



NEBRASKA AUDITOR OF PUBLIC ACCOUNTS

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March 8, 2013

Catherine Lang, Commissioner
Nebraska Department of Labor
550 South 16th Street
Lincoln, Nebraska 68509-4600

Dear Ms. Lang:

We have audited the basic financial statements of the State of Nebraska (the State) as of and for the year ended June 30, 2012, in accordance with auditing standards generally accepted in the United States of America, and have issued our report thereon dated January 16, 2013. In planning and performing our audit, we considered the State's internal control over financial reporting (internal control) as a basis for designing audit procedures for the purpose of expressing our opinions on the basic financial statements of the State, but not for the purpose of expressing an opinion on the effectiveness of the State's internal control. Accordingly, we do not express an opinion on the effectiveness of the State's internal control.

In connection with our audit described above, we noted certain internal control or compliance matters related to the activities of the Nebraska Department of Labor (the Agency) or other operational matters that are presented below for your consideration. These comments and recommendations, which have been discussed with the appropriate members of the Agency's management, are intended to improve internal control or result in other operating efficiencies.

Our consideration of internal control included a review of prior year comments and recommendations. To the extent the situations that prompted the recommendations in the prior year still exist, they have been incorporated in the comments presented for the current year. All other prior year comments and recommendations (if applicable) have been satisfactorily resolved.

Our consideration of internal control was for the limited purpose described in the first paragraph and was not designed to identify all deficiencies in internal control that might be material weaknesses or significant deficiencies and, therefore, material weaknesses or significant deficiencies may exist that were not identified. However, as discussed below, we identified certain deficiencies in internal control that we consider to be significant deficiencies.

A deficiency in internal control exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent, or detect and correct misstatements on a timely basis. A material weakness is a

deficiency, or a combination of deficiencies in internal control, such that there is a reasonable possibility that a material misstatement of the entity's financial statements will not be prevented, or detected and corrected, on a timely basis. We did not identify any deficiencies in internal control that we consider to be material weaknesses.

A significant deficiency is a deficiency, or combination of deficiencies, in internal control that is less severe than a material weakness, yet important enough to merit attention by those charged with governance. We consider Comment Number 1 (Audit Requests for Information Denied) and Comment Number 2 (Accrual Information) to be significant deficiencies.

These comments will also be reported in the State of Nebraska's Statewide Single Audit Report Schedule of Findings and Questioned Costs.

Draft copies of this letter were furnished to the Agency to provide them an opportunity to review the letter and to respond to the comments and recommendations included in this letter. All formal responses received have been incorporated into this letter. Responses have been objectively evaluated and recognized, as appropriate, in the letter. Responses that indicate corrective action has been taken were not verified at this time, but will be verified in the next audit.

The following are our comments and recommendations for the year ended June 30, 2012.

1. Audit Requests for Information Denied

Neb. Rev. Stat. § 84-305 (Reissue 2008) provides, in relevant part:

“The Auditor of Public Accounts shall have access to all records of any public entity, in whatever form or mode the records may be, unless the auditor's access to the records is specifically prohibited or limited by federal or state law.”

Good business practice, which necessarily entails compliance with statutory directives, such as that referenced above, requires timely responses to both requests for audit documentation and access to financial systems by the Auditor of Public Accounts (APA).

Applicable professional financial auditing standards also mandate cooperation with a financial audit. Most specifically, U.S. Auditing Standards, AU § 316.04 provides, in relevant part:

“Management, along with those charged with governance, should set the proper tone; create and maintain a culture of honesty and high ethical standards; and establish appropriate controls to prevent, deter, and detect fraud.”

AU § 316.68 further states,

“The auditor's assessment of the risks of material misstatement due to fraud should be ongoing throughout the audit. Conditions may be identified during fieldwork that change or support a judgment regarding the assessment of the risks, such as the following:

- *Unusual delays by the entity in providing requested information*

- *Unwillingness to facilitate auditor access to key electronic files for testing through the use of computer-assisted audit techniques”*

Furthermore, the Appendix Examples of Fraud Risk Factors (A.2) to AU § 316 warns auditors against the following:

“Formal or informal restrictions on the auditor that inappropriately limit access to people or information...”

“Domineering management behavior in dealing with the auditor, especially involving attempts to influence the scope of the auditor’s work...”

During testing of the State Comprehensive Annual Financial Report (CAFR) the Nebraska Department of Labor (Agency) did not comply timely with the APA’s requests for audit documentation and access to financial systems.

OnBase System Access

Several State agencies began using the OnBase System (OnBase) during the fiscal year ended June 30, 2012. OnBase was used to store payment related documentation and the approval process for payments entered into EnterpriseOne, the State’s accounting system.

On August 15, 2012, the APA sent an email to all State agencies, requesting full inquiry-only access to OnBase to conduct the audit of the State’s CAFR. The APA sent a second and third request to the Agency’s Commissioner on October 4 and October 10, 2012, reiterating the initial request for inquiry-only access to OnBase. On October 11, 2012, the Commissioner replied that she did not believe the three systems currently maintained in OnBase were involved in the CAFR; therefore, not until OnBase was used for other systems would the Agency grant the APA access, as needed.

This began an extensive series of communications in which the APA made repeated requests for access to OnBase, and the Agency denied those requests. As of February 6, 2013, the APA had still been refused access to OnBase – some 175 days from the initial request.

Date	APA Request/Labor Response
8/15/2012	The APA requested, from all state agencies, inquiry-only access to OnBase.
10/4/2012	The APA sent another request to the Agency’s Commissioner, requesting inquiry-only access to OnBase.
10/10/2012	The APA followed up on the status of the access request.
10/11/2012	The Commissioner stated there were three systems deployed in OnBase and, to her knowledge, those systems were not involved in the CAFR. The Agency would supply the requested access when other systems were deployed in OnBase, as needed.
10/11/2012	The APA and the Commissioner discussed the requested access further via phone.

Date	APA Request/Labor Response
10/31/2012	The APA sent an email to the Commissioner, explaining that the CAFR audit covers all State expenditures. Although the APA's request for access was made within the context of that audit, it appeared the Agency did not intend to provide such access. The APA asked the Commissioner to confirm her intentions regarding the APA's request for access.
11/15/2012	The APA sent a certified letter to the Commissioner, requesting access to OnBase.
11/29/2012	The APA received a letter from the Commissioner, stating the Agency would be happy to provide specific documents for a specific audit period.
11/29/2012	The APA again requested access to all Agency records in OnBase.
11/30/2012	The Commissioner replied that she would provide read-only access to all OnBase records for the Agency and requested a list of APA staff that needed such access.
11/30/2012	The APA provided the Commissioner with a list of APA staff needing access to OnBase.
12/13/2012	The APA followed up on the status of the request for access.
12/14/2012	The Commissioner stated that the APA's access was pending approval from the Agency's Federal partners to ensure compliance with Federal requirements. If the APA wanted immediate, read-only access to all OnBase records, the Commissioner said, a computer at the Agency's administrative office would be set up for the APA to access those records.
12/14/2012	The APA requested a copy of any correspondence between the Agency and its Federal partners regarding the APA's access to OnBase.
12/17/2012	The APA requested a complete listing of all Agency OnBase users for an information technology audit.
12/17/2012	The Commissioner sent a letter to the APA containing Agency email communications with the United States Department of Labor (USDOL) and the Social Security Administration (SSA). The Commissioner stated that, based upon the direction provided by the USDOL, the Agency would be unable to provide the APA access to OnBase in the manner requested. Federal regulations require a written agreement between the APA and the Agency in accordance with 20 CFR 603.10.
12/27/2012	The APA followed up on the status of the December 17, 2012, request for a complete listing of OnBase users.
12/27/2012	An Agency representative responded that she was waiting for the Commissioner's approval to provide the listing. She was beginning to prepare the listing and would provide it by December 31, 2012.
1/2/2013	The APA followed up on the status of the request for a listing of OnBase users.
1/2/2013	The Agency replied that the request was complete, and the APA would receive printed copies of the information that same day.
1/3/2013	The APA asked for electronic copies of the information requested.
1/3/2013	The Agency provided the requested electronic copies.
1/10/2013	The APA requested a meeting to discuss the systems contained within OnBase.

Date	APA Request/Labor Response
1/10/2013	The Agency indicated the meeting should include the individual in charge of internal security, who was out of the office until January 22, 2013.
1/11/2013	The APA requested we move forward with a meeting to discuss OnBase and any required follow up could be discussed at a later date.
1/11/2013	The Agency requested the appropriate internal security person be involved and requested the APA's questions.
1/11/2013	The APA provided general OnBase questions and asked if we could start testing the week of January 14, 2013.
1/11/2013	An Agency representative requested an agenda for the meeting and indicated some discussion items would involve Directors in each of the impacted areas.
1/11/2013	The APA requested contacts for the various areas and asked who could be contacted to discuss the process of assigning user access to OnBase. The APA requested a meeting with the Access Request Processing (ARP) OnBase contact.
1/14/2013	The ARP representative indicated he was available at anytime. A meeting was scheduled for January 16, 2013.
1/16/2013	The APA performed a walkthrough of the ARP process and was given contact information for the other systems in OnBase.
1/17/2013	The APA requested meetings with the contacts in charge of various systems within OnBase.
1/17/2013	The Agency provided contacts for the OnBase Unemployment Insurance (UI), NEworks, and Work Opportunity Tax Credit (WOTC) systems.
1/17/2013	The APA requested a meeting with the UI contacts. A meeting was arranged for January 18, 2013.
1/18/2013	The APA met with the Agency and walked through the UI process.
1/22/2013	The APA followed up on the status of the email sent January 17, 2013, requesting a meeting to walk through the NEworks and WOTC systems within OnBase. The APA scheduled a meeting for January 24, 2013, with the individual in-charge of internal security. The APA also requested a list of all changes made to OnBase.
1/24/2013	The APA met with the Agency's internal security. Testing of user access and OnBase changes was performed, and ARP controls were observed. The APA asked when access to OnBase documents would be granted and was told this was a question for management.
1/25/2013	The APA sent an email to the Commissioner asking for access to OnBase, from a computer at the Agency's administrative office, as offered by the Commissioner on December 14, 2012. The APA also followed up with Agency staff regarding the status of the meeting requested on January 17, 2013, and January 22, 2013.
1/25/2013	The Agency responded with available meeting times. A meeting was scheduled for February 1, 2013.
1/31/2013	The APA followed up on the status of the email sent to the Commissioner on January 25, 2013.
1/31/2013	The Commissioner responded about concerns with USDOL requirements and wanted clarification on what additional information the APA needed.
1/31/2013	The APA responded that IDs had been set up within the system but no passwords had been provided in order to access the system. Also, the IDs did not have access to documents stored in OnBase.

Date	APA Request/Labor Response
1/31/2013	The Commissioner said she would check into the issue and respond shortly.
2/1/2013	The APA completed a walkthrough of the Neworks and WOTC systems within OnBase and obtained the requested system screenshots.
2/4/2013	The APA followed up with the Commissioner on her January 31, 2013 email.
2/6/2013	The Commissioner asked about the specific audit and the period for the audit. She also indicated the APA would receive access to all documents except Unemployment Insurance in OnBase by February 19, 2013.

According to the Nebraska Attorney General, through Op. Att’y Gen. No. 07004 (Feb. 9, 2007), an agency’s compliance with a statutory directive requiring access to records for audit purposes must occur within “a time frame that is reasonable under the circumstances.” As the above chronology reveals, the Agency’s refusal to comply with the APA’s repeated requests for access to the OnBase system was unreasonable under any circumstances. Thus, the Agency clearly failed to comply with § 84-305.

CAFR Audit Testing

The annual State CAFR is supposed to be completed by December 31st of the reporting year in order for the State to receive the Certificate of Achievement for Excellence in Financial Reporting from the Government Finance Officers Association (GFOA).

During testing, the Agency delayed compliance with the APA’s requests for information regarding updating of memos and detailed testing of Agency financial transactions for up to 90 days. The APA had to follow up repeatedly on all outstanding requests in order to obtain the documentation necessary to complete testing. Furthermore, the Agency did not submit their signed representation letter until January 15, 2013. The APA requested the letter be returned by December 20, 2012. It is unknown why the Agency continually delayed, by as much as three months, complying with the APA’s requests for information.

As a direct result of the Agency’s ongoing delays to provide the APA with support in a timely manner, the APA was unable to complete the testing of the Agency’s information until December 14, 2012.

When the Agency does not submit needed information timely to the auditors, there is an increased risk the CAFR will not be completed by December 31st.

We recommend the Agency ensure all financial system access is provided to the APA in compliance with § 84-305 and as addressed by applicable professional auditing standards. We also recommend the Agency work to ensure supporting documentation is provided promptly upon request by the auditors.

Agency Response: OnBase System Access The Nebraska Department of Labor (NDOL) is not aware of any documents that the agency has failed to provide to the Auditor of Public Accounts (APA). NDOL did not have any document storage of a financial nature in the OnBase System for the CAFR audit period ending June 30, 2012. The only operative OnBase system at NDOL for

the CAFR audit period ending June 30, 2012 was Access Request Processing (ARP), which became operative on June 25, 2012. NDOL received a request for a meeting on ARP with the APA on January 11, 2013. NDOL performed a walkthrough of ARP with APA on January 16, 2013.

The level of access to OnBase that was requested by the APA is not allowed under the NDOL federal grants. NDOL received instructions from US Department of Labor (USDOL) regarding record access to unemployment documents on December 14, 2012. Said instructions were provided to the APA on December 17, 2012.

CAFR Audit Testing Management fully understands and respectfully disagrees. Out of the thousands of pages requested of specific documents, management only had one instance of the delay that is being reported above. The original request was part of the ICQ's and yet it was not an ICQ, which was perhaps the rationale for it being sidelined or delayed. Management asked for an outstanding list and went through this list weekly unless there were conflicts during the audit work period, as a way of making sure all requests were complied with as timely as possible. The document being used as an example of the unresponsiveness of management was received at the start of the audit. However it was not brought to management's attention during any of the weekly meetings, and was resent November 20th. At this point there was no clear directions on which information the auditor was looking for as the type of receipts that were being tracked were not designated in either the email or in the actual document itself. Further emails were exchanged. Answers were received on November 28th. Management then responded after interviewing several persons who were involved in the receipt process. This took two weeks to receive the answers, document the process and send the response back to APA. There were over one thousand one hundred emails received in the Controllers inbox related to this year's audit. Management acknowledges it is their responsibility to reply with all requests and will attempt to track all requests.

In reference to the comment on the Management Representation Letter, the representation letter states that the agency has provided all records requested for the audit period ending June 30, 2012. In a letter dated November 15, 2012, the APA indicated that the agency had failed to provide all documents requested. In an email note dated December 20, 2012, the agency requested clarification of this very issue from the APA, seeking an explanation of how the agency could in good conscience sign the representation letter. Until the issue of documentation was resolved, it would not have been appropriate for NDOL to sign a representation letter certifying that all documents requested had been provided. Additionally, the APA indicated in an email dated November 29, 2012 that the IT audit had been extended and the APA did not complete all field work for the audit until a walkthrough on February 1, 2013. Therefore the representation letter was signed before the audit was even completed.

APA Response: The APA requested access to OnBase on August 15, 2012. The APA was unable to determine that there were no financial records contained within the system or that the only operative system started on June 25, 2012, as we were not given access to review the information contained within the OnBase system.

As for the delays in information for CAFR testing, we incurred delays in several areas of testing, including analytical review, memos, and questionnaires. The APA CAFR audit team did not meet with the Agency weekly to go over outstanding items; instead, the Agency was contacted periodically throughout the week to follow up on outstanding items. Numerous emails were sent due to untimely responses to information requested and because the Agency's Controller requested she be carbon copied on all correspondence. The Agency also requested all initial correspondence be via email instead of personal contact.

2. Accrual Information

In preparation for the CAFR, the Department of Administrative Services State Accounting Division (State Accounting) obtains financial statement amounts from the Agency for the Unemployment Insurance Fund. A good internal control plan requires the Agency to have procedures to accurately report financial activity for the Unemployment Insurance Fund to State Accounting.

During testing of the Unemployment Insurance Fund financial statements, we noted the following:

- The Agency did not properly report unemployment insurance disbursements. The Agency reported \$3,070,240 as miscellaneous operating expenses; however, only \$931,111 of those expenses should have been recorded as operating expenses. The remaining \$2,139,129 should have been reported as personal services expense on the financial statements. A similar adjustment was made during the prior audit.
- The Agency uses QuickBooks to record its financial activity for the Unemployment Insurance Fund. During the audit, we noted that receivable and payable balances in QuickBooks were not accurately recorded, as the Agency did not enter beginning balances when it began using the system in fiscal year 2010.
- The Agency did not calculate a reasonable contributions receivable allowance for doubtful accounts. An allowance for doubtful accounts is calculated to determine an estimated amount that will not be collected based upon past collection history. The calculation did not consider an aging analysis of accounts receivable.

Without proper controls to ensure amounts reported to State Accounting are accurate and complete, there is an increased risk of financial statement misstatement.

We recommend the Agency implement procedures to ensure financial statement activity and accruals are complete and accurate when reported to State Accounting, including consideration of allowance for doubtful accounts. We also recommend the Agency ensure balances in QuickBooks are accurate and complete.

Agency Response: Management had it broken out in the final report. On the draft report it was not broken out. This was only a change in the line item for the expenditure which DAS would have corrected when preparing the financial statements. There was no adjustment required.

The July 2009 opening balances were not factored in order to get the financial information off of spreadsheets, and into a financial system. Opening balances were not determinable, except for cash accounts, which were entered into the system. There is really no payables outstanding balance, except what would be due at the end of the year from US treasury, which is paid within, usually a one or two day settlement. After three years there should not be any outstanding balances, and if there were, they would be offset by an allowance by this point in time. There is no material amount to be reported. It would result in a gross up of the Accounts Receivable as well as gross up in the Allowance for Bad Debt.

The amount which would have required an allowance calculation was for a total of \$1.4 million. DAS Accounting along with management decided that the amount was not material to estimate an allowance. The total amount of the contributions receivable was roughly \$37.3 million of which \$35.9 million were actually received prior to the completion of the CAFR file creation; therefore no allowance would be necessary since all funds were received in total. The remaining \$1.4 million was not material enough to set up an allowance.

APA Response: The APA received the Agency's financials from the Department of Administrative Services – State Accounting Division (State Accounting) on October 10, 2012. The APA noted the error in miscellaneous operating expenses and brought it to the Agency's attention on October 12, 2012. The Agency responded to the APA on November 1, 2012, that a discussion was held with State Accounting regarding the error. The APA received revised financial statements on November 7, 2012, from State Accounting. The final CAFR report was corrected, after the adjustment was brought to the Agency's attention by the APA.

When the APA inquired why there was no allowance in the financial statements, the Agency's Accountant emailed the APA, and carbon copied the Agency's Controller, with their calculation for the allowance and stated the amount was immaterial. The allowance was calculated as a percentage of write-offs during the year. This rate was then multiplied by \$1 million in receivables, for a calculated allowance of \$827. However, the APA informed the Agency the allowance should be calculated on \$37.3 million in contributions receivable and the rate should be based upon the history of collections, not write-offs. The figures included in the Agency's response were not provided during the audit.

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Our audit procedures are designed primarily on a test basis and, therefore, may not bring to light all weaknesses in policies or procedures that may exist. Our objective is, however, to use our knowledge of the Agency and its interaction with other State agencies and administrative departments gained during our work to make comments and suggestions that we hope will be useful to the Agency.

This report is intended solely for the information and use of the Agency, the Governor and State Legislature, others within the Agency, Federal awarding agencies, pass-through entities, and management of the State of Nebraska and is not intended to be and should not be used by anyone other than the specified parties. However, this report is a matter of public record and its distribution is not limited.

SIGNED ORIGINAL ON FILE

Pat Reding, CPA, CFE
Assistant Deputy Auditor