



NEBRASKA AUDITOR OF PUBLIC ACCOUNTS

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December 18, 2014

Major General Daryl L. Bohac
Adjutant General
Nebraska Military Department
2433 NE 24th Street
Lincoln, Nebraska 68524-8210

Dear Major General Bohac:

We have audited the basic financial statements of the State of Nebraska (State) as of and for the year ended June 30, 2014, in accordance with auditing standards generally accepted in the United States of America and standards applicable to financial audits contained in *Government Auditing Standards* issued by the Comptroller General of the United States, and have issued our report thereon dated December 16, 2014. 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 Military Department (Agency) or other operational matters that are presented below for your consideration. The comment and recommendation, which has been discussed with the appropriate members of the Agency's management, is 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, where applicable. To the extent the situations that prompted the recommendations in the prior year still exist, they have been incorporated in the comment 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.

Draft copies of this letter were furnished to the Agency to provide management with an opportunity to review and to respond to the comment and recommendation contained herein. 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 is our comment and recommendation for the year ended June 30, 2014.

Capitalization of Construction Costs

Nebraska State Accounting Manual, AM-005, General Policies, Section 28, states:

Building improvements are capitalized when the project enhances the functionality of the building either by effectiveness or efficiency, or extends the life of the building and the accumulated costs are \$100,000 or greater.

The Agency expensed \$1,395,419 in construction costs related to a building improvement. After the Auditor of Public Accounts (APA) questioned whether the costs should have been capitalized, the Agency determined \$791,118 was improperly expensed and should have been capitalized. However, the Agency was unable to provide adequate supporting documentation for the amount. The APA determined at least \$1,075,419 should have been capitalized based on documentation provided for work performed.

When building improvements are not properly capitalized in accordance with State policies, there is an increased risk the financial statements will be misstated.

We recommend the Agency ensure compliance with State policies regarding capitalization of building improvements. Furthermore, we recommend the Agency ensure adequate documentation is on file to support amounts capitalized.

Agency Response: The Nebraska Military Department (NMD) acknowledges the recommendation of the Auditor of Public Accounts (APA) office, but disagrees with the finding and interpretation regarding the total amount to be capitalized for the Spirit of '76 Armory Secure Compartmented Information Facility (SCIF) Project. The NMD reported and capitalized expenditures in accordance with federal guidelines (DD Form 1354) which clearly states the category codes for Capital Improvement and the TOTAL Asset Placed-In-Service for real property.

The NMD provided substantive documentation of the capital improvement costs plus the planning and design costs – to include; General Ledger reports by subsidiary totaling \$791,118 as described above by line of coding, document number, expenditure amount, and actual work performed as they related to the construction. Also provided for review were the General Ledger reports by subsidiary of routine maintenance, repair and sustainment costs totaling \$284,301 (delta amount in question) by line of coding, document number, expenditure amount, and actual work performed. These are costs that would have occurred regardless of whether the SCIF project had taken place and, in our opinion, should not be included in the capitalized costs of the facility.

APA Response: The APA first requested documentation from the Agency in August 2014 and was not provided invoices until the end of October 2014, three months after first requested. When the APA was provided documentation it was determined the process used by the Agency was to split each invoice by a percentage that was determined at the start of the project. For each invoice approximately 56% was capitalized and 44% was expensed. The Agency did not provide documentation for how the percentages were determined and the method used was not in accordance with accounting standards for financial reporting purposes. The APA reviewed the expenses and determined \$1,075,419 enhanced the functionality of the building and therefore should have been capitalized.

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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 communication 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 communication is a matter of public record, and its distribution is not limited.



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