necessary to support the usage of sick leave in excess of ten or more days in a row. Article III, Section 19 of the Nebraska Constitution provides that, "the legislature shall never grant any extra compensation to any public officer, agent, or servant after services have been rendered . . . " Secretary of State Personnel Policies state "Employees who left state service for other than disciplinary reasons and return within one year shall be given credit for previous state service by having their service date reinstated minus the amount of time absent."

We noted the following:

- There was a lack of segregation of duties over the payroll process as one individual was responsible for all phases of the payroll process.

- The allocation of payroll costs to business units was based on budgeted amounts, not on actual time worked. Timesheets were used to document total time worked and to document time worked on Federal programs but not to document time worked on other programs. This was a comment in a prior audit.

- Vacation leave balances were still recorded on NIS for two terminated employees tested. The vacation leave balances were not reduced to zero because the payment of the terminated employees final pay was incorrectly coded when the employee's final payroll was processed.

- The Secretary of State had sick and vacation leave balances recorded on NIS.

- Supporting documentation was not on file for two employees tested who used more than ten consecutive days of sick leave.

- One terminated employee received a severance package. They were paid compensation of $1,632 for time they did not work. Their employment terminated on May 14, 2004 and they were paid through the end of May.

- The adjusted service date recorded in NIS was incorrect for two employees.

COMMENTS AND RECOMMENDATIONS
(Continued)

5. Internal Control Over Payroll (Continued)

The lack of an adequate segregation of duties over the payroll process includes but is not limited to the risk of fictitious employees, unauthorized salary changes or overrides, and inaccurate leave reporting. When the allocation of payroll costs to different programs is based on budgeted amounts and not the actual time worked on different programs documented on timesheets, the allocation of payroll costs between programs may be incorrect. Without detailed timesheets time can only be allocated using a best guess allocation, which can lead to the wrong amount being charged to each fund. When terminated employees still have leave balances recorded on NIS there is a risk if the individual returns to State employment the old balances may incorrectly be reinstated. Also financial reports may include incorrect amounts for compensated absences which are not valid. Without requiring supporting documentation for the usage of more than ten consecutive days of sick leave the risk sick leave may be misused is increased. Paying severance compensation increases the payroll costs of the Secretary of State and is prohibited by the State Constitution. Because an incorrect adjusted service date was used for two employees one employee earned 29 hours of vacation and 40 hours of sick leave, and another employee earned 32 hours of vacation and 52 hours of sick leave more than they should have earned based on their correct service date.

> We recommend the Secretary of State implement a segregation of duties over the payroll process. Procedures should be implemented which allocate payroll costs based on actual time worked for all employees who work on multiple programs. The payment of a terminated employee's vacation leave balances should be recorded using the correct code so vacation leave balances are reduced to zero in NIS with the final paycheck. Supporting documentation for consecutive sick leave usage of more than ten days should be required and maintained on file. Terminated employees should not receive severance compensation, unless the State is receiving something in return for the compensation. Adjusted service dates recorded on NIS should be verified and updated only when the criteria for recognizing prior State service is met.

Secretary of State's Response: The lack of segregation is in part due to having only a single budget and finance officer available to perform the payroll duties. We make every attempt to utilize internal controls through a monthly review of the payroll by the Budget Officer & Chief Deputy Secretary of State who is cognizant of office salary levels. A written notice is sent monthly to DAS Payroll processing when completed by Secretary of State Personnel.

The allocations of payroll costs follow program funding that are distributed by business units within NIS. We will review our allocation and investigate the various ways to track actual payroll costs to budgeted programs during this next fiscal year.

COMMENTS AND RECOMMENDATIONS
(Continued)

5. Internal Control Over Payroll (Concluded)

Secretary of State's Response, Concluded:
Vacation balances not reduced to zero in the NIS. This was an oversight by the budget officer. The new NIS payroll system has impacted specific entries and their affect on the HR/Payroll system. The two balances in question have been zeroed out and corrected within the payroll system.

The Secretary of State does not earn sick & vacation leave balances even though the NIS system reflected the accrual of those balances. Our budget officer has zeroed out and corrected those balances with an update to the NIS payroll system.

Supporting documentation for extended sick leave absences will be required for all employees in accordance with Secretary of State Policy.

Terminated employees payment policy & procedures will be reviewed during the fiscal year to determine what benefits will be made available to separating employees. We will also research practices of other state agencies in this area.

The service dates adjusted by the budget officer have all been corrected to reflect the appropriate start dates. The budget officer was unaware that the total years of service would calculate at a different rate based on that adjustment. This was an oversight on his part. An adjustment in the NIS data base has been made to correct the leave amounts.

6. Segregation of Duties Over Revenues and Related Receivables

Good internal control requires a segregation of duties so no one individual can handle all phases of a transaction from beginning to end. Good internal control also includes a plan of organization, procedures, and records designed to provide reliable financial records.

There was a lack of segregation of duties over revenues and related receivables in the Business Services Division, Licensing and Administration Division, and Records Management Division. One individual could handle all phases of a transaction. In addition, we noted there was no reconciliation between the Deposit Documents for receipts and the General Ledger. The lack of a segregation of duties over receipts was a comment in a prior audit.

Without a proper segregation of duties in place the risk of concealed errors or irregularities is increased.

> We recommend the Secretary of State implement procedures to ensure a segregation of duties exists or establish adequate compensating controls.

COMMENTS AND RECOMMENDATIONS
(Continued)

6. Segregation of Duties Over Revenues and Related Receivables (Concluded)

Secretary of State's Response: The lack of segregation is in part due to the number of employees that are available to perform the various receivable functions. In the Business Services, Licensing and Administration Divisions we work to separate the duties of receipt transactions. We make every attempt to utilize internal controls. With the implementation of NIS we will reevaluate our receivable process.

In the Records Management Division, revenue documents are generated in NIS by the Administrative Assistant, the NIS documents are approved by the Director, the NIS documents are then turned over to the State Treasurer who completes the transaction. Copies of the paper documents are retained by the Accountant I. Accounts receivable billing documents (IBTs) are created in NIS by the Administrative Assistant, approved by the Director, preaudited by the Accountant I, and transmitted by the Controller. Copies of the paper documents are retained by the Accountant I. Additional employees are not available in the division to be involved in this process.

7. Fixed Assets

Good internal control requires a segregation of duties so no one individual can handle all phases of a transaction from beginning to end. Good internal control also includes a plan of organization, procedures, and records designed to provide reliable financial records. Neb. Rev. Stat. Section 81-1118.02(1) R.R.S. 1999 states, "Each executive, department, commission, or other state agency . . . shall annually make or cause to be made an inventory of all property, including furniture and equipment, belonging to the State of Nebraska and in the possession, custody, or control of any executive, department, commission, or other state agency."

We noted the following:

- Three employees were authorized to perform all aspects of the fixed asset process as they were set up with fixed asset functional matrix code 30 in NIS. There were no compensating controls to ensure an adequate segregation of duties. The lack of segregation of duties over fixed assets was a comment in a prior report.

- Eight items totaling $81,060 were incorrectly coded to a fixed asset object account code. No correcting journal entries were made.

- Two items totaling $6,980 had the wrong acquired date and did not appear on the fixed asset listing.

- Shelving units purchased through Master Lease were not given a tag number and therefore were not included on the fixed asset listing as of June 30, 2004. Master lease payments for the fiscal year totaled $4,501.

COMMENTS AND RECOMMENDATIONS
(Continued)

7. <u>Fixed Assets</u> (Continued)

- One of five assets tested could not be located. The item in question was a microfiche reader that was located at and surplused by the Department of Labor.

- The Records Management Division did not perform an annual inventory of items under their control. This was a comment in a prior audit.

- There was no review of the NIS Fixed Asset Integrity Reports.

- NIS functional access to fixed assets was not terminated for one employee who transferred between divisions within the Office. The employee's job duties no longer included any part of the fixed asset process.

- One item on the Asset Master List had an incorrect asset type.

Without a proper segregation of duties in place the risk of concealed errors or irregularities is increased. When statutory procedures are not followed, important control procedures over fixed assets are lost, and the chance for loss or misuse of fixed assets increases.

We recommend the following:
- Procedures be implemented to ensure a segregation of duties exists or adequate compensating controls be established.
- Procedures be implemented to properly account for fixed assets.
- An annual physical inventory be completed for assets under the control of the Records Management Division.
- Documented periodic reviews of NIS Fixed Asset Integrity Reports to ensure assets are properly recorded.
- Procedures be implemented to remove NIS functional access to fixed assets when access is no longer required for an employee's job duties.

Secretary of State's Response: The three individuals with the functional matrix code 30 were established to provide backup for fixed asset input and updates within NIS. We will review our fixed asset internal controls and evaluate our matrix codes to determine where segregation of duties can be improved.

As to bullet pointes 2-5, the incorrectly coded fixed assets will be reviewed by our budget officer to determine what the correct coding should have been. The implementation of NIS required inventory system changes, we will develop procedures to properly account for assets.

COMMENTS AND RECOMMENDATIONS
(Continued)

7. <u>Fixed Assets</u> (Concluded)

Secretary of State's Response, Concluded:
Three employees of the Records Management Division attended training in NIS fixed asset software on August 26, 2004. That training had not been previously available. Procedures within the division will be implemented in conjunction with the other divisions within the agency. An annual physical inventory of all divisions will be implemented.

The review of the NIS Fixed Asset Integrity Reports was only completed at the time of asset purchases. Our office does not make monthly fixed asset purchases and thus has not run the reports monthly. With the implementation of NIS and the new process associated with fixed asset inventory our budget officer or appropriate personnel will review the Fixed Asset Integrity Report on a monthly basis.

The NIS functional access to fixed assets for an internally transferred employee was left open to assist in training of her replacement. This also allows us to provide the backup of personnel to complete NIS transactions when authorized personnel are out of the office. We will review our procedures to ensure that when employees transfer to other divisions that functional accesses be reviewed and terminated as required.

8. <u>Travel Expenses</u>

Nebraska State Accounting Manual, AM-005, regarding travel policies states meal expenses must be substantiated under the State's Accountable Plan. Internal Revenue Service (IRS) Publication 463 regarding reimbursement for travel expenses states that a restaurant receipt should include, "The name and location of the restaurant." Supporting documentation for meals should include the name of the restaurant and the city. Good internal control includes procedures to ensure requirements of the State's accountable plan are met and reimbursements are in compliance with IRS Publication 463 guidelines.

Good internal control requires procedures to ensure disbursements are reasonable, necessary, and in accordance with State guidelines. Good internal control also requires policies and procedures to ensure meal reimbursements are reasonable based on location. DAS Accounting Division recommends the General Services Administration (GSA) - Federal per diem rates be used as a reasonable guideline for meal and lodging reimbursements.

The State of Nebraska only reimburses expenses incurred by State employees traveling on official State business. Travel expenses of individuals who are not State employees traveling with a State employee are the responsibility of the individual or the State employee not the State of Nebraska.

COMMENTS AND RECOMMENDATIONS
(Continued)

8. <u>Travel Expenses</u> (Continued)

We noted the following:

- One of seven expense reimbursements tested did not include the name of the restaurants where the meals were purchased.
- Two employees had three days and one employee had one day of meal reimbursements that were over the GSA Federal meal reimbursement guidelines. Two of the employees did not have receipts with their expense reimbursements, therefore, creating taxable income when the meal reimbursement was over the guidelines.
- An employee was reimbursed for the double occupancy room rate when their spouse traveled with them on a trip. The difference between the single occupancy room rate and the double occupancy room rate was $28.63 per day. There were 5 days claimed at this rate for a total over reimbursement of $143.15.

When expense reimbursements are not in compliance with IRS accountable plan requirements there is a risk the accountable plan may be questioned by the IRS and all meal expense reimbursements become taxable income to State employees. There is an increased cost to the State when meal guidelines are exceeded and non-State employee expenses are paid.

> We recommend the Secretary of State review all travel expense reimbursements to ensure meal expenses claimed are supported by adequate supporting documentation including meal receipts/logs, the name of each restaurant, and the breakdown of meals. We further recommend the Secretary of State review controls and procedures to ensure travel expenses are reasonable, necessary, and in accordance with State travel policies and procedures.

Secretary of State's Response: The State accounting memo provides that only actual meal expenses should be reimbursed. The statement that DAS uses Federal per diem rates as a reasonable guideline is not consistent with what is stated in the DAS manual. The only reference to GSA guidelines in the State Accounting Manual is in "Travel Expense Policies" "6. Meals", which states that the GSA guidelines should not be used as a per diem for reimbursement, actual cost should be used. The Secretary of State does however encourage a policy of reasonable and prudent meal expenses based upon location and situation. Excessive meal or travel expenses are not allowed.

In Response to concerns about IRS categorizing meal reimbursements as income in FY 2003 2004 the Secretary of State has implemented a policy of having receipts or a meal log for all reimbursable meal expenses.

COMMENTS AND RECOMMENDATIONS
(Continued)

8. Travel Expenses (Concluded)

Secretary of State's Response, Concluded
The double occupancy room rate that was mistakenly reported rather than the single rate has been reimbursed to the state. We will review future lodging reimbursement requests to make sure that this mistake will not be repeated.

APA's Response: In order to provide guidance to agency directors and other responsible individuals in determining the reasonableness of employees' expense claims, the Department of Administrative Services sent all agencies, boards, and commissions a memo on December 12, 2000. The memo states "From this time forward, we are recommending departments utilize the Federal maximum per diem standards as published by the government as a reasonable guideline." This is not inconsistent with the Nebraska State Accounting Manual as the actuality of a meal reimbursement claim is not the only factor in determining whether a meal expense was reasonable.

9. Federal Funds Were Not Posted Timely

Good internal control requires timely posting of revenues to appropriate funds. When revenues are not posted on a timely basis, the balances of the funds involved are not accurately stated.

The Secretary of State received $5,000,000 in Federal funds through an Automated Clearinghouse (ACH) receipt transaction as part of the Help America Vote Act of 2002 in April 2003. The monies were not posted to NIS until September 2003, over four months after the monies were deposited in a State account.

> We recommend the Secretary of State implement procedures to ensure ACH transaction monies are posted to NIS in a timely manner.

Secretary of State's Response: There is a discrepancy within the NIS on how posted records are displayed. Our records show that a posted entry was made to our federal fund account after the preparation of the ACH document. We have documentation of this which can be provided upon request. This transaction took place when new terminology and new procedures were being implemented in NIS. The transaction in question was reflected in the federal funds deposited to state funds. Subsequent transactions including a federal fund deposit during June of 2004 have been accurately reflected in NIS financial reporting.

APA's Response: The $5,000,000 was not posted to a revenue object account code and was not reflected in the fund balance of the Secretary of State in NIS until September 2003. Good internal controls would require a review process be in place to ensure transactions are correctly posted in a timely manner.

COMMENTS AND RECOMMENDATIONS
(Continued)

10. Accounts Receivable Functional Matrix Code 36

Good internal control requires adequate controls be in place over accounting functions and without an adequate segregation of duties there is an increased risk of loss or theft of State funds.

There were six individuals with an accounts receivable functional matrix code 36, which is to be used only by agencies that are not able to segregate their duties. These individuals were able to enter, revise, delete, void, and approve deposits.

> We recommend the Secretary of State review their NIS User Authorization and make updates as necessary to increase the effectiveness of internal controls.

Secretary of State's Response: The six individuals with functional matrix code 36 to process receivables work in the various Divisions, Administration, Business Services and Records Management. Each of these has separate and distinct functions. We promote the segregation of duties wherever possible but also want to provide the necessary backup in each division to make deposits in a timely manner when the primary employee may be out of the office. Our office will further review our internal controls in this area to determine if we can reduce the AR exposure and reduce the number of functional matrix code 36.

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STATE OF NEBRASKA OFFICE OF THE SECRETARY OF STATE

INDEPENDENT ACCOUNTANT'S REPORT

We have examined the accompanying schedule of revenues, expenditures, and changes in fund balances of the State of Nebraska Office of the Secretary of State (Office) for the fiscal year ended June 30, 2004. The Office's management is responsible for the schedule of revenues, expenditures, and changes in fund balances. Our responsibility is to express an opinion based on our examination.

Our examination was conducted in accordance with attestation standards established by the American Institute of Certified Public Accountants, and the standards applicable to attestation engagements contained in *Government Auditing Standards* issued by the Comptroller General of the United States, and accordingly, included examining, on a test basis, evidence supporting the schedule of revenues, expenditures, and changes in fund balances and performing such other procedures as we considered necessary in the circumstances. We believe that our examination provides a reasonable basis for our opinion.

In our opinion, the schedule referred to above presents, in all material respects, the revenues, expenditures, and changes in fund balances of the State of Nebraska Office of the Secretary of State for the fiscal year ended June 30, 2004, based on the accounting system and procedures prescribed by the State of Nebraska Director of Administrative Services as described in Note 1.

In accordance with *Government Auditing Standards,* we have also issued our report dated September 9, 2004, on our consideration of the State of Nebraska Office of the Secretary of State's internal control over financial reporting and our tests of its compliance with certain provisions of laws, regulations, contracts, and grants. That report is an integral part of an attestation engagement performed in accordance with *Government Auditing Standards* and should be read in conjunction with this report in considering the results of our examination.

This report is intended solely for the information and use of the Office and the appropriate Federal and regulatory agencies. However, this report is a matter of public record and its distribution is not limited.

Timothy J. Chamney CPA

September 9, 2004 Assistant Deputy Auditor

STATE OF NEBRASKA OFFICE OF THE SECRETARY OF STATE

SCHEDULE OF REVENUES, EXPENDITURES, AND CHANGES IN FUND BALANCES

For the Fiscal Year Ended June 30, 2004

	General Fund 10000	Collection Agency Fund 20910	Corporation Cash Fund 20920
REVENUES:			
Appropriations	$ 650,502	$ -	$ -
Taxes:			
Domestic Corporation Taxes	2,468,214	-	-
Foreign Corporation Taxes	9,212,885	-	-
Other Taxes	51,360	-	-
Intergovernmental	-	-	-
Sales & Charges	1,540,558	96,569	538,384
Miscellaneous	38,180	9,770	32,556
TOTAL REVENUES	13,961,699	106,339	570,940
EXPENDITURES:			
Personal Services	568,641	50,987	254,948
Operating	63,944	4,631	220,987
Travel	17,917	4,036	444
Capital Outlay	-	-	328
TOTAL EXPENDITURES	650,502	59,654	476,707
Excess (Deficiency) of Revenues Over (Under) Expenditures	13,311,197	46,685	94,233
OTHER FINANCING SOURCES (USES):			
Sales of Assets	-	-	-
Deposit to General Fund	(13,311,197)	-	-
TOTAL OTHER FINANCING SOURCES (USES)	(13,311,197)	-	-
Net Change in Fund Balances	-	46,685	94,233
FUND BALANCES, JULY 1, 2003	3,039	224,066	769,974
FUND BALANCES, JUNE 30, 2004	$ 3,039	$ 270,751	$ 864,207
FUND BALANCES CONSIST OF:			
General Cash	$ -	$ 270,735	$ 864,171
Non-Sufficient Fund Items	-	-	80
Deposits with Vendors	3,039	16	-
Accounts Receivable	-	-	6
Due to Fund	-	-	(50)
TOTAL FUND BALANCES	$ 3,039	$ 270,751	$ 864,207

The accompanying notes are an integral part of the schedule.

Records Management Cash Fund 20930	Administration Cash Fund 20940	Election Administration Fund 20950	Uniform Commercial Code Fund 26110	Micrographics Service Fund 50900	**Total (Memorandum Only)**
$ -	$ -	$ -	$ -	$ -	$ 650,502
-	-	-	-	-	2,468,214
-	-	-	-	-	9,212,885
-	-	-	-	-	51,360
-	-	4,920,376	-	-	4,920,376
1,315,564	96,211	40,085	596,755	780,673	5,004,799
32,050	8,784	205,361	124,847	21,991	473,539
1,347,614	104,995	5,165,822	721,602	802,664	22,781,675
1,311	71,044	183,172	417,886	388,947	1,936,936
1,314,606	50,117	265,638	316,291	390,706	2,626,920
2,040	5,155	19,431	7,377	7,289	63,689
8,950	-	8,100	54,956	73,054	145,388
1,326,907	126,316	476,341	796,510	859,996	4,772,933
20,707	(21,321)	4,689,481	(74,908)	(57,332)	18,008,742
-	925	-	-	1,441	2,366
-	-	-	-	-	(13,311,197)
-	925	-	-	1,441	(13,308,831)
20,707	(20,396)	4,689,481	(74,908)	(55,891)	4,699,911
755,961	225,744	5,209,931	638,274	387,541	8,214,530
$ 776,668	$ 205,348	$ 9,899,412	$ 563,366	$ 331,650	$ 12,914,441
$ 776,651	$ 205,318	$ 9,899,412	$ 556,933	$ 259,335	$ 12,832,555
-	-	-	-	-	80
-	-	-	2,706	-	5,761
17	30	-	3,727	72,315	76,095
-	-	-	-	-	(50)
$ 776,668	$ 205,348	$ 9,899,412	$ 563,366	$ 331,650	$ 12,914,441

NOTES TO THE SCHEDULE

For the Fiscal Year Ended June 30, 2004

1. Criteria

The accounting policies of the State of Nebraska Office of the Secretary of State are on the basis of accounting as prescribed by the State of Nebraska Department of Administrative Services (DAS).

Per Neb. Rev. Stat. Section 81-1107(2) R.R.S. 1999, the State of Nebraska Director of Administrative Services duties include "The keeping of general accounts and the adoption and promulgation of appropriate rules, regulations, and administrative orders designed to assure a uniform and effective system of accounts and accounting, the approval of all vouchers, and the preparation and issuance of warrants for all purposes."

The Nebraska Information System (NIS) is the official accounting system prescribed by DAS for the State of Nebraska. Policies and procedures are detailed in NIS manuals and Nebraska Accounting System Concepts published by DAS and available to the public. The financial information used to prepare the schedule of revenues, expenditures, and changes in fund balances for the Office was obtained directly from the NIS. NIS records accounts receivable and accounts payable as transactions occur. As such certain revenues are recorded when earned and expenditures are recorded when a liability is incurred, regardless of the timing of related cash flows. The accounts payable liability recorded on NIS, and thus recorded as expenditures, as of June 30, 2004 includes only those payables posted to NIS before June 30, 2004 and not yet paid as of that date. The amount recorded as expenditures as of June 30, 2004 **does not** include amounts for goods and services received before June 30, 2004 which had not been posted to NIS as of June 30, 2004. NIS does not include liabilities for accrued payroll and compensated absences.

The fund types established by NIS that are used by the Office are:

10000 – General Fund – accounts for all financial resources not required to be accounted for in another fund.

20000 – Cash Funds – account for revenues generated by specific activities from sources outside of State government and the expenditures directly related to the generation of the revenues. Cash funds are established by State statutes and must be used in accordance with those statutes.

50000 – Revolving Funds – account for the operation of state agencies which provide goods and services to other departments or agencies within state government.

NOTES TO THE SCHEDULE
(Continued)

1. Criteria (Continued)

The major revenue object account codes established by NIS used by the Office are:

Appropriations – Appropriations are granted by the Legislature to make expenditures and to incur obligations. The amount of appropriations reported as revenue is the amount of expenditures.

Taxes – Compulsory charges levied by a government for the purpose of financing services performed for the common benefit. Taxes recorded as revenue for the Office consists primarily of domestic and foreign corporation tax.

Intergovernmental – Revenue from other governments in the form of grants, entitlements, shared revenues, payments in lieu of taxes, or reimbursements.

Sales & Charges – Income derived from sales of merchandise and commodities, compensation for services rendered, and charges for various licenses, permits, and fees.

Miscellaneous – Revenue from sources not covered by other major categories, such as investment income.

The major expenditure object account titles established by NIS used by the Office are:

Personal Services – Salaries, wages, and related employee benefits provided for all persons employed by the Office.

Operating – Expenditures directly related to a program's primary service activities.

Travel – All travel expenses for any state officer, employee, or member of any commission, council, committee, or board of the State.

Capital Outlay – Expenditures which result in the acquisition of or an addition to capital assets. Capital assets are resources of a long-term character, owned or held by the government.

Other significant object account codes established by NIS and used by the Office include:

Assets – Resources owned or held by a government that have monetary value. Assets include cash accounts, deposits with vendors, and receivable accounts. Accounts receivable are recorded as an increase to revenues and an increase to fund balance on the schedule. Cash accounts and deposits with vendors are also included in fund balance and are reported as recorded on NIS.

NOTES TO THE SCHEDULE
(Continued)

1. Criteria (Concluded)

Liabilities – Legal obligations arising out of transactions in the past that must be liquidated, renewed, or refunded at some future date. Accounts payable transactions increase expenditures and decrease fund balance. Other liabilities recorded on NIS for the Office's funds at June 30, 2004 included Due to Fund. The activity of this account is not recorded on the Schedule of Revenues, Expenditures, and Changes in Fund Balances as it is not recorded through revenue and expenditure accounts.

2. State Agency

The State of Nebraska Office of the Secretary of State (Office) is a State agency established under and governed by the laws of the State of Nebraska. As such, the Office is exempt from State and Federal income taxes. The schedule includes all funds of the Office.

The State of Nebraska Office of the Secretary of State is part of the primary government for the State of Nebraska.

3. Totals

The Totals "Memorandum Only" column represents an aggregation of individual account balances. The column is presented for overview informational purposes and does not present consolidated financial information because interfund balances and transactions have not been eliminated.

4. Capital Assets

Under NIS, capital assets are not capitalized in the funds used to acquire or construct them. Instead, capital acquisitions are reflected as expenditures. Capital assets, which would include property, plant, equipment, and infrastructure assets (e.g., roads, bridges, sidewalks, and similar items) would be reported for the State of Nebraska in the Comprehensive Annual Financial Report (CAFR). The Office values all capital assets at cost where historical records are available and at estimated historical cost where no historical records exist. Donated capital assets are valued at their estimated fair market value on the date received. Generally, equipment that has a cost of $1,500 at the date of acquisition and has an expected useful life of two or more years is capitalized. Depreciation expenses would be reported in the CAFR in the funds used to acquire or construct them for the State of Nebraska. The cost of normal maintenance and repairs that does not add to the value of the asset or extend asset life is not capitalized.

Equipment is depreciated using the straight-line method with estimated useful lives of three to ten years.

NOTES TO THE SCHEDULE
(Continued)

4. Capital Assets (Concluded)

Capital asset activity of the Office for the fiscal year ended June 30, 2004 was as follows:

	Beginning Balance	Increases	Decreases	Ending Balance
Capital assets				
Equipment	$ 2,649,651	$ 58,051	$ 136,305	$ 2,571,397
Less accumulated depreciation for:				
Equipment				2,364,161
Total capital assets, net of depreciation				$ 207,236

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STATE OF NEBRASKA OFFICE OF THE SECRETARY OF STATE

REPORT ON COMPLIANCE AND ON INTERNAL CONTROL OVER FINANCIAL REPORTING BASED ON AN EXAMINATION OF THE SCHEDULE OF REVENUES, EXPENDITURES, AND CHANGES IN FUND BALANCES PERFORMED IN ACCORDANCE WITH *GOVERNMENT AUDITING STANDARDS*

We have examined the accompanying schedule of revenues, expenditures, and changes in fund balances of the State of Nebraska Office of the Secretary of State for the fiscal year ended June 30, 2004, and have issued our report thereon dated September 9, 2004. We conducted our examination in accordance with attestation standards established by the American Institute of Certified Public Accountants and the standards applicable to attestation engagements contained in *Government Auditing Standards*, issued by the Comptroller General of the United States.

Compliance

As part of obtaining reasonable assurance about whether the State of Nebraska Office of the Secretary of State's schedule of revenues, expenditures, and changes in fund balances, is free of material misstatement, we performed tests of its compliance with certain provisions of laws, regulations, contracts, and grants, noncompliance with which could have a direct and material effect on the determination of financial schedule amounts. However, providing an opinion on compliance with those provisions was not an objective of our examination, and, accordingly, we do not express such an opinion. The results of our tests disclosed no instances of noncompliance that are required to be reported under *Government Auditing Standards*. We noted certain immaterial instances of noncompliance that we have reported to management of the State of Nebraska Office of the Secretary of State in the Comments Section of this report as Comment Number 4 (Billings and Payments Were Not Made in a Timely Manner), Comment Number 5 (Internal Control Over Payroll), Comment Number 7 (Fixed Assets), and Comment Number 8 (Travel Expenses).

Internal Control Over Financial Reporting

In planning and performing our examination, we considered the State of Nebraska Office of the Secretary of State's internal control over financial reporting in order to determine our procedures for the purpose of expressing our opinion on the schedule of revenues, expenditures, and changes in fund balances, and not to provide assurance on the internal control over financial reporting. However, we noted certain matters involving the internal control over financial reporting and its operation that we consider to be reportable conditions. Reportable conditions involve matters coming to our attention relating to significant deficiencies in the design or operation of the internal control over financial reporting that, in our judgment, could adversely affect the State of Nebraska Office of the Secretary of State's ability to record, process, summarize, and report financial data consistent with the assertions of management in the financial schedule. Reportable conditions are described in the Comments Section of the report as Comment Number 1 (Nebraska Information System and Accounting Procedures), Comment Number 4 (Billings and Payments Were Not Made in a Timely Manner), Comment Number 5 (Internal Control Over Payroll), Comment Number 6 (Segregation of Duties Over Revenues and Related Receivables), Comment Number 7 (Fixed Assets), and Comment Number 10 (Accounts Receivable Functional Matrix Code 36).

A material weakness is a condition in which the design or operation of one or more of the internal control components does not reduce to a relatively low level the risk that misstatements in amounts that would be material in relation to the financial schedule being examined may occur and not be detected within a timely period by employees in the normal course of performing their assigned functions. Our consideration of the internal control over financial reporting would not necessarily disclose all matters in the internal control that might be reportable conditions and, accordingly, would not necessarily disclose all reportable conditions that are also considered to be material weaknesses. However, we believe that none of the reportable conditions described above are material weaknesses. We also noted other matters involving internal control over financial reporting that we have reported to management of the State of Nebraska Office of the Secretary of State in the Comments Section of the report as Comment Number 8 (Travel Expenses) and Comment Number 9 (Federal Funds Were Not Posted Timely).

This report is intended solely for the information and use of the Office and the appropriate Federal and regulatory agencies. However, this report is a matter of public record and its distribution is not limited.

Timothy J. Channer CPA

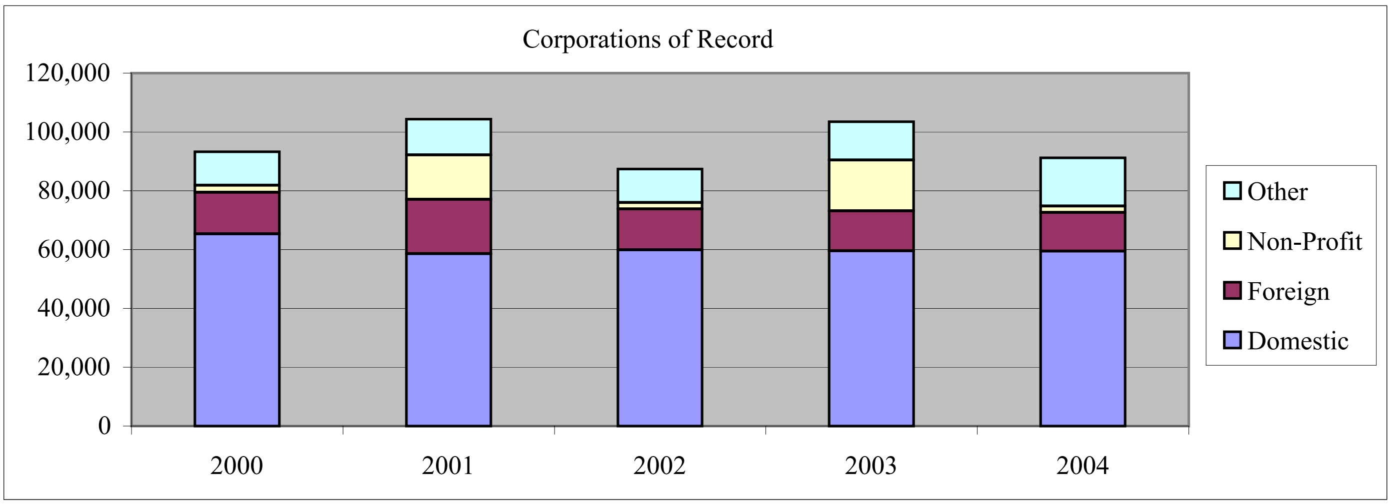
September 9, 2004 Assistant Deputy Auditor

STATISTICAL SECTION

Our examination was conducted for the purpose of forming an opinion on the schedule of revenues, expenditures, and changes in fund balances. Statistical Section information is presented for purposes of additional analysis. Such information has not been subjected to the procedures applied in the examination of the schedule of revenues, expenditures, and changes in fund balances, and, accordingly, we express no opinion on it.

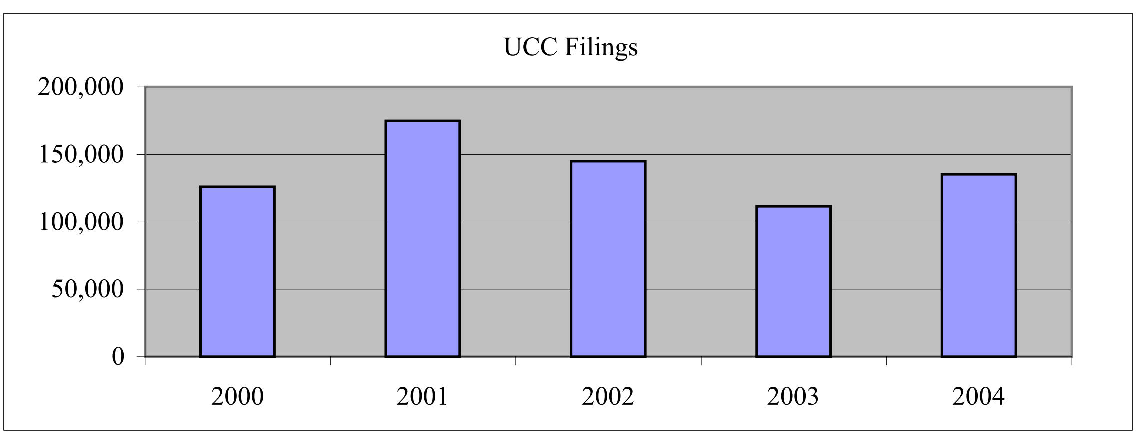
STATE OF NEBRASKA OFFICE OF THE SECRETARY OF STATE
PROGRAM 51 AND PROGRAM 89

	Program 51 - Enforcement of Standards - Corporations				
	Fiscal Year 2000	Fiscal Year 2001	Fiscal Year 2002	Fiscal Year 2003	Fiscal Year 2004
Corporations of Record:					
Domestic	65,317	58,588	59,930	59,581	59,403
Foreign	14,099	18,472	13,852	13,617	13,183
Non-Profit (Biennial Fee Collection)	2,465	15,092	2,221	17,203	2,163
Other	11,355	12,159	11,367	13,061	16,444
Taxes and Fees Collected*	$ 7,949,258	$ 7,983,163	$ 8,065,623	$ 8,532,821	$ 13,592,462



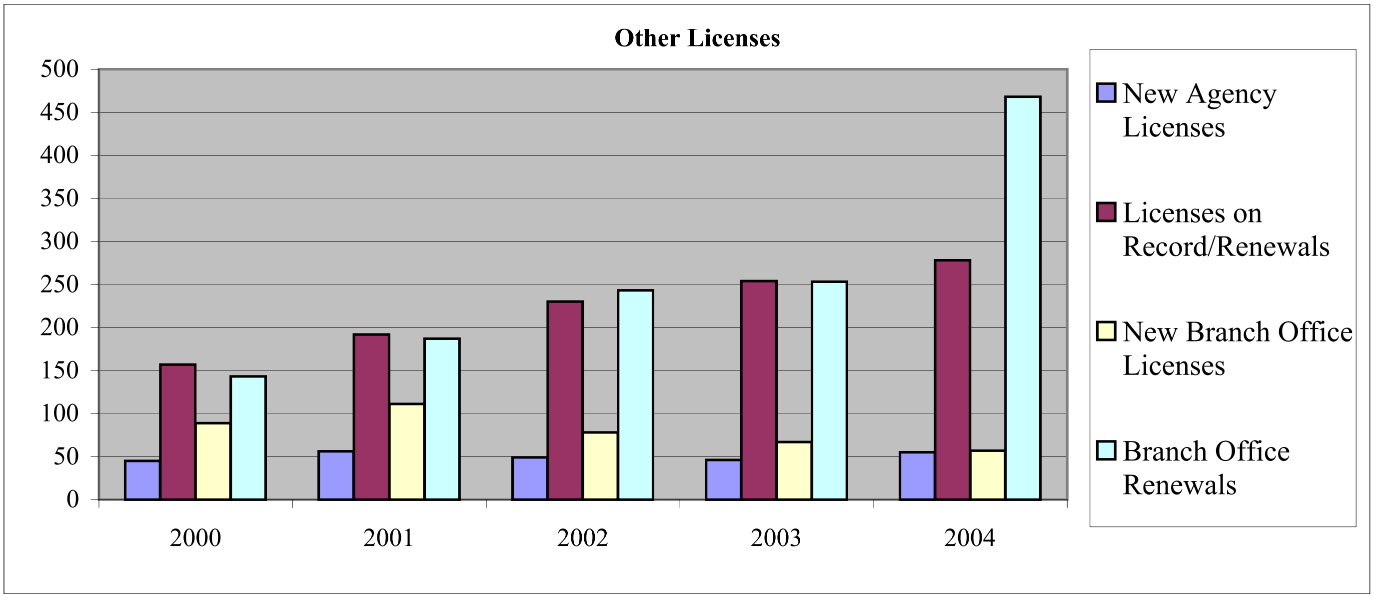
*2003 Neb. Laws LB 524 changed the payment requirement of corporation taxes from an annual fee to a biennial fee for each even numbered calendar year. This Act became operative on January 1, 2004. Taxes collected during fiscal year 2004 were nearly twice the amount collected in fiscal year 2003.

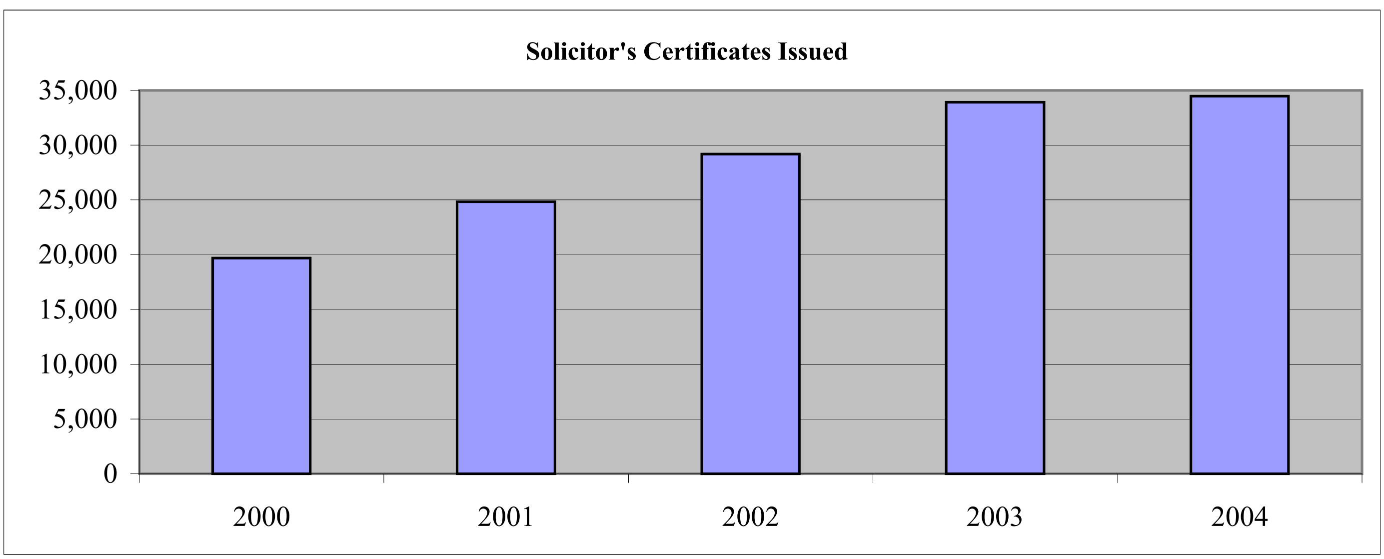
	Program 89 - Uniform Commercial Code Central Filing				
	Fiscal Year 2000	Fiscal Year 2001	Fiscal Year 2002	Fiscal Year 2003	Fiscal Year 2004
UCC Filings	125,902	174,851	144,969	11,451	135,279
Fees Collected	$ 1,618,316	$ 718,909	$ 668,605	$ 513,121	$ 697,668



STATE OF NEBRASKA OFFICE OF THE SECRETARY OF STATE
PROGRAM 53

	Program 53 - Enforcement of Standards - Collection Agencies				
	Fiscal Year 2000	Fiscal Year 2001	Fiscal Year 2002	Fiscal Year 2003	Fiscal Year 2004
Number of Licenses/Renewals:					
New Agency Licenses	45	56	49	46	55
Licenses on Record/Renewals	157	192	230	254	278
New Branch Office Licenses	89	111	78	67	57
Branch Office Renewals	143	187	243	253	468
Solicitor's Certificates Issued	19,679	24,843	29,175	33,920	34,461
Fees Collected*	$ 157,304	$ 197,907	$ 80,945	$ 83,575	$ 96,569





* Neb. Rev. Stat. Section 45-620 R.R.S. 1998 states, ". . . the amount of the fees shall be fixed by the Board and shall not exceed the amounts actually necessary to sustain the administration and enforcement of the act." Due to a steadily increasing fund balance, the Collection Agency Licensing Board reduced the fee amount for a solicitor's certificate and renewal of solicitor's certificate. Beginning in fiscal year 2002, the fee was reduced from $5.00 to $1.00.