

**ATTESTATION REPORT
OF THE
NEBRASKA DEPARTMENT OF REVENUE
JULY 1, 2005 THROUGH JUNE 30, 2006**

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Issued on December 18, 2006

NEBRASKA DEPARTMENT OF REVENUE

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NEBRASKA DEPARTMENT OF REVENUE

BACKGROUND

The 1969 Legislature created the Department of Revenue (Department) and established the State Tax Commissioner as its chief executive officer. The Tax Commissioner is appointed by the Governor with the advice and consent of the Legislature. The statutory purpose of the Department is to execute the revenue laws of the State. The Department has indirect authority over State revenues and directly administers major State tax revenues except liquor and insurance taxes.

The Department is comprised of the following areas: Administration; Audit; Charitable Gaming; Finance and Management; Investigation; Legal; Lottery; Motor Fuels; Research; Revenue Operations; Special Services; and Taxpayer Services.

Administration - The Department's administration includes the State Tax Commissioner, Finance and Management Services Director, Hearing Officer, Personnel Administrator, Legislative Liaison, Special Assistants, and Administrative Assistant to the State Tax Commissioner. They provide the administrative support necessary for carrying out the directives of the State Tax Commissioner.

Audit - The Audit area conducts audits for all department-administered tax programs except those administered by the Charitable Gaming, Lottery, and Motor Fuels Divisions. Audits are usually conducted at the location of the taxpayer's records. The division also conducts an annual audit of the Nebraska Auditor of Public Accounts. In addition, they provide education to taxpayers.

Charitable Gaming - The Legislature established the Charitable Gaming Division in 1986 to regulate charitable gaming activities in Nebraska. These games include bingo; lottery by the sale of pickle cards; nonprofit lotteries and raffles; county, city, and village lotteries (keno); and gift enterprises conducted for business promotion purposes. The division oversees these gaming activities to ensure they are conducted fairly and properly and the proceeds raised are spent only in a manner provided by law.

In 1993, the office of the Athletic Commission was moved into the Charitable Gaming Division. The Commission regulates professional wrestling and boxing, amateur boxing for contestants 16 years of age and over, and all sparring matches and exhibitions in the State by licensure and enforcement of the Athletic Commission laws.

Finance and Management - The Finance section prepares the State budget request in conjunction with the State Tax Commissioner, accounts for day-to-day expenditures of the Department and prepares monthly reports for management. Finance is responsible for establishing and implementing internal accounting controls, and performing the cashing function for all cash and checks received by the Department. Information Services coordinates, designs, and manages all computer functions within the Department. The e-commerce section is responsible for electronic commerce within the Department, which includes electronic funds transfer, Federal and State electronic tax filing programs, and online filing options for individuals and businesses.

NEBRASKA DEPARTMENT OF REVENUE

BACKGROUND

(Continued)

Investigation - Investigative Services conducts investigations relating to the State lottery, charitable gaming, motor fuels, and taxpayer services. The division conducts background investigations of potential State lottery employees, retailers and contractors, and potential charitable gaming licensees. The division also is responsible for overseeing the physical security and the uniformed security contractor relating to the State lottery.

Legal - Legal Services serves as internal legal counsel for the State Tax Commissioner and the entire Department. This area represents the Nebraska Department of Revenue during all stages of audit resolution and at all formal hearings before the State Tax Commissioner. They are responsible for initiating and/or reviewing all legal documents, proposed legislation, regulations, revenue rulings, contracts, and forms for legal content. This area also monitors taxation at the Federal level for impact on State tax revenue. In addition, they provide assistance to county officials in the administration of documentary stamp tax and the homestead exemption program.

Lottery - The Nebraska Lottery was created in 1993 and is a cash-funded division. The Lottery division is responsible for contracting for scratch ticket production and related services, online lotto equipment and related services, advertising and security, and recruitment and screening for lottery retailers, lottery product development and lottery revenue collection. The Lottery sells scratch tickets and lottery tickets through a statewide retailer network.

Motor Fuels - The Motor Fuels Division was established in 1991. The Motor Fuels Division administers the following motor fuels tax programs: Motor Vehicle Fuels, Diesel Fuels, Compressed Fuels, Alternative Fuels, Aircraft Fuels, and the Petroleum Release Remedial Action Act. The division is also responsible for the Ethanol Producers Incentive Program.

Research - Research Services prepares revenue estimates and cash flow projections for use by the State Tax Commissioner and the Legislature. This information is used by the Nebraska Economic Forecasting Board to set general fund revenue estimates. Research Services also calculates state aid payments under programs for aid to local governments that are administered by the Nebraska Department of Revenue.

Revenue Operations - The Revenue Operations Division processes the tax programs administered by the Department, except those processed by the Lottery, Charitable Gaming, and Motor Fuels Divisions. The division processes revenue and refund requests including all tax returns, permit applications, required reports, and refund claims.

Special Services - Special Services provides day-to-day support services for the Department. These include forms design and management, word processing, Web site design and maintenance, communications, departmental mailings, purchasing, and security.

NEBRASKA DEPARTMENT OF REVENUE

BACKGROUND

(Continued)

Taxpayer Services - The Taxpayer Services Division provides taxpayer assistance, education, enforcement, and tax collection services. It coordinates communication between taxpayers and the Department through offices in six Nebraska cities.

MISSION STATEMENT

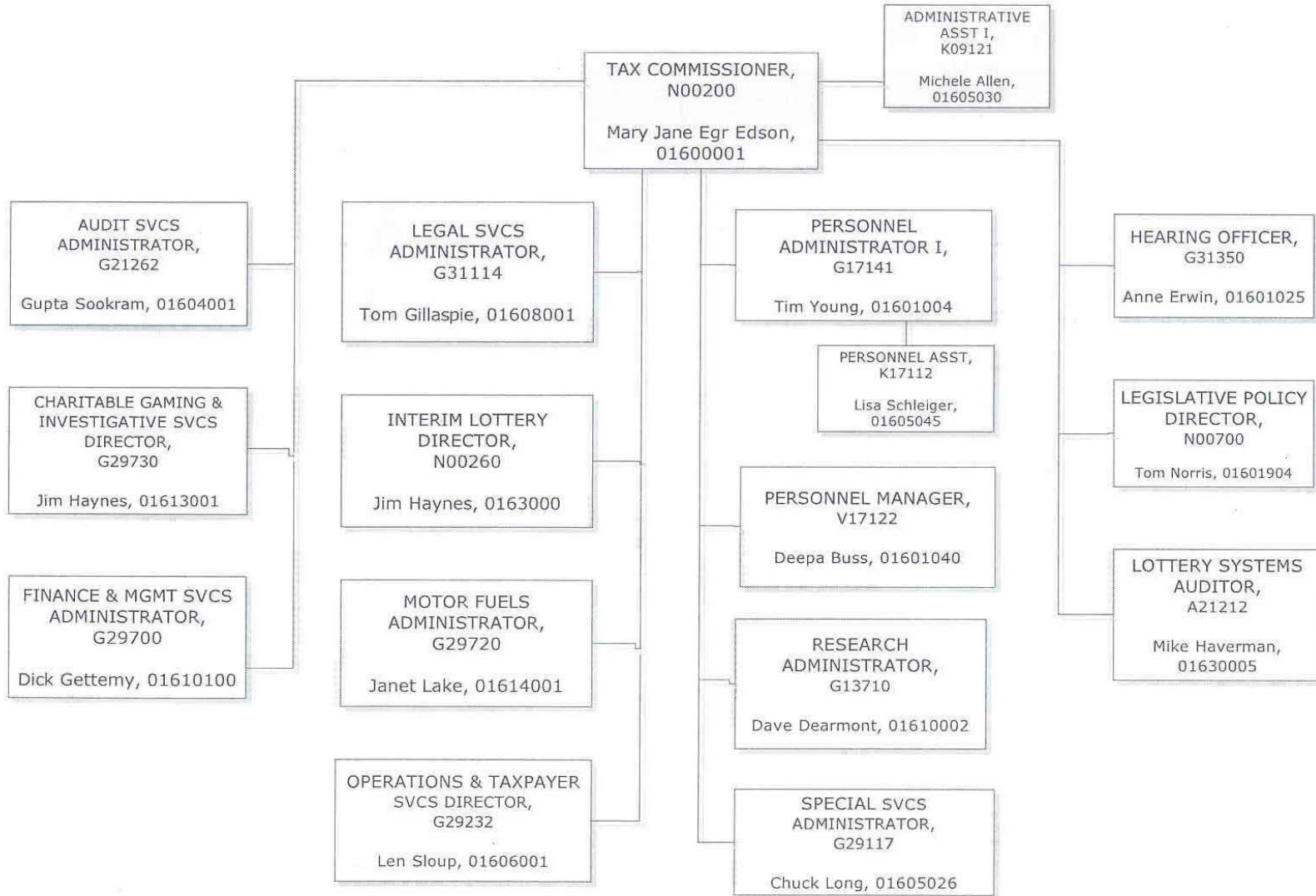
The mission of the Department is to serve the public by administering the State revenue laws with integrity, efficiency, and consistency.

VISION STATEMENT

The Department of Revenue will administer the revenue and lottery laws of the State in the most efficient and effective manner possible using current technology to more efficiently collect revenue and receive returns via electronic means.

NEBRASKA DEPARTMENT OF REVENUE

ORGANIZATIONAL CHART



NEBRASKA DEPARTMENT OF REVENUE

EXIT CONFERENCE

An exit conference was held November 29, 2006, with the Department to discuss the results of our examination. Those in attendance for the Nebraska Department of Revenue were:

NAME	TITLE
Richard A. Gettemy	Administrator Finance and Management Services
Chuck Long	Administrator Special Services
Myle Nguyen	Accountant
Ron Gottula	Accounting and Finance Manager
Tim Young	Personnel Administrator
Wally Jernigan	Athletic Commissioner
Alison Traynowicz	Athletic Commission

NEBRASKA DEPARTMENT OF REVENUE

SUMMARY OF COMMENTS

During our examination of the Nebraska Department of Revenue, we noted certain matters involving the internal control over financial reporting and other operational matters that are presented here.

1. ***Interest on Sales and Use Tax Returns:*** The Department collected \$1.6 billion in receipts for Retailer and Motor Vehicle Sales and Use Tax during the fiscal year ended June 30, 2006. We tested 22 tax returns and noted one tax return was not properly assessed interest. The Department did not have procedures to ensure interest was properly assessed on all delinquent tax returns paid through Electronic Funds Transfer (EFT).
2. ***Homestead Exemption Income Limits:*** Income limits used to determine the amount of property tax relief an individual received for calendar year 2005 were incorrectly rounded. In addition, amounts listed in the 2004 guide were improperly rounded. The Department disbursed \$53.7 million to counties for Homestead Exemption during fiscal year 2006.
3. ***Payroll Issues:*** We noted several issues regarding the Department's payroll including a lack of independent review of payroll, incorrect pay at termination, incomplete personnel files, improper distribution of leave paid, incorrectly calculated leave balances, and improperly lapsing of leave balances at calendar year end.
4. ***Charitable Gaming Transfers:*** One of eleven revenue journal entries tested was for the incorrect amount. A journal entry to transfer license fees to the Charitable Gaming Operations Fund was completed based on the incorrect fee amount. An additional \$39,750 should have been transferred.
5. ***Capital Assets:*** Operating expenses were overstated and capital outlay was understated by \$29,371 due to the improper posting of a reverse receipt against a purchase order. The Department's capital asset balance and additions were overstated by \$19,800 due to an error in creating tag numbers on NIS.
6. ***Fines and Penalties - Charitable Gaming Division:*** The Department assesses administrative fines for Charitable Gaming violations. The Department's procedures and State statutes for depositing of fines are in conflict with the Nebraska Constitution.
7. ***Reconciliation of Bank Records to Nebraska Information System:*** The Department of Administrative Services' reconciliation process is still not done in a timely manner and continues to reflect unknown variances.

NEBRASKA DEPARTMENT OF REVENUE

SUMMARY OF COMMENTS

(Continued)

Athletic Commission:

1. ***Fines and Penalties:*** The Athletic Commission assesses fines for violations of the Commission's rules and regulations. The Commission's procedures for depositing of fines are in conflict with the Nebraska Constitution.

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

Draft copies of this report were furnished to the Department 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. 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.

NEBRASKA DEPARTMENT OF REVENUE

COMMENTS AND RECOMMENDATIONS

1. Interest on Sales and Use Tax Returns

Neb. Rev. Stat. Section 77-2708(1)(c) R.S.Supp., 2005 states “Failure to file the return, filing after the required filing date, failure to remit the net amount of the tax due, or remitting the net amount of the tax due after the required filing date shall be cause for penalty, in addition to interest, ...”

Neb. Rev. Stat. Section 77-2711(11) R.S.Supp., 2005 states “The Tax Commissioner in his or her discretion may waive all or part of any penalties provided by the provisions of such act, but may not waive the minimum interest on delinquent taxes specified in section 45-104.02 ...”

For the fiscal year ended June 30, 2006, the penalty for late Sales and Use Tax returns was 10% of the total tax due. The interest rate established by the State Tax Commissioner was an annual rate of 6%.

The Department collected \$1.6 billion in receipts for Retailer and Motor Vehicle Sales and Use Tax during the fiscal year ended June 30, 2006. We tested 22 tax returns and noted one tax return was not properly assessed interest. The return was filed on time; however, payment was made seven days after the required filing date. The interest that should have been assessed on the delinquent payment was \$466.

The Department did not have procedures to ensure interest was properly assessed on all delinquent tax returns paid through Electronic Funds Transfer (EFT).

Without adequate procedures to ensure the Department is collecting interest on delinquent tax returns, there is an increased risk of loss of revenue and noncompliance with State statutes.

We recommend the Department implement procedures to ensure interest is being collected on all delinquent tax returns.

Department’s Response: A review by the Department of Revenue has revealed that the type of occurrence cited above is rare. But, the Department agrees with this recommendation and has implemented procedures for a temporary manual review of specifically identified accounts until programming changes can be made toward the end of this fiscal year to ensure that all interest is properly assessed.

NEBRASKA DEPARTMENT OF REVENUE

COMMENTS AND RECOMMENDATIONS

(Continued)

2. Homestead Exemption Income Limits

Neb. Rev. Stat. Section 77-3507(4) R.R.S. 2003 and Neb. Rev. Stat. Sections 77-3508(4) and 77-3509(4) R.S.Supp., 2005 state “The income eligibility amounts shall be adjusted for cumulative inflation since 2000. If any amount is not a multiple of one hundred dollars, the amount shall be rounded to the next lower multiple of one hundred dollars.”

The Department disbursed \$53.7 million to counties for Homestead Exemption during fiscal year 2006. During our review of the Homestead Exemption income limits, we noted some of the income limits for calendar year 2005 were incorrectly rounded. The Department rounded the calculated limit to the next lowest multiple of fifty dollars instead of the next lowest multiple of one hundred dollars as required by statute. In addition, amounts listed in the 2004 guide were improperly rounded. The income limits determine the amount of property tax relief an individual will receive.

When income limits are not properly rounded there is an increased risk the individual received additional exemption and the State reimbursed the counties more than the amount allowed by statute.

We recommend the Department ensure the income limits are correctly rounded to comply with State statutes.

Department's Response: The tables in the 2007 Homestead guide have been corrected.

3. Payroll Issues

Internal Control Over Payroll

Good internal control requires an adequate segregation of duties or compensating controls to ensure no one individual is in a position to both perpetrate and conceal errors or irregularities. Good internal control also requires access to the payroll processing function within NIS be restricted to individuals who require the access to complete their job duties.

One employee had access on NIS to perform all payroll functions and was responsible for the final review of payroll. There was no documented independent review of this employee's pay to ensure hours worked and amount paid were accurate. The Department also did not compare leave used on timesheets to the payroll register to ensure leave used was properly recorded. This was noted in our prior report.

NEBRASKA DEPARTMENT OF REVENUE

COMMENTS AND RECOMMENDATIONS

(Continued)

3. Payroll Issues (Continued)

Internal Control Over Payroll (Concluded)

Additionally, the Department granted eight employees access to the payroll processing function within NIS; however, only five employees required the access to complete their job duties.

Excessive access to the payroll function and a lack of segregation of duties increases the risk of unauthorized changes to payroll.

We recommend the Department implement procedures to ensure an adequate segregation of duties over the processing of payroll. We also recommend the Department ensure access to the payroll processing function is limited to employees who need access to complete their job duties.

Department's Response: According to NIS Security, HR22 access is required for Authorized Agents to perform the execution control query. The Department has implemented procedures to have another employee review the hours worked and amount paid to the employee responsible for the final review of payroll. We feel that the addition of this independent review to our regular review process, along with NIS execution control limitations, is adequate to address your security concerns.

Employee Terminations

State of Nebraska Classified System Personnel Rules and Regulations Chapter 9, Section 004.03 states, "Employees who leave state government employment for any reason shall be paid for any unused accumulated vacation leave earned, calculated on their base hourly rate."

Neb. Rev. Stat. Section 84-1308 R.S.Supp., 2004 states, "(1) Each employee who is a member of the retirement system shall pay or have paid on his or her behalf a sum equal to four and thirty-three hundredths percent of his or her monthly compensation until such time as he or she has paid during any calendar year a total of eight hundred sixty-four dollars, after which time he or she shall pay a sum equal to four and eight-tenths percent of his or her monthly compensation for the remainder of such calendar year ..."

Good internal control requires procedures be in place to ensure employees are paid correctly at termination.

NEBRASKA DEPARTMENT OF REVENUE

COMMENTS AND RECOMMENDATIONS

(Continued)

3. Payroll Issues (Continued)

Employee Terminations (Concluded)

We noted the following during our testing of six employee terminations:

- Six employees were not paid correctly for their vacation balance at termination. Four of the six employees were not paid their entire vacation balance at termination. Underpayments ranged from \$85 to \$1,063 for 6.6 to 93.26 hours, respectively. The other two employees were paid in excess of their vacation balances at termination. Overpayments were for \$27 and \$206 for 1.94 and 44.7 hours, respectively.
- The retirement contribution on the final paycheck was incorrect for one employee. The employee contributed \$144 to the retirement system on his final check. The employee should have contributed \$155 to the retirement system resulting in an under contribution of \$11. This was noted in our prior report.

The Department was not in compliance with State statutes and rules and regulations. Without adequate procedures to ensure employees are being paid correctly, there is an increased risk of loss of State funds or misstatement of Personal Service Limitations.

We recommend the Department implement procedures to ensure employees are paid the correct amount at termination and payouts are in accordance with all applicable statutes and rules and regulations.

Department's Response: A payroll termination checklist has been created that will be used each time there is a termination. Retirement contributions will be a standard 4.8% beginning in 2007 which will eliminate the possible error of using the incorrect percentage. All unpaid vacation balances have now been paid out and a procedure for verifying vacation and sick leave payout has been established.

Payroll Detail Testing

The Employment Eligibility Verification (Federal Form I-9) Form states, "All employees, citizens and non-citizens, hired after November 6, 1986, must complete Section 1 of this form at the time of hire, which is the actual beginning of employment. The employer is responsible for ensuring that Section 1 is timely and properly completed."

NEBRASKA DEPARTMENT OF REVENUE

COMMENTS AND RECOMMENDATIONS

(Continued)

3. Payroll Issues (Continued)

Payroll Detail Testing (Continued)

The NAPE/AFSCME and State of Nebraska Labor Contract, Article 14.15 Authorized Leave states, "Employees returning to work on or after July 1, 2001, after a break in service of less than five calendar years shall have their accumulated unpaid sick leave balance reinstated, unless the employee previously received a payout of sick leave. The employee's service date shall be adjusted for the period of absence."

Title 273 NAC 9-006.01 requires the adjustment of service date for any employee who has a leave of absence which exceeds 14 consecutive days.

Good internal control requires procedures to allocate vacation and sick leave to the appropriate funds and procedures to ensure employee leave balances are correctly recorded.

We tested 16 employees in the payroll detail test and noted the following:

- Four employees did not have a Federal Form I-9 on file.
- Two employees were paid from more than one fund; however, their vacation and sick pay were not distributed in the same manner as the regular pay.
- One employee had an incorrect adjusted service date recorded on NIS. The employee had a break in service equal to 142 days and their service date was adjusted incorrectly by the Department.
- Four employees had incorrect leave balances on NIS. Two employees' vacation balances were overstated on NIS by 1 hour and 8 hours. Two employees' sick leave balances were understated by 4 and 4.5 hours.

A similar finding was noted in our prior report.

As a result the Department is not in compliance with Federal Form I-9 or rules and regulations. Without procedures to allocate leave paid between funds there is an increased risk of inaccurate recording of expenditures. Inaccurate recording of adjusted service dates could result in employees earning incorrect leave amounts. Failure to maintain accurate leave balances increases the risk employees will be overpaid at termination.

NEBRASKA DEPARTMENT OF REVENUE

COMMENTS AND RECOMMENDATIONS

(Continued)

3. **Payroll Issues** (Continued)

Payroll Detail Testing (Concluded)

We recommend the Department ensure all employees have a Federal Form I-9 on file. We also recommend leave paid be allocated between funds consistently with regular pay, service dates be adjusted to ensure leave is being accrued in the correct amounts, and leave balances are adequately maintained.

Department's Response: All required I-9's have been completed for current employees. Employees processing new employee paperwork have been alerted to use the new employee checklist to avoid overlooking the form. The Department is in the process of upgrading our electronic time record system to capture leave allocation in a way that is compatible with NIS. A leave service adjustment calculator has been developed and the appropriate staff has been instructed to use it in all leave adjustment situations and place the resulting documentation in the Personnel file. The Department will continue to work on eliminating errors in the leave earnings area. NIS has now automated the leave earnings adjustment in the payroll system which should reduce the chance for errors.

Leave Balancing

Title 273 NAC 9-004.02 states, "All employee's accumulated vacation time in excess of thirty-five days shall be forfeited as of December 31st of each calendar year. In special and meritorious cases, when it would cause hardship for an employee to take earned vacation leave before December 31, excess carryover leave may be approved by the Agency Head. In these cases, the agency head shall assure hours carried over shall be used within the next six months. In no case shall approved carry over vacation continue from year to year."

Good internal control requires procedures to ensure leave balances are properly lapsed at year end.

One of six employees tested did not have their vacation leave balance properly lapsed at the end of the year. The employee carried 18 hours above the maximum carryover amount between years without Department approval. We also noted the Department allows employees to carryover more than the maximum leave amount without the approval of the State Tax Commissioner; however, the Department does not have a written policy to allow for this carryover. A similar finding was noted in our prior report.

NEBRASKA DEPARTMENT OF REVENUE

COMMENTS AND RECOMMENDATIONS

(Continued)

3. Payroll Issues (Concluded)

Leave Balancing (Concluded)

The Department is not in compliance with State statutes and rules and regulations. Without adequate procedures to balance leave at year end the risk increases employees will carryover more than the maximum amount of leave allowed.

We recommend the Department implement procedures to ensure excessive leave balances are lapsed at year end. We also recommend the Department implement a written policy to address leave carryover without the State Tax Commissioner's approval.

Department's Response: A thorough review of leave balances is being completed at this time. All leave balances will be adjusted in accordance with DAS Accounting rules.

4. Charitable Gaming Transfers

Neb. Rev. Stat. Sections 9-329 and 9-329.02 R.S.Supp., 2004 establish the biennial license fees for a sales agent and pickle card operator at \$100 and requires the fees to be deposited into the Charitable Gaming Operations Fund. The Department deposits the fees into the General Fund and creates a monthly journal entry to move the fees into the Charitable Gaming Operations Fund.

One of eleven revenue journal entries tested was for the incorrect amount. A journal entry was completed to transfer the pickle card operators and sales agent license fees to the Charitable Gaming Operations Fund. The transfer was completed based on a fee of \$50; however, the fee was actually \$100 for each type. The sales and charges for the Charitable Gaming Operations Fund were understated by \$39,750 and sales and charges for the General Fund were overstated by the same amount.

When journal entries are not completed for the correct amount there is an increased risk of a misstatement of revenues.

We recommend the Department implement procedures to ensure all journal entries are for the correct amounts.

NEBRASKA DEPARTMENT OF REVENUE

COMMENTS AND RECOMMENDATIONS

(Continued)

4. Charitable Gaming Transfers (Concluded)

Department's Response: A correcting journal entry has been processed to transfer the necessary funds from the General Fund to the Charitable Gaming Operations Fund. In addition, effective 12/01/2006, new validation procedures were implemented so that the fees are deposited directly into that Charitable Gaming Operations Fund, eliminating the need for journal entry transfers.

5. Capital Assets

Good internal control requires procedures to ensure expenditures are coded to the correct account and items purchased are added correctly to the capital asset inventory. Sound business practice requires procedures to ensure transactions are appropriately passed on or posted to the capital asset ledger.

During our review of the Department's capital assets, we noted the following:

- NIS allows agencies to receive items against purchase orders previously created and generate the payment voucher at the same time. The Department originally received against a purchase order and coded the payment to a capital outlay account. After review, the Department realized the document should have been coded to an operating expense account. A reverse receipt was done against the incorrect account, causing an overstatement of operating expenses by \$29,371 and an understatement of capital outlay of the same amount.
- One of two transactions tested on the Passed Transaction Report was not properly passed on, resulting in improper posting to the capital asset ledger. The Department purchased 8 laptops in 2003 and created one capital asset tag number on NIS for the total cost of \$19,800. In fiscal year 2006, the Department created a journal entry to correctly allocate the total cost and create 8 separate tag numbers on NIS. Through this process the Department had created 8 tag numbers with a total cost of \$19,800 and still had the original tag with a cost of \$19,800. This resulted in an overstatement of the capital asset balance at year end and additions during the year.

When documents are not properly reversed there is an increased risk of misstatement of expenditures.

When transactions are not properly passed on there is an increased risk of misstatement of the capital asset inventory.

NEBRASKA DEPARTMENT OF REVENUE

COMMENTS AND RECOMMENDATIONS

(Continued)

5. Capital Assets (Concluded)

We recommend the Department implement procedures to ensure transactions are appropriately passed on or posted to the capital asset ledger. We also recommend the Department implement procedures to ensure reverse receipts and receipts against purchase orders are posted to the correct account.

Department's Response: The Department of Revenue Special Services area has revised their procedures to ensure that transactions are appropriately passed on or posted to the capital asset ledger. In addition, Finance will work closely with procurement personnel to ensure that receipts against purchase orders are posted correctly in order to minimize the need for reverse receipts.

6. Fines and Penalties - Charitable Gaming Division

The Nebraska Constitution Article VII, Section 5(1) states, “. . . all fines, penalties, and license money arising under the general laws of the state . . . shall belong and be paid over to the counties respectively where the same may be levied or imposed . . . All such fines, penalties, and license money shall be appropriated exclusively to the use and support of the common schools in the respective subdivisions where the same may accrue . . .”

Neb. Rev. Stat. Section 79-1035.01 R.R.S. 2003 created the Permanent School Fund and states the principal balance of the fund “shall be held and invested in perpetuity by the state in trust for the support of its common schools. The annual interest and other income, but not the principal, is subject to use for the support and maintenance of the common schools in each public school district of the state as the Legislature provides in accordance with Article VII, Section 9, of the Constitution of Nebraska.”

Neb. Rev. Stat. Sections 9-226.02, 9-322.01, 9-418.02, and 9-621 R.R.S. 1997, direct the Department to deposit administrative fines into the Permanent School Fund.

The Department deposits administrative fines for Charitable Gaming violations into the Charitable Gaming Operations Fund. As needed, transfers are done to move the fines into the Permanent School Fund. The Department's procedures for depositing of fines and the statutes noted above are in conflict with the Nebraska Constitution.

If fines are deposited into the Permanent School Fund as provided by statute and Department procedures, the monies are not being distributed as required by the Nebraska Constitution.

NEBRASKA DEPARTMENT OF REVENUE

COMMENTS AND RECOMMENDATIONS

(Continued)

6. **Fines and Penalties - Charitable Gaming Division** (Concluded)

We recommend the Department request a legal opinion from the Attorney General requesting guidance for the appropriate fund to deposit all fines. We also recommend the Department work with the Legislature to resolve the apparent conflict between State statutes and the Nebraska Constitution.

Department's Response: The \$50.00 of Administrative Fines collected during the audit period will be processed in accordance with existing State Statute.

7. **Reconciliation of Bank Records to Nebraska Information System**

During the audit of the Comprehensive Annual Financial Report (CAFR) of the State of Nebraska, we noted the absence of a completed reconciliation between the State Treasurer's bank statements and the accounting records on the Nebraska Information System (NIS). This has been an issue for the Department of Administrative Services Accounting Division (State Accounting) for many years. Our previous comments noted monthly reconciliations were not completed in a timely manner and showed significant unknown variances with bank records short compared to accounting records. Although State Accounting continues to work on the reconciliation of bank records to NIS accounting records, we continue to note areas where improvement is needed in the reconciliation process to ensure NIS integrity and operational efficiency.

As of October 31, 2006, State Accounting has developed a very detailed process of analyzing bank activity compared to activity recorded on NIS to identify reconciling items, but continued progress is needed. State Accounting continues to work on reconciliations for the months of June 2005 through June 2006 to determine the reasons for the continuing unknown variances. We have reviewed the reconciliations and noted the month of June 2006 shows an unknown variance of \$2,657,411. Again, the reconciliations show bank records short compared to accounting records.

Good internal control requires a plan of organization, procedures, and records designed to safeguard assets and provide reliable financial information. Without a timely and complete reconciliation of bank records to NIS accounting records, there is a greater risk for fraud or errors to occur and to remain undetected.

We recommend State Accounting continue the reconciliation process to ensure all financial information is correct on NIS. We also recommend, when a consistent cash variance between bank

NEBRASKA DEPARTMENT OF REVENUE

COMMENTS AND RECOMMENDATIONS

(Continued)

7. Reconciliation of Bank Records to Nebraska Information System (Concluded)

records and accounting records is obtained, State Accounting should submit the shortage amount to the Governor and the Legislature. The Governor and the Legislature should then develop a plan to correct NIS accounting records and resolve the shortage noted.

This issue is the responsibility of State Accounting; however, as the variance has not been identified by fund or agency, this issue directly affects all Nebraska State agencies' financial information and must be disclosed in this report.

Department's Response: As indicated above, this audit finding pertains to the responsibility of State Accounting only and not the Nebraska Department of Revenue. But we would like to point out we currently do a daily reconciliation of Nebraska Information System (NIS) deposits to Nebraska On-line Validation (NOV) controls. In addition, the Department compares NIS receipt totals with State Accounting on a monthly basis to ensure the accuracy of reported financial information.

ATHLETIC COMMISSION

1. Fines and Penalties

The Nebraska Constitution Article VII, Section 5(1) states, “. . . all fines, penalties, and license money arising under the general laws of the state . . . shall belong and be paid over to the counties respectively where the same may be levied or imposed . . . All such fines, penalties, and license money shall be appropriated exclusively to the use and support of the common schools in the respective subdivisions where the same may accrue . . .”

The Athletic Commission assesses fines in accordance with Title 38 NAC; however, there is no guidance on where these fines should be deposited.

Fines assessed by the Athletic Commissioner were deposited into the Athletic Commission Cash Fund. The Commission's procedures for depositing of fines are in conflict with the Nebraska Constitution.

If fines are deposited into the Athletic Commission Cash Fund as provided by Commission procedures, the monies are not being distributed as required by the Nebraska Constitution.

NEBRASKA DEPARTMENT OF REVENUE

COMMENTS AND RECOMMENDATIONS
(Continued)

ATHLETIC COMMISSION (Concluded)

1. Fines and Penalties (Concluded)

We recommend the Athletic Commission request a legal opinion from the Attorney General requesting guidance for the appropriate fund to deposit all fines.

Athletic Commission's Response: The Athletic Commissioner has requested guidance from the Attorney General on the proper disposition of fines imposed by the Athletic Commissioner, and has been advised that fine monies should be forwarded to the State Treasurer for distribution in accordance with Article VII, ss 5, of the Nebraska Constitution. Accordingly, all fine monies will be transferred in accordance with the Attorney General's direction.

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NEBRASKA DEPARTMENT OF REVENUE

INDEPENDENT ACCOUNTANT'S REPORT

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We have examined the accompanying schedule of revenues, expenditures, and changes in fund balances of the Nebraska Department of Revenue (Department) for the fiscal year ended June 30, 2006. The Department'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.

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Asst. Deputy Auditor
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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.

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Dennis Meyer, CGFM
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In our opinion, the schedule referred to above presents, in all material respects, the revenues, expenditures, and changes in fund balances of the Nebraska Department of Revenue for the fiscal year ended June 30, 2006, based on the accounting system and procedures prescribed by the State of Nebraska Director of Administrative Services as described in Note 1.

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In accordance with *Government Auditing Standards*, we have also issued our report dated November 29, 2006, on our consideration of the Nebraska Department of Revenue's internal control over financial reporting and our tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements and other matters. The purpose of that report is to

describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing, and not to provide an opinion on the internal control over financial reporting or on compliance. That report is an integral part of an attestation engagement performed in accordance with *Government Auditing Standards* and should be considered in assessing the results of our examination.

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

A handwritten signature in blue ink that reads "Pat Reding, CPA". The signature is written in a cursive, flowing style.

Assistant Deputy Auditor

November 29, 2006

NEBRASKA DEPARTMENT OF REVENUE
SCHEDULE OF REVENUES, EXPENDITURES, AND CHANGES IN FUND BALANCES
For the Fiscal Year Ended June 30, 2006

	State General Fund 10000	Revenue Enforcement Cash Fund 21540	Lottery Operating Cash Fund 21560	MJ & Cont Subst Tax Admin Fund 21570	Revenue Contractor Enforcement Fund 21575	Waste Red/ Recycling Incentive Fund 21580	Petro Rel Rem Action Coll Fund 21590
REVENUES:							
Appropriations	\$ 75,103,395	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -
Taxes	3,192,092,840	-	-	34,961	-	-	-
Intergovernmental	-	-	-	-	-	-	-
Sales & Charges	581,953	-	-	-	41,000	-	-
Miscellaneous	109,142	37,125	50,096	4,171	2,405	266	443
TOTAL REVENUES	3,267,887,330	37,125	50,096	39,132	43,405	266	443
EXPENDITURES:							
Personal Services	16,091,366	200,869	1,321,573	32	3,083	9,525	28,000
Operating	5,054,340	148,780	11,189,791	-	-	9,348	-
Travel	154,417	531	54,925	-	-	-	-
Capital Outlay	79,140	239,075	18,505	-	-	-	-
Government Aid	53,724,132	-	-	-	-	-	-
TOTAL EXPENDITURES	75,103,395	589,255	12,584,794	32	3,083	18,873	28,000
Excess (Deficiency) of Revenues Over (Under) Expenditures	3,192,783,935	(552,130)	(12,534,698)	39,100	40,322	(18,607)	(27,557)
OTHER FINANCING SOURCES (USES):							
Sales of Assets	7,658	-	622	-	-	-	-
Deposit to General Fund	(3,192,785,966)	-	-	-	-	-	-
Deposit to/from Common Fund	-	-	-	-	-	-	-
Operating Transfers In	-	-	13,000,000	-	-	20,000	25,250
Operating Transfers Out	(5,627)	-	-	-	-	-	-
TOTAL OTHER FINANCING SOURCES (USES)	(3,192,783,935)	-	13,000,622	-	-	20,000	25,250
Net Change in Fund Balances	-	(552,130)	465,924	39,100	40,322	1,393	(2,307)
FUND BALANCES, JULY 1, 2005	143,558	1,007,554	913,509	98,573	38,290	2,675	2,755
FUND BALANCES, JUNE 30, 2006	\$ 143,558	\$ 455,424	\$ 1,379,433	\$ 137,673	\$ 78,612	\$ 4,068	\$ 448
FUND BALANCES CONSIST OF:							
General Cash	\$ -	\$ 455,396	\$ 1,377,433	\$ 137,673	\$ 78,612	\$ 4,068	\$ 448
Petty Cash	-	-	2,000	-	-	-	-
NSF Items	-	-	-	-	-	-	-
Deposits with Vendors	143,558	-	-	-	-	-	-
Accounts Receivable Invoiced	-	28	-	-	-	-	-
Due to Vendors	-	-	-	-	-	-	-
Jackpot Prizes Payable	-	-	-	-	-	-	-
Due to Fund	-	-	-	-	-	-	-
Due to Government	-	-	-	-	-	-	-
TOTAL FUND BALANCES	\$ 143,558	\$ 455,424	\$ 1,379,433	\$ 137,673	\$ 78,612	\$ 4,068	\$ 448

The accompanying notes are an integral part of the schedule.

(Continued)

NEBRASKA DEPARTMENT OF REVENUE
SCHEDULE OF REVENUES, EXPENDITURES, AND CHANGES IN FUND BALANCES
For the Fiscal Year Ended June 30, 2006

	Agriculture Alcohol Fuel Tax Fund 21600	Litter Fee Collection Fund 21610	Severance Tax Admin Fund 21630	Miscellaneous Receipts Fund 21650	Charitable Gaming Operations Fund 21660	Tobacco Products Admin Fund 21670	Employment & Investment Fund 21680
REVENUES:							
Appropriations	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -
Taxes	326,720	-	31,430	-	2,119,245	5,199,589	-
Intergovernmental	-	-	-	-	-	-	-
Sales & Charges	-	-	-	47	148,669	480	6,000
Miscellaneous	-	229	15,173	7,649	42,148	259,077	279
TOTAL REVENUES	326,720	229	46,603	7,696	2,310,062	5,459,146	6,279
EXPENDITURES:							
Personal Services	-	7,991	1,717	4,419	1,573,906	10,301	23,040
Operating	-	795	-	-	156,031	18,789	-
Travel	-	-	-	-	103,640	-	-
Capital Outlay	-	-	-	-	-	-	-
Government Aid	-	-	-	-	-	-	-
TOTAL EXPENDITURES	-	8,786	1,717	4,419	1,833,577	29,090	23,040
Excess (Deficiency) of Revenues Over (Under) Expenditures	326,720	(8,557)	44,886	3,277	476,485	5,430,056	(16,761)
OTHER FINANCING SOURCES (USES):							
Sales of Assets	-	-	-	-	174	-	-
Deposit to General Fund	-	-	-	-	-	-	-
Deposit to/from Common Fund	(326,720)	-	-	-	-	-	-
Operating Transfers In	-	10,000	-	-	-	-	-
Operating Transfers Out	-	-	-	-	(300,000)	(6,000,000)	-
TOTAL OTHER FINANCING SOURCES (USES)	(326,720)	10,000	-	-	(299,826)	(6,000,000)	-
Net Change in Fund Balances	-	1,443	44,886	3,277	176,659	(569,944)	(16,761)
FUND BALANCES, JULY 1, 2005	-	5,923	353,269	185,066	712,450	3,928,956	18,131
FUND BALANCES, JUNE 30, 2006	\$ -	\$ 7,366	\$ 398,155	\$ 188,343	\$ 889,109	\$ 3,359,012	\$ 1,370
FUND BALANCES CONSIST OF:							
General Cash	\$ -	\$ 7,366	\$ 397,355	\$ 188,343	\$ 886,109	\$ 3,359,012	\$ 1,370
Petty Cash	-	-	800	-	3,000	-	-
NSF Items	-	-	-	-	-	-	-
Deposits with Vendors	-	-	-	-	-	-	-
Accounts Receivable Invoiced	-	-	-	-	-	-	-
Due to Vendors	-	-	-	-	-	-	-
Jackpot Prizes Payable	-	-	-	-	-	-	-
Due to Fund	-	-	-	-	-	-	-
Due to Government	-	-	-	-	-	-	-
TOTAL FUND BALANCES	\$ -	\$ 7,366	\$ 398,155	\$ 188,343	\$ 889,109	\$ 3,359,012	\$ 1,370

The accompanying notes are an integral part of the schedule.

(Continued)

NEBRASKA DEPARTMENT OF REVENUE
SCHEDULE OF REVENUES, EXPENDITURES, AND CHANGES IN FUND BALANCES
For the Fiscal Year Ended June 30, 2006

	Nebraska Advantage Fund 21687	Empl Expan & Invest Incent Fund 21689	Motor Fuel Tax Enforcement Fund 21700	Quality Jobs Fund 21760	Invest Nebraska Fund 21770	Nebraska Health Care Fund 22640	Athletic Commission Cash Fund 24310
REVENUES:							
Appropriations	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -
Taxes	-	-	-	-	-	-	22,987
Intergovernmental	-	-	1,563	-	-	-	-
Sales & Charges	143,000	5,480	-	-	-	-	6,047
Miscellaneous	1,261	106	29,537	499	2,500	-	831
TOTAL REVENUES	144,261	5,586	31,100	499	2,500	-	29,865
EXPENDITURES:							
Personal Services	-	5,063	1,709,940	-	11,799	29,896	31,684
Operating	-	-	194,803	-	1,158	-	5,414
Travel	-	-	55,449	-	-	-	2,544
Capital Outlay	-	-	18,651	-	-	-	-
Government Aid	-	-	-	-	-	-	-
TOTAL EXPENDITURES	-	5,063	1,978,843	-	12,957	29,896	39,642
Excess (Deficiency) of Revenues Over (Under) Expenditures	144,261	523	(1,947,743)	499	(10,457)	(29,896)	(9,777)
OTHER FINANCING SOURCES (USES):							
Sales of Assets	-	-	1,774	-	-	-	-
Deposit to General Fund	-	-	-	-	-	-	-
Deposit to/from Common Fund	-	-	-	-	-	(4,348)	-
Operating Transfers In	-	-	2,000,000	-	-	34,244	-
Operating Transfers Out	-	-	-	-	-	-	-
TOTAL OTHER FINANCING SOURCES (USES)	-	-	2,001,774	-	-	29,896	-
Net Change in Fund Balances	144,261	523	54,031	499	(10,457)	-	(9,777)
FUND BALANCES, JULY 1, 2005	-	1,196	704,079	11,943	68,865	-	24,247
FUND BALANCES, JUNE 30, 2006	\$ 144,261	\$ 1,719	\$ 758,110	\$ 12,442	\$ 58,408	\$ -	\$ 14,470
FUND BALANCES CONSIST OF:							
General Cash	\$ 144,261	\$ 1,719	\$ 758,059	\$ 12,442	\$ 58,408	\$ -	\$ 14,442
Petty Cash	-	-	-	-	-	-	-
NSF Items	-	-	-	-	-	-	-
Deposits with Vendors	-	-	-	-	-	-	28
Accounts Receivable Invoiced	-	-	17	-	-	-	-
Due to Vendors	-	-	34	-	-	-	-
Jackpot Prizes Payable	-	-	-	-	-	-	-
Due to Fund	-	-	-	-	-	-	-
Due to Government	-	-	-	-	-	-	-
TOTAL FUND BALANCES	\$ 144,261	\$ 1,719	\$ 758,110	\$ 12,442	\$ 58,408	\$ -	\$ 14,470

The accompanying notes are an integral part of the schedule.

(Continued)

NEBRASKA DEPARTMENT OF REVENUE
SCHEDULE OF REVENUES, EXPENDITURES, AND CHANGES IN FUND BALANCES
For the Fiscal Year Ended June 30, 2006

	Oil & Gas Conservation Fund 25710	Ethanol Production Incentive Fund 26020	Grade Cross Const Fund 26710	Waste Red & Recycling Incentive Fund 28390	Litter Reduct & Recycle Fund 28400	Petro Release Cash Fund 28490	Investigative Forfeiture Fund 41610
REVENUES:							
Appropriations	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -
Taxes	554,787	309,262	3,092,810	2,432,512	1,497,750	11,303,276	-
Intergovernmental	-	-	-	-	-	-	-
Sales & Charges	-	-	-	-	-	-	-
Miscellaneous	-	-	-	-	-	-	771
TOTAL REVENUES	554,787	309,262	3,092,810	2,432,512	1,497,750	11,303,276	771
EXPENDITURES:							
Personal Services	-	-	-	-	-	-	-
Operating	-	-	-	-	-	-	40
Travel	-	-	-	-	-	-	-
Capital Outlay	-	-	-	-	-	-	-
Government Aid	-	-	-	-	-	-	-
TOTAL EXPENDITURES	-	-	-	-	-	-	40
Excess (Deficiency) of Revenues Over (Under) Expenditures	554,787	309,262	3,092,810	2,432,512	1,497,750	11,303,276	731
OTHER FINANCING SOURCES (USES):							
Sales of Assets	-	-	-	-	-	-	-
Deposit to General Fund	-	-	-	-	-	-	-
Deposit to/from Common Fund	(554,787)	(309,262)	(3,092,810)	(2,412,512)	(1,487,750)	(11,278,026)	-
Operating Transfers In	-	-	-	-	-	-	-
Operating Transfers Out	-	-	-	(20,000)	(10,000)	(25,250)	-
TOTAL OTHER FINANCING SOURCES (USES)	(554,787)	(309,262)	(3,092,810)	(2,432,512)	(1,497,750)	(11,303,276)	-
Net Change in Fund Balances	-	-	-	-	-	-	731
FUND BALANCES, JULY 1, 2005	-	-	-	-	-	-	18,479
FUND BALANCES, JUNE 30, 2006	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ 19,210
FUND BALANCES CONSIST OF:							
General Cash	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ 19,210
Petty Cash	-	-	-	-	-	-	-
NSF Items	-	-	-	-	-	-	-
Deposits with Vendors	-	-	-	-	-	-	-
Accounts Receivable Invoiced	-	-	-	-	-	-	-
Due to Vendors	-	-	-	-	-	-	-
Jackpot Prizes Payable	-	-	-	-	-	-	-
Due to Fund	-	-	-	-	-	-	-
Due to Government	-	-	-	-	-	-	-
TOTAL FUND BALANCES	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ 19,210

The accompanying notes are an integral part of the schedule.

(Continued)

NEBRASKA DEPARTMENT OF REVENUE
SCHEDULE OF REVENUES, EXPENDITURES, AND CHANGES IN FUND BALANCES
For the Fiscal Year Ended June 30, 2006

	Miscellaneous Services Fund 51620	Highway Trust Fund 61240	State Lottery Operation Trust Fund 61610	State Lottery Prize Trust Fund 61620	Municipal Equalization Fund 61630	Revenue Distribution Fund 71620	Totals (Memorandum Only)
REVENUES:							
Appropriations	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ 75,103,395
Taxes	-	291,941,800	-	-	-	1,213,984	3,512,173,953
Intergovernmental	-	-	-	-	-	-	1,563
Sales & Charges	874	-	62,048,610	-	8,510,905	-	71,493,065
Miscellaneous	886	450	315,047	155,690	83,835	-	1,119,616
TOTAL REVENUES	1,760	291,942,250	62,363,657	155,690	8,594,740	1,213,984	3,659,891,592
EXPENDITURES:							
Personal Services	-	-	-	-	-	-	21,064,204
Operating	-	-	-	19,637,265	-	-	36,416,554
Travel	-	-	-	-	-	-	371,506
Capital Outlay	-	-	-	-	-	-	355,371
Government Aid	-	-	-	-	14,757,700	-	68,481,832
TOTAL EXPENDITURES	-	-	-	19,637,265	14,757,700	-	126,689,467
Excess (Deficiency) of Revenues Over (Under) Expenditures	1,760	291,942,250	62,363,657	(19,481,575)	(6,162,960)	1,213,984	3,533,202,125
OTHER FINANCING SOURCES (USES):							
Sales of Assets	-	-	-	-	-	-	10,228
Deposit to General Fund	-	-	-	-	-	-	(3,192,785,966)
Deposit to/from Common Fund	-	(291,942,250)	-	-	-	-	(311,408,465)
Operating Transfers In	-	-	-	20,526,000	7,045,058	-	42,660,552
Operating Transfers Out	-	-	(61,127,895)	-	-	-	(67,488,772)
TOTAL OTHER FINANCING SOURCES (USES)	-	(291,942,250)	(61,127,895)	20,526,000	7,045,058	-	(3,529,012,423)
Net Change in Fund Balances	1,760	-	1,235,762	1,044,425	882,098	1,213,984	4,189,702
FUND BALANCES, JULY 1, 2005	19,845	-	3,640,310	694,032	-	16,415,487	29,009,192
FUND BALANCES, JUNE 30, 2006	\$ 21,605	\$ -	\$ 4,876,072	\$ 1,738,457	\$ 882,098	\$ 17,629,471	\$ 33,198,894
FUND BALANCES CONSIST OF:							
General Cash	\$ 21,605	\$ -	\$ 4,872,748	\$ 1,828,770	\$ 882,098	\$ 17,629,471	\$ 33,136,418
Petty Cash	-	-	300	-	-	-	6,100
NSF Items	-	-	3,024	-	-	-	3,024
Deposits with Vendors	-	-	-	-	-	-	143,586
Accounts Receivable Invoiced	-	-	-	-	-	-	45
Due to Vendors	-	-	-	(35,479)	-	-	(35,445)
Jackpot Prizes Payable	-	-	-	(4,684)	-	-	(4,684)
Due to Fund	-	-	-	(40,150)	-	-	(40,150)
Due to Government	-	-	-	(10,000)	-	-	(10,000)
TOTAL FUND BALANCES	\$ 21,605	\$ -	\$ 4,876,072	\$ 1,738,457	\$ 882,098	\$ 17,629,471	\$ 33,198,894

The accompanying notes are an integral part of the schedule.

(Concluded)

NEBRASKA DEPARTMENT OF REVENUE

NOTES TO THE SCHEDULE

For the Fiscal Year Ended June 30, 2006

1. Criteria

The accounting policies of the Nebraska Department of Revenue (Department) 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.S.Supp., 2004, 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 the Nebraska State Accounting Manual published by DAS – Accounting Division and available to the public. The financial information used to prepare the schedule of revenues, expenditures, and changes in fund balances for the Department 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, 2006, includes only those payables posted to NIS before June 30, 2006, and not yet paid as of that date. The amount recorded as expenditures as of June 30, 2006, **does not** include amounts for goods and services received before June 30, 2006, which had not been posted to NIS as of June 30, 2006.

NIS also records other liabilities in accounts titled Due to Fund, Jackpot Prizes Payable, and Due to Government for the Department. The assets in these funds are being held by the State as an agent and will be used to pay those liabilities to individuals, private organizations, other governments, and/or other funds. The recording of those liabilities reduces the fund balance/equity. For further information of the activity recorded to those accounts for the fiscal year ended June 30, 2006, see Notes 6, 7, and 8.

The Department had no accounts receivable at June 30, 2006. The NIS system does not include liabilities for accrued payroll, compensated absences, and taxpayer refunds.

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

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

NEBRASKA DEPARTMENT OF REVENUE

NOTES TO THE SCHEDULE

(Continued)

1. **Criteria** (Continued)

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.

40000 – Federal Funds – account for all federal grants and contracts received by the State. Expenditures must be made in accordance with applicable federal requirements.

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

60000 – Trust Funds – account for assets held by the State in a trustee capacity. Expenditures are made in accordance with the terms of the trust.

70000 – Distributive Funds – account for assets held by the State as an agent for individuals, private organizations, other governments, and/or other funds.

The major revenue object account codes established by NIS used by the Department 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 Department consists of income taxes, sales and use taxes, motor fuels taxes, and various other taxes.

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.

NEBRASKA DEPARTMENT OF REVENUE

NOTES TO THE SCHEDULE

(Continued)

1. Criteria (Concluded)

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

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

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.

Government Aid – Payment of Federal and/or State money to governmental subdivisions, State agencies, local health and welfare offices, individuals, etc., in furtherance of local activities and accomplishment of State programs.

Other significant object account codes established by NIS and used by the Department 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.

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 Department's funds at June 30, 2006, included Due to Fund, Jackpot Prizes Payable, and Due to Government. The activity of these accounts are not recorded on the Schedule of Revenues, Expenditures, and Changes in Fund Balances as they are not recorded through revenue and expenditure accounts. The activity processed on NIS through these accounts is summarized in Notes 6, 7, and 8.

Other Financing Sources – Operating transfers and proceeds of fixed asset dispositions.

NEBRASKA DEPARTMENT OF REVENUE

NOTES TO THE SCHEDULE

(Continued)

2. State Agency

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

The Nebraska Department of Revenue 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. General Cash

General cash accounts are under the control of the State Treasurer or other administrative bodies as determined by law. All cash deposited with the State Treasurer is initially maintained in a pooled cash account. On a daily basis, the State Treasurer invests cash not needed for current operations with the State's Investment Council that maintains an operating investment pool for such investments. Interest earned on those investments is allocated to funds based on their percentage of the investment pool.

5. 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 Department 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 the asset's life is not capitalized.

NEBRASKA DEPARTMENT OF REVENUE

NOTES TO THE SCHEDULE

(Continued)

5. Capital Assets (Concluded)

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

Capital asset activity of the Department for the fiscal year ended June 30, 2006, was as follows:

	Beginning Balance	Increases	Decreases	Ending Balance
Capital Assets				
Equipment	<u>\$ 1,793,523</u>	<u>\$ 423,580</u>	<u>\$ 308,052</u>	\$ 1,909,051
Less accumulated depreciation for:				
Equipment				<u>1,354,495</u>
Total capital assets, net of depreciation				<u>\$ 554,556</u>

6. Changes in Jackpot Prizes Payable

Fund	Balance July 1, 2005	In	Out	Balance June 30, 2006
State Lottery Prize Trust				
Fund 61620	\$ 4,684	\$ 182,304,391	\$(182,304,391)	\$ 4,684

The activity in this account consists of monies received from the Multistate Lottery Association for Lottery grand prize winners and payment of these monies to the grand prize winners.

7. Changes in Due to Fund

Fund	Balance July 1, 2005	In	Out	Balance June 30, 2006
State Lottery Prize Trust				
Fund 61620	\$ 26,802	\$ 18,366,207	\$ (18,352,859)	\$ 40,150

Amounts recorded in this account are the withholding of State income taxes for Nebraska Lottery prize winners and the transfer of those amounts to the State General Fund.

NEBRASKA DEPARTMENT OF REVENUE

NOTES TO THE SCHEDULE

(Continued)

8. Changes in Due to Government

Fund	Balance July 1, 2005	In	Out	Balance June 30, 2006
State Lottery Prize Trust				
Fund 61620	\$ -	\$ 47,582,786	\$ (47,572,786)	\$ 10,000

Amounts recorded in this account are the withholding of Federal income taxes for Nebraska Lottery prize winners and the payment of those taxes to the Federal Government.

9. Deposits to/from Common Funds

Deposits to other agencies include the collection of taxes and fees by the Department of Revenue that are credited to the Agriculture Alcohol Fuel Tax, Oil and Gas Conservation, Ethanol Production Incentive, Grade Cross Construction, Waste Reduction and Recycling Incentive, Litter Reduction and Recycle, Petroleum Release, and Highway Trust Funds in accordance with State statutes.

10. Transfers

Neb. Rev. Stat. Section 9-812 R.S.Supp., 2004 requires the Department to transfer funds from the State Lottery Operation Trust Fund to the State Lottery Prize Trust Fund, the Lottery Operation Cash Fund, and various other beneficiary funds.

Neb. Rev. Stat. Section 77-913 R.R.S. 2003 requires the State Treasurer to transfer 30 percent of the balance in the Insurance Tax Fund to the Municipal Equalization Fund on May 1 of each year.

2005 Neb. Laws LB 425, Section 275, authorized the State Treasurer to transfer \$6,000,000 from the Tobacco Products Administration Fund to the General Fund.

11. Cigarette Tax Distributions

Neb. Rev. Stat. Section 77-2602 R.S.Supp., 2005 requires the State Treasurer to distribute the proceeds from cigarette taxes to multiple funds. The tax is originally deposited into the State General Fund. The distributions reduce the amount of revenue shown on the Schedule of Revenues, Expenditures, and Changes in Fund Balances. The amount distributed to funds other than the State General Fund was \$19,476,932.

NEBRASKA DEPARTMENT OF REVENUE

NOTES TO THE SCHEDULE

(Continued)

12. Documentary Stamp Tax

Neb. Rev. Stat. Section 76-903 R.S.Supp., 2005 requires the State Treasurer to credit certain funds for portions of the Documentary Stamp Tax. The Department collects the tax and records it as revenue to the General Fund. The State Treasurer then transfers the funds in accordance with State statute and records the transaction by reducing the same revenue account. The amount transferred in accordance with State statute was \$14,429,584.

13. Sales Tax on Motor Vehicles

Neb. Rev. Stat. Section 77-27,132 R.R.S. 2003 requires the State Treasurer to credit to the Highway Trust Fund all of the proceeds of the sales taxes derived from motor vehicles, trailers, and semitrailers, except the proceeds in excess of five percent which are required to be credited to the General Fund. The Department initially deposits all sales tax on motor vehicles into the Revenue Distribution Fund. The Department then reduces the revenue in the Distribution Fund and credits the Highway Trust Fund and the General Fund. Additionally, Neb. Rev. Stat. Section 77-27,144 R.R.S. 2003 allows the Department to deduct three percent from the sales tax remitted for credit to the Municipal Equalization Fund. Below is a summary of the activity recorded through the revenue account for Motor Vehicle Sales Tax.

Amount Received		\$ 172,997,532
Refunds to Cities	(22,696,469)	
Transfers to Highway Trust Fund and State General Fund	(148,318,819)	
Department of Revenue Sales Tax Administration Fee	(703,856)	
Taxpayer Refunds	(140,180)	
Total Refunds		<u>(171,859,324)</u>
Amount to be Distributed at year end		<u>\$ 1,138,208</u>

14. Tax Refunds

Tax revenues shown on the Schedule of Revenues, Expenditures, and Changes in Fund Balances are net of refunds issued. Below is a summary of the amounts refunded for significant tax types deposited into the State General Fund.

NEBRASKA DEPARTMENT OF REVENUE

NOTES TO THE SCHEDULE

(Continued)

14. Tax Refunds (Concluded)

Retailers Sales and Use Tax

Amount Received		\$ 1,578,325,963
Refunds to Cities	(249,939,965)	
Employment and Investment Growth City and State		
Sales Tax Refunds	(77,345,678)	
Department of Revenue Sales Tax Administration Fee	(7,723,440)	
Taxpayer Refunds	(7,509,517)	
Miscellaneous Refunds	(133,925)	
Total Refunds		(342,652,525)
Retailers Sales and Use Tax Net of Refunds		\$ 1,235,673,438

Individual Income Tax

Withholding Income Tax	\$ 1,301,751,317	
Estimated Income Tax	248,530,581	
Final Income Tax Return	244,858,126	
Total Received		1,795,140,024
Refunds to Taxpayers		(259,884,587)
Individual Income Tax Net of Refunds		\$ 1,535,255,437

Corporate Income Tax

Amount Received	\$ 283,829,324	
Refunds to Taxpayers	(21,533,867)	
Corporate Income Tax Net of Refunds		\$ 262,295,457

STATE OF NEBRASKA AUDITOR OF PUBLIC ACCOUNTS



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

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Nebraska Department of Revenue
Lincoln, Nebraska

We have examined the accompanying schedule of revenues, expenditures, and changes in fund balances of the Nebraska Department of Revenue for the fiscal year ended June 30, 2006, and have issued our report thereon dated November 29, 2006. 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.

Internal Control Over Financial Reporting

In planning and performing our examination, we considered the Nebraska Department of Revenue'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 an opinion on the internal control over financial reporting. Our consideration of the internal control over financial reporting would not necessarily disclose all matters in the internal control over financial reporting that might be material weaknesses. A material weakness is a reportable 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 caused by error or fraud 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. We noted no matters involving the internal control over financial reporting and its operation that we consider to be material weaknesses.

Compliance and Other Matters

As part of obtaining reasonable assurance about whether the Nebraska Department of Revenue'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 grant agreements, 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 or other matters that are required to be reported under *Government Auditing Standards*.

We noted certain additional items that we reported to management of the Nebraska Department of Revenue in the Comments Section of this report as Comment Number 1 (Interest on Sales and Use Tax Returns), Comment Number 2 (Homestead Exemption Income Limits), Comment Number 3 (Payroll Issues), Comment Number 4 (Charitable Gaming Transfers), Comment Number 5 (Capital Assets), Comment Number 6 (Fines and Penalties - Charitable Gaming Division), Comment Number 7 (Reconciliation of Bank Records to Nebraska Information System), and Athletic Commission Comment Number 1 (Fines and Penalties).

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

A handwritten signature in blue ink that reads "Pat Reding, CPA".

Assistant Deputy Auditor

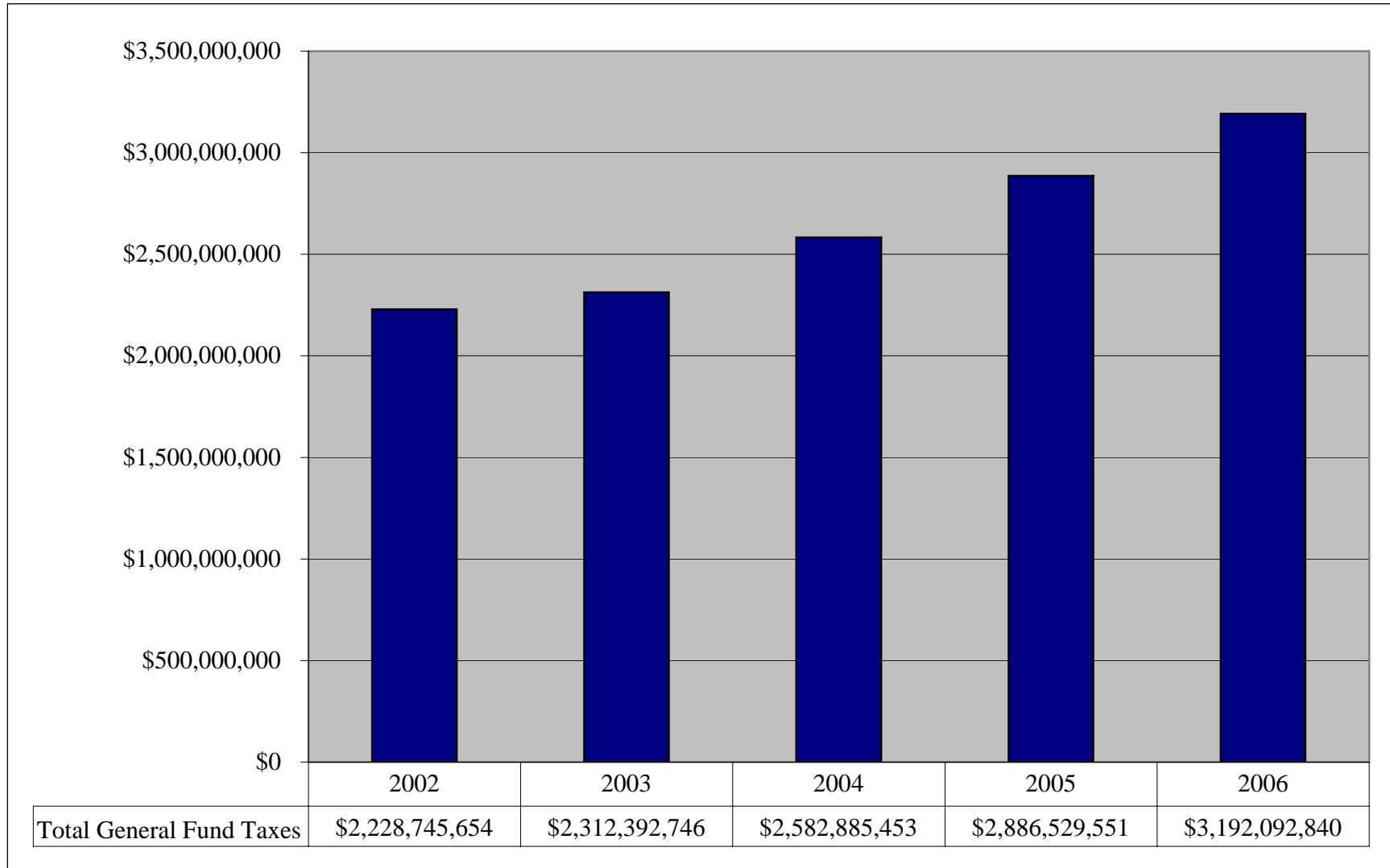
November 29, 2006

NEBRASKA DEPARTMENT OF REVENUE

STATISTICAL SECTION

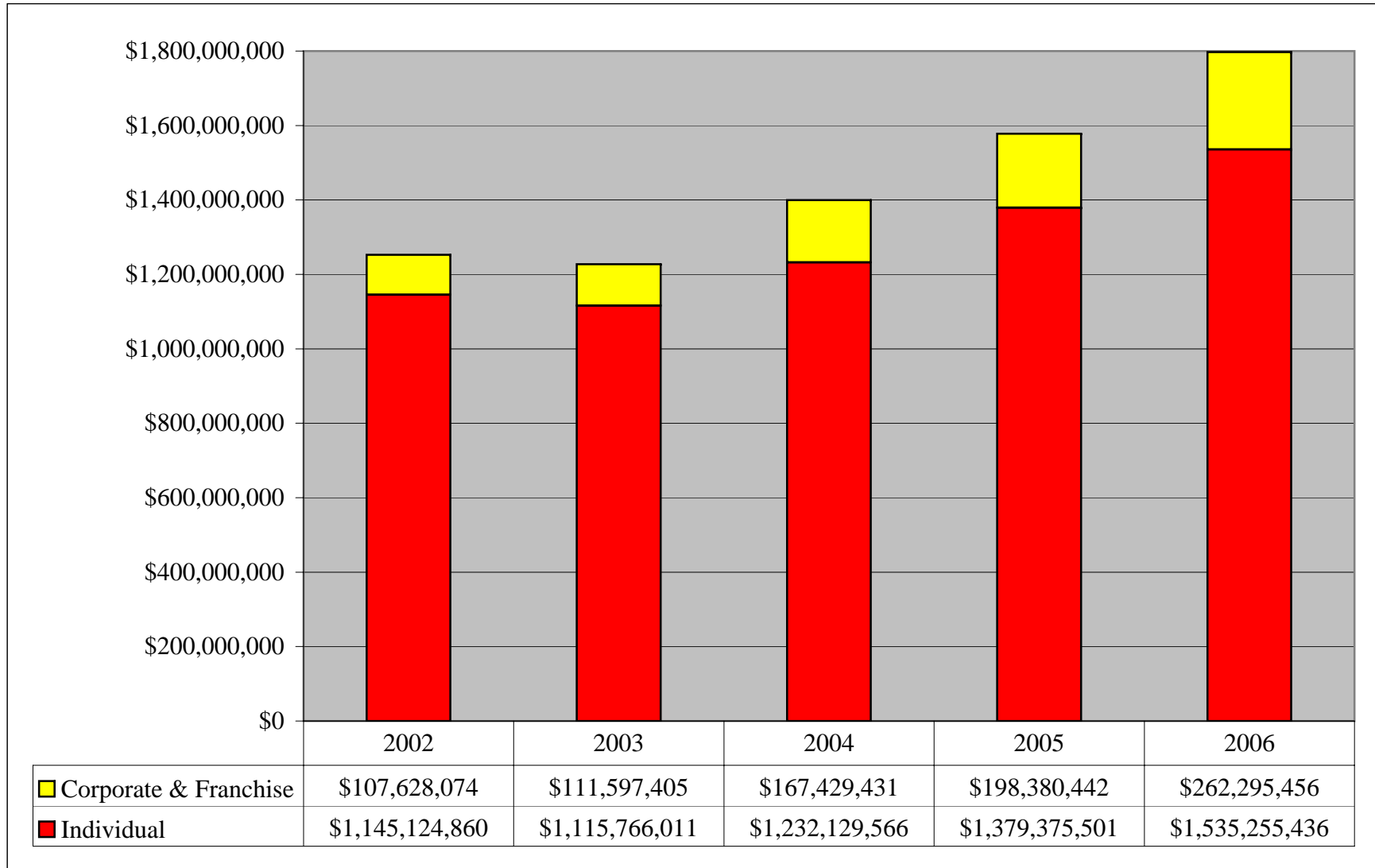
Our examination was conducted for the purpose of forming an opinion on the schedule of revenues, expenditures, and changes in fund balances. Statistical Section information is presented for purposes of additional analysis. Such information has not been subjected to the procedures applied in the examination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

NEBRASKA DEPARTMENT OF REVENUE
SCHEDULE OF TOTAL GENERAL FUND TAX REVENUES
For the Fiscal Years Ended June 30, 2002, 2003, 2004, 2005, and 2006



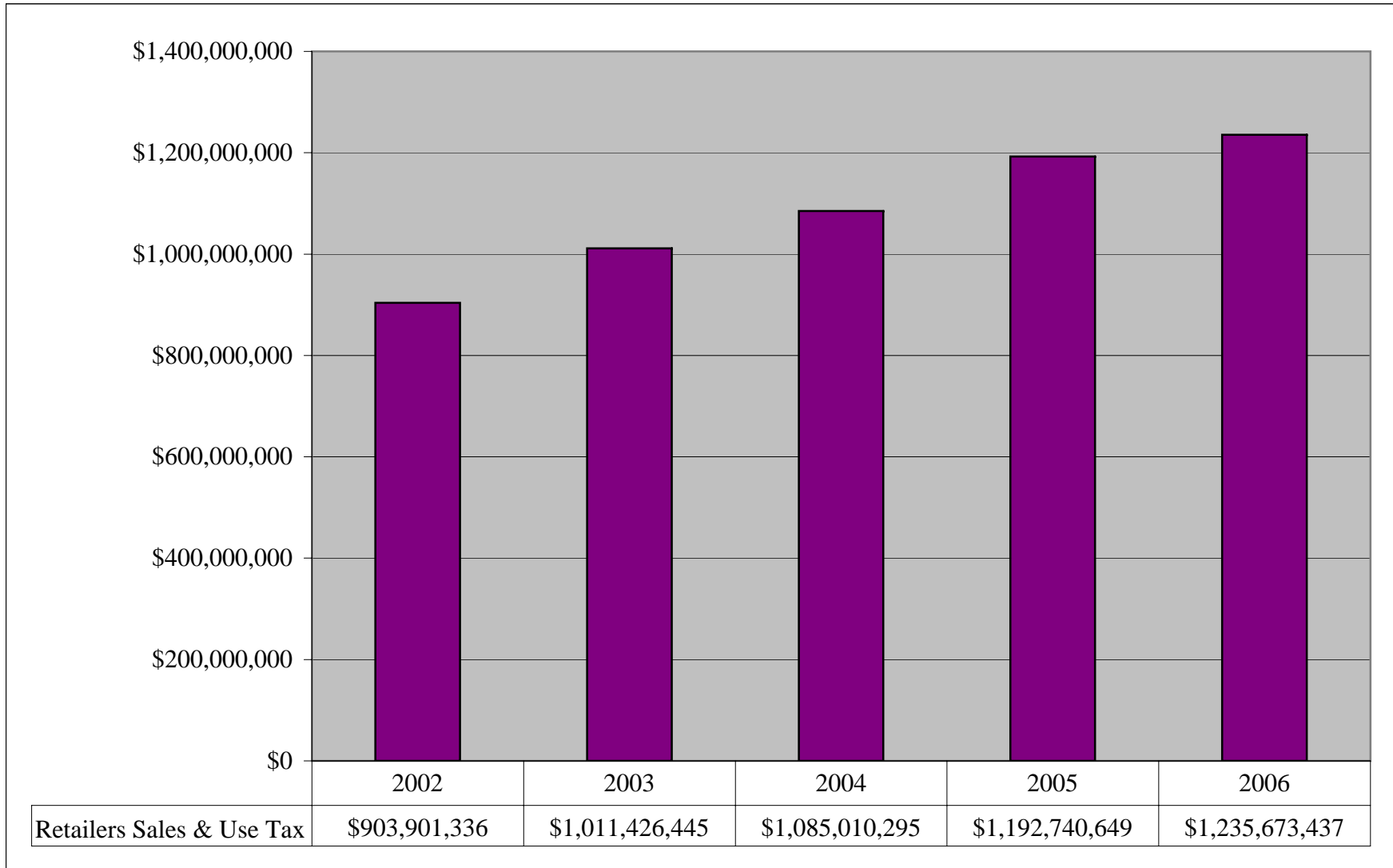
Note: Amounts shown are net of refunds.

NEBRASKA DEPARTMENT OF REVENUE
SCHEDULE OF CORPORATE AND FRANCHISE AND INDIVIDUAL INCOME TAX REVENUES
For the Fiscal Years Ended June 30, 2002, 2003, 2004, 2005, and 2006



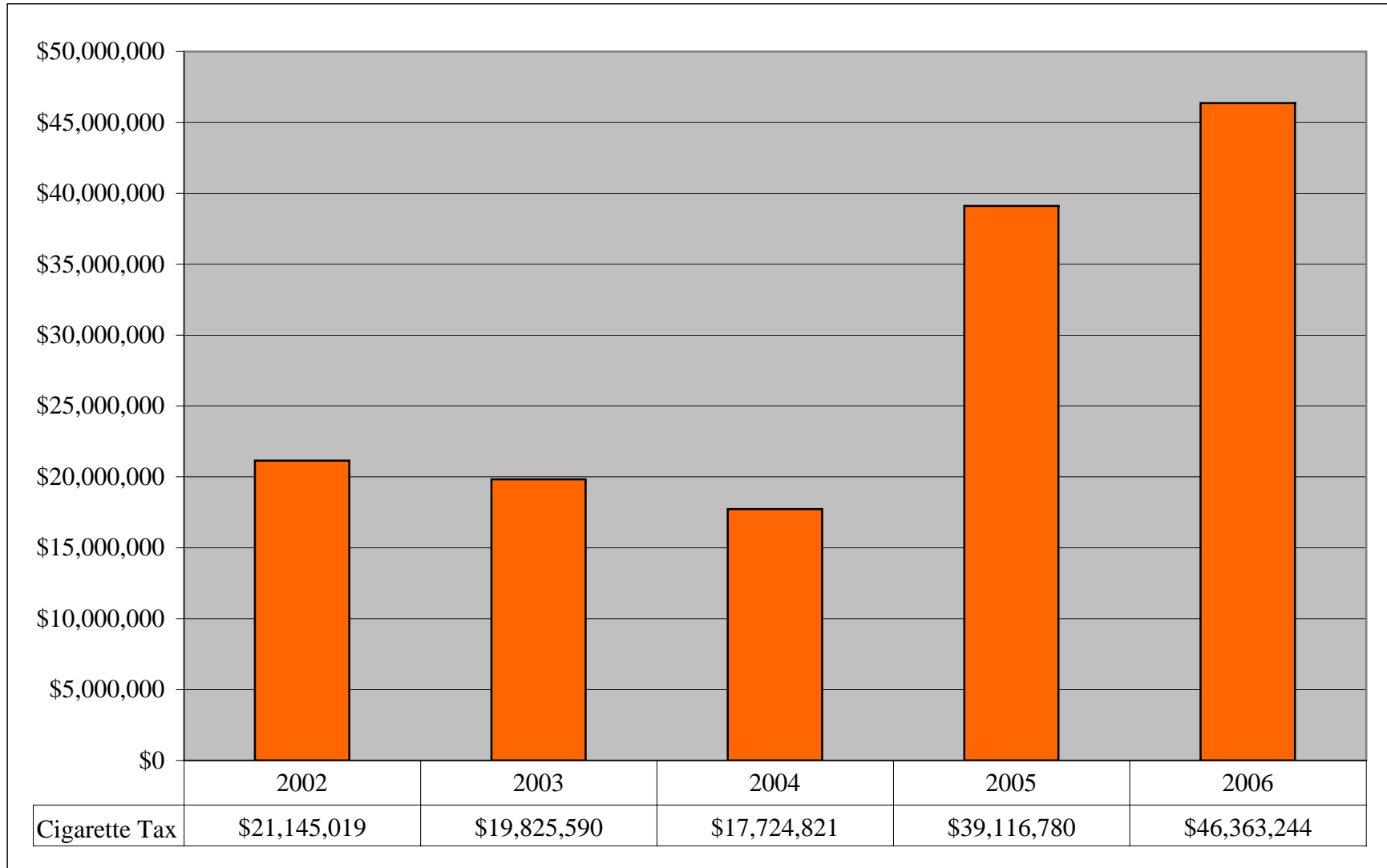
NOTE: Amounts shown are net of refunds.

NEBRASKA DEPARTMENT OF REVENUE
SCHEDULE OF RETAILERS SALES AND USE TAX REVENUES
For the Fiscal Years Ended June 30, 2002, 2003, 2004, 2005, and 2006



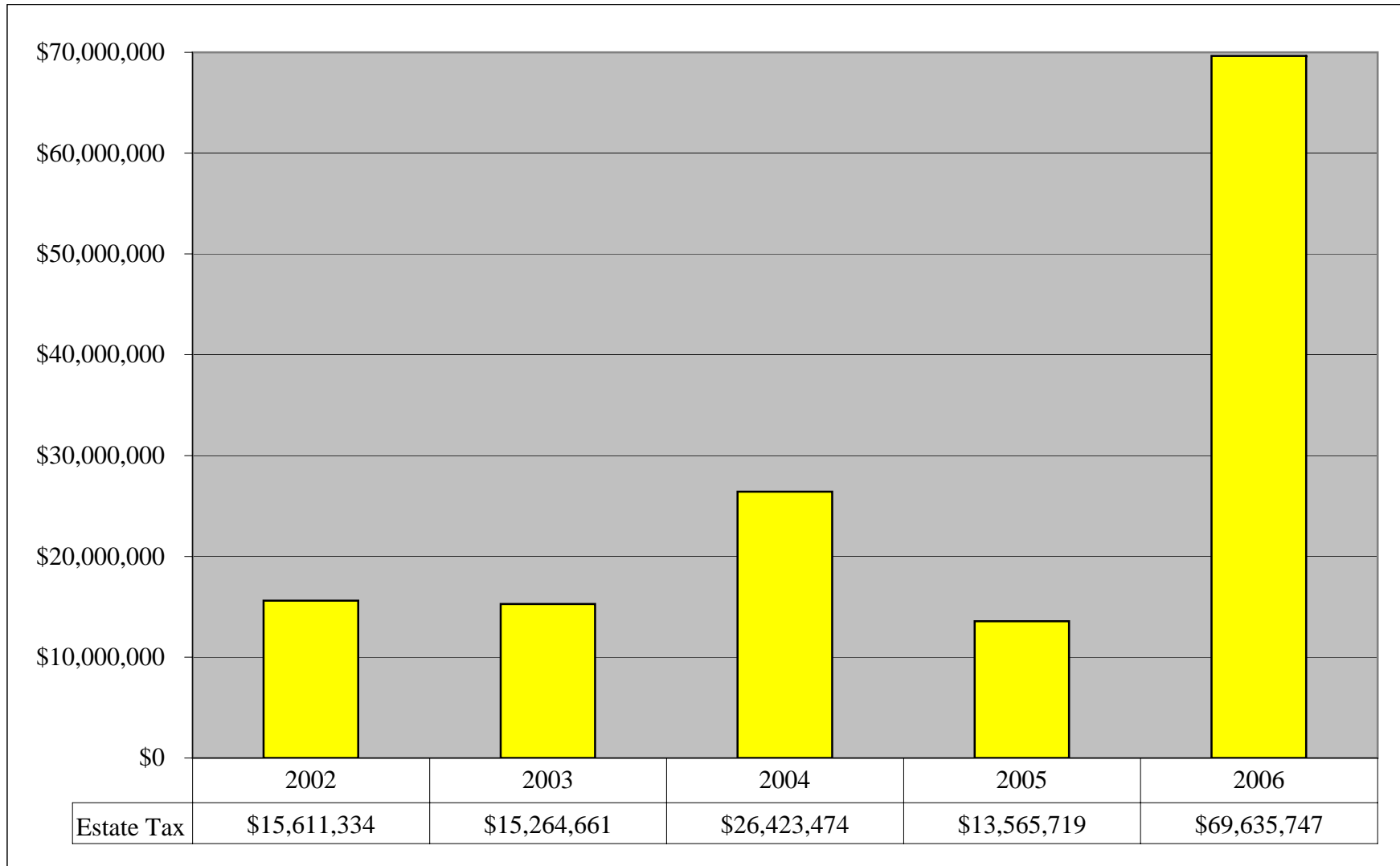
NOTE: Amounts shown are net of refunds.

NEBRASKA DEPARTMENT OF REVENUE
SCHEDULE OF CIGARETTE TAX REVENUES
 For the Fiscal Years Ended June 30, 2002, 2003, 2004, 2005, and 2006



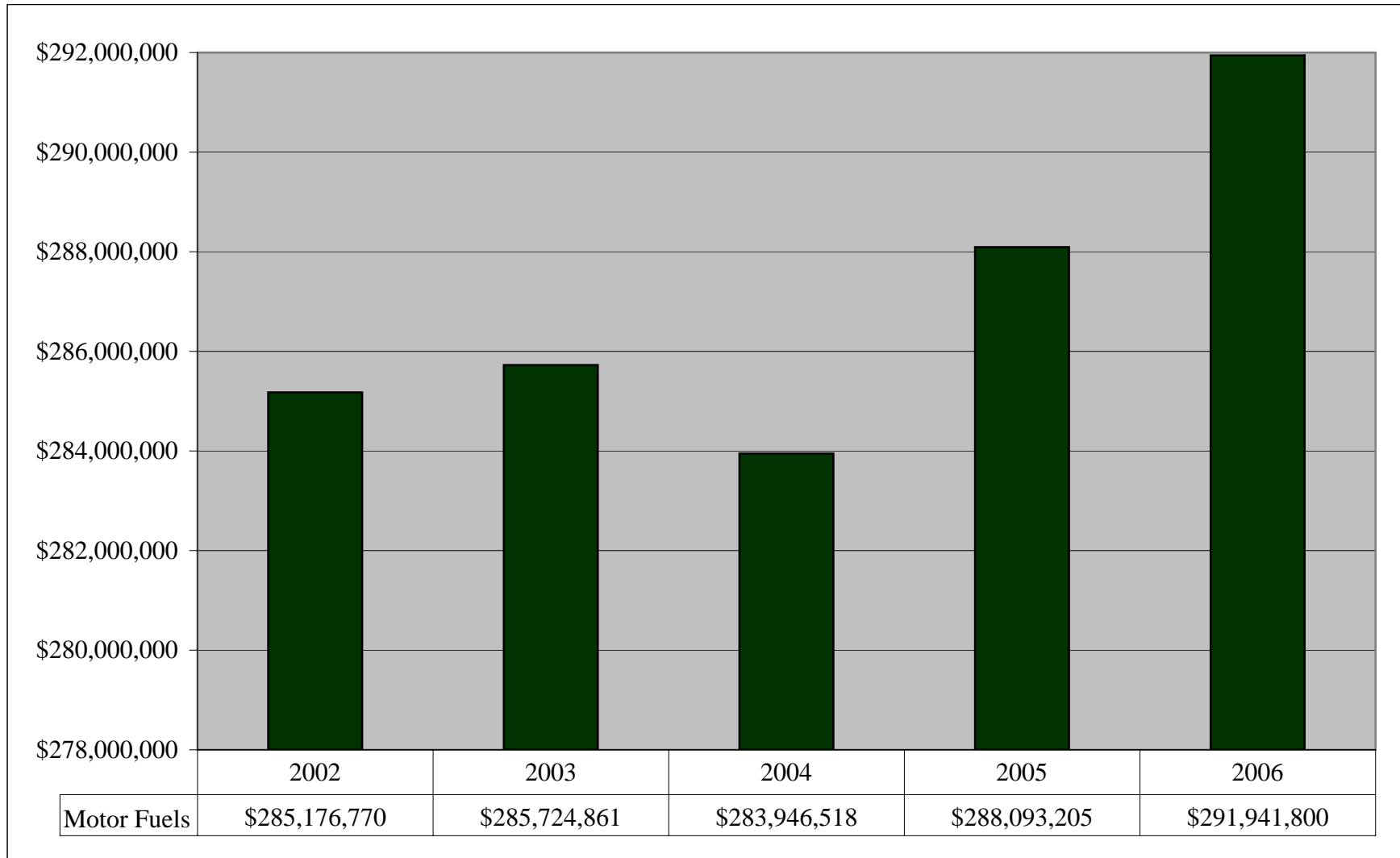
NOTE: Amounts shown are net of refunds.

NEBRASKA DEPARTMENT OF REVENUE
SCHEDULE OF ESTATE TAX REVENUES
For the Fiscal Years Ended June 30, 2002, 2003, 2004, 2005, and 2006



NOTE: Amounts shown are net of refunds.

NEBRASKA DEPARTMENT OF REVENUE
SCHEDULE OF MOTOR FUELS TAX REVENUES
For the Fiscal Years Ended June 30, 2002, 2003, 2004, 2005, and 2006



NOTE 1: Amounts shown are net of refunds.

NOTE 2: Motor Fuels taxes are deposited into the Highway Trust Fund in accordance with State Statutes.