NEBRASKA AUDITOR OF PUBLIC ACCOUNTS

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John Albin, Commissioner
Department of Labor
550 South 16th Street
Lincoln, Nebraska 68509

Dear Mr. Albin:

In planning and performing our audit of the financial statements of the governmental activities, the business-type activities, the aggregate discretely presented component units, each major fund, and the aggregate remaining fund information of the State of Nebraska (State) as of and for the year ended June 30, 2015, 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, we have issued our report thereon dated December 17, 2015. 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 that are appropriate in the circumstances for the purpose of expressing our opinions on the 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 Department of Labor (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 a certain deficiency in internal control that we consider to be a significant deficiency.

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 (Errors in Financial Information) to be a significant deficiency.

This comment 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 management with an opportunity to review and to respond to the comments and recommendations contained herein. All formal responses received have been incorporated into this 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 they will be verified in the next audit.

The following are our comments and recommendations for the year ended June 30, 2015.

1. Errors in Financial Information

A good internal control plan and sound business practices require adequate policies and procedures to ensure information used to compile financial statements is complete and accurate.

The Auditor of Public Accounts (APA) noted several instances where financial information was incomplete or inaccurately recorded in the accounting system used to generate the State's financial statements. Consequently, audit adjustments were necessary to ensure the financial statements were materially correct.

The Agency entered Unemployment Compensation (UC) activity into the State's accounting system from the Tax Management System (TMS) and the Benefit Payment System (BPS). TMS was used to record employer contributions, and BPS was used to record benefit payments to recipients. During testing of the financial activity entered into the accounting system, the APA noted the following issues:

- Accounts receivable and charges for services were understated by $16,494,267, due to the Agency using an improper report to record the employer contribution receivable activity at June 30.

- The Agency pays benefits to claimants on behalf of other States and, in turn, receives reimbursement from other States. The Agency recorded the payments as expenditures and the reimbursements as revenues, causing unemployment claims and charges for services to be overstated by $2,974,100. The reimbursements should have reduced the expenditures, as these were not actual expenditures or revenues of the Agency, but that of another State.

- Unemployment claims were overstated by $2,607,637 because the Agency recorded a transfer of State Unemployment Insurance Tax (SUIT) for the last quarter in 2014 as an expenditure instead of a transfer between funds.

- Accounts payable was overstated by $2,259,394 due to an improper entry in the accounting system for a transfer of SUIT at the end of the year.

- When the Agency determines benefits have been paid in error, a receivable is established in the accounting system. The journal entry should reduce the original expenditure and record a receivable; however, the Agency reduced revenue. This caused an error of $1,512,193.

There were several other errors, totaling $876,577, related to over and understated activity that was improperly recorded in the accounting system.

A similar finding was noted during the previous audit.

When adequate procedures are not in place to ensure the accuracy of financial information used to compile the financial statements, there is a greater risk that material misstatements may occur and remain undetected.

> We recommend the Agency implement procedures to ensure that all financial information is complete and accurate.

Agency Response:

- *A/R and charges for services were understated - After researching this, it was learned that the amount of taxes due from employers for the second quarter ended June 30, was not due/payable until July 31. Instead of using the June month-end numbers, we must wait until the end of July to show the amount owing as of June 30.*

- *Intrastate payments incorrectly recorded - We agree with this finding. The benefits paid out on our behalf by another state should reduce the cost of benefits when we are reimbursed. They should not result in revenue. This will change with the January 2016 entries and a YTD adjustment will be made for the amounts from July-Dec 2015.*

- *Unemployment claims were overstated and A/P was overstated due to SUIT transfer - We will meet with the auditors to discuss how to correct this going forward. The Department of Labor has funds on two different state ledgers (8-digit state funds and 10-digit federal funds). This and the remaining entry listed within the finding are similar in nature and we will be seeking clarity on when an entry should be a transfer between funds versus the creation of a payable or a reduction in expenses.*

- *Benefits paid in error entry incorrect - We agree with this finding, the entry incorrectly reduced revenue instead of an expenditure. Effective January 2016, journal entries will be reviewed by at least two people before being posted to check for accuracy of accounts.*

2. Lack of Accurate Bank Reconciliations

A good internal control plan requires accounting records to be reconciled to the bank and variances identified and corrected.

The Agency used four separate bank accounts for the UC program. Two were used primarily to receipt taxes, the third was used to disburse benefits, and the fourth was the trust fund held with the Federal government.

Benefit Payment Reconciliation

For 1 of 25 days tested, benefits paid in the BPS system did not agree to the bank statement. According to the Agency, there was a platform change in July 2014 for the banking debit cards. This change caused several claimants to miss benefit payments. The Agency later corrected the payments for what it believed was all claimants. However, during testing, we identified $6,698 in rejected benefit payments that had not been properly paid. After the APA brought this to the Agency's attention, it was able to identify 27 claimants who had not received proper payment.

The payments were recorded as paid in BPS; however, the payment had never actually been made. Because this should have caused a discrepancy in the bank reconciliations, the APA asked how the Agency's bank reconciliation procedures would not have caught the discrepancy. The Agency was unable to explain why but noted that the reconciliation process was lacking during this time period.

Furthermore, it was noted that the outstanding checks listing used by the Agency for bank reconciliation procedures was inaccurate.

Employer Contribution Reconciliation

During testing of activity recorded in the accounting system, we noted TMS reports were used to record cash activity prior to March 2015. Starting in March 2015, the Agency began to record cash activity from the two bank accounts. All other activity recorded in the accounting system was from the TMS reports, causing daily variances due to timing, as there is typically a day's lag between the TMS system activity and that of the bank. Therefore, the Agency created a "plug figure" in order to balance the daily journal entries in the accounting system. The APA attempted to reconcile cash between the accounting system and TMS for the fiscal year ended June 30, 2015; the accounting system was less by $47,097.

Additionally, because the Agency did not properly record the TMS activity in the accounting system, the bank reconciliations were not accurate or useful. For example, entering activity from the bank would not identify collections recorded in TMS that had not been deposited to the bank.

When bank reconciliations are not accurate and complete, there is an increased risk of loss of State funds. Furthermore, when reconciliation procedures are not adequate and outstanding benefit payments are not identified, there is an increased risk that claimants will not receive all eligible benefits.

> We recommend the Agency implement procedures to ensure bank reconciliations are accurate and complete. We further recommend that entries in the accounting system accurately reflect the system records to ensure financial statements are proper.

Agency Response: A complete dissection of the bank reconciliation and journal entry process was entered into at the completion of the audit in October 2015. As of January 2016, the Trust Fund and the UC Clearing – ACH accounts are current and general ledger balances match paper statement balances. We are documenting the entries and templates during this process as well. The Benefits and UC Clearing – Non-ACH accounts are going through the same process at this time. Entries will be booked using system reports and compared to bank statements during a month-end reconciliation process. Any unidentified items will be placed in a suspense account until they can be reconciled to the correct GL account. It is our goal to not have any unidentified items carry over more than 60 days by the end of June 2016.

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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.

Don Dunlap

Don Dunlap, CPA
Assistant Deputy Auditor