NEBRASKA AUDITOR OF PUBLIC ACCOUNTS

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State Auditor

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December 15, 2016

To: Governor's office representatives - Chief of Staff, Matt Miltenberger and to the Speaker of the Legislative Council – Jim Scheer

We have audited 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, as of and for the year ended June 30, 2016, which collectively comprise the State of Nebraska's basic financial statements, and have issued our report thereon dated December 15, 2016. Professional standards require that we provide you with information about our responsibilities under generally accepted auditing standards and *Government Auditing* Standards, as well as the accompanying information related to the conduct of our audit.

Our Responsibility Under Professional Standards

We are responsible for forming and expressing an opinion about whether the financial statements, which have been prepared by management, are presented fairly, in all material respects, in conformity with U.S. generally accepted accounting principles. We have a responsibility to perform our audit of the financial statements in accordance with professional standards. In carrying out this responsibility, we planned and performed the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement, whether caused by error or fraud. Because of the nature of audit evidence and the characteristics of fraud, we are to obtain reasonable, not absolute, assurance that material misstatements are detected. We have no responsibility to plan and perform the audit to obtain reasonable assurance that misstatements, whether caused by error or fraud, that are not material to the financial statements are detected. Our audit does not relieve management of their responsibilities.

In addition, in planning and performing our audit of the financial statements, we considered internal control over financial reporting (internal control) as a basis for designing our auditing procedures for the purpose of expressing our opinion on the financial statements but not for the purpose of expressing an opinion on the effectiveness of the State of Nebraska's internal control. Accordingly, we do not express an opinion on the effectiveness of the State of Nebraska's internal control.

We also have a responsibility to communicate significant matters related to the financial statement audit that are, in our professional judgment, relevant to the responsibilities of those charge with governance in overseeing the financial reporting process. We are not required to design procedures for the purpose of identifying other matters to communicate to you.

We applied certain limited procedures to the Management's Discussion and Analysis, the Budgetary Comparison Schedules, the Information About Infrastructure Assets Reported Using the Modified Approach, and the Information About Pension Plans, which are required supplementary information (RSI) that supplements the basic financial statements. Our procedures consisted of inquiries of management regarding the methods of preparing the information and comparing the information for consistency with management's responses to our inquiries, the basic financial statements, and other knowledge we obtained during our audit of the basic financial statements. We did not audit the RSI and do not express an opinion or provide any assurance on the RSI.

We were engaged to report on the combining statements which accompany the financial statements but are not RSI. With respect to this supplementary information, we made certain inquiries of management and evaluated the form, content, and methods of preparing the information to determine that the information complies with accounting principles generally accepted in the United State of America, the method of preparing it has not changed from the prior period, and the information is appropriate and complete in relation to our audit of the financial statements. We compared and reconciled the supplementary information to the underlying accounting records used to prepare the financial statements or to the financial statements themselves.

We were not engaged to report on the introductory and statistical sections, which accompany the financial statements but are not RSI. Such information has not been subjected to the auditing procedures applied in the audit of the basic financial statements, and accordingly, we do not express an opinion or provide any assurance on it.

Management Letters

We have communicated to management in separate management letters our comments and recommendations for improvement in procedures and internal controls. We did not identify any material weaknesses but significant deficiencies were identified and communicated to the Department of Administrative Services, the Department of Health and Human Services, the Department of Education, and the Department of Labor.

Other Information in Documents Containing Audited Financial Statements

Our responsibility for other information in documents containing the State of Nebraska's financial statements and our auditors' report thereon does not extend beyond the financial information identified in our auditors' report, and we have no obligation to perform any procedures to corroborate other information contained in these documents. We have, however, read the other information included in the State of Nebraska's comprehensive annual financial report, and no matters came to our attention that cause us to believe that such information, or its manner of presentation, is materially inconsistent with the information, or manner of its presentation, appearing in the financial statements.

Accounting Practices and Alternative Treatments

Unusual Transactions

As disclosed in Note 15 to the financial statements the following restatements to the financial statements were made:

Component Units Net Position – The Nebraska State College System restated prior year net position due to overstatement of some liabilities and understatement of assets. These errors caused the fiscal year 2015 ending net position to be understated. As a result, the beginning Net Position for Component Units on the Statements of Activities increased by $457,000.

University of Nebraska Foundation – As of July 1, 2015, the Board of Directors for the UNF Charitable Gift Fund (UNFCGF), a related organization, amended its articles of incorporation and bylaws to grant control of its board to the Board of Directors of the Foundation. The Foundation has accounted for the change in control as a change in reporting entity for financial reporting purposes. As such, the financial statements of the UNFCGF are consolidated with the Foundation's 2016 financial statements and its net assets as of July 1, 2015 of $4,736,000, have been reflected as an addition to net assets in the accompanying statement of activities.

The Federal Fund beginning Fund Balance for fiscal year 2015 was increased by $5,957,000 due to a loans receivable that had not been reported in the prior year. This resulted in an increase in the Governmental Activities Net Position – Beginning on the Statement of Activities of $5,957,000.

Qualitative Aspects of Accounting Practices

We have discussed with management our judgments about the quality, not just the acceptability, of the State of Nebraska's accounting principles as applied in its financial reporting. The discussions generally included such matters as the consistency of the State of Nebraska's accounting policies and their application, and the understandability and completeness of the State of Nebraska's financial statements, which include related disclosures.

Management is responsible for the selection and use of appropriate accounting policies. The significant accounting policies used by the State of Nebraska are described in Note 1 to the financial statements.

Management Judgments and Accounting Estimates

The preparation of the financial statements requires management of the State of Nebraska to make a number of estimates and assumptions relating to the reported amounts of assets and liabilities and the disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the period.

Management uses estimates for instance when calculating the reserve for bad debts; lives of property and equipment; and self-insurance reserves. We evaluated the key factors and assumptions used in these estimates in determining that the estimates were reasonable in relation to the financial statements taken as a whole.

Significant Difficulties Encountered During the Audit

We encountered no significant difficulties in dealing with management in performing our audit other than several delays encountered in obtaining audit documentation required to be provided by the Department of Administrative Services.

Disagreements with Management

There were no disagreements with management on financial accounting and reporting matters that, if not satisfactorily resolved, would have caused a modification of our auditors' reports on the State of Nebraska's financial statements.

Significant Issues Discussed, or Subject to Correspondence, with Management
We generally discuss a variety of matters, including the application of accounting principles and auditing standards, with management throughout our field work.

Financial Statement Misstatements
In connection with our audit of the State of Nebraska's financial statements, we have discussed with management certain financial statement misstatements that have not been corrected in the State of Nebraska's books and records as of and for the year ended June 30, 2016. We have reported such misstatements to management on a Schedule of Uncorrected Financial Statement Misstatements and have received written representations from management that management believes that the effects of the uncorrected financial statement misstatements are immaterial, both individually and in the aggregate, to the financial statements taken as a whole. The attached schedule summarizes uncorrected misstatements of the financial statements.

The following material misstatement detected as a result of audit procedures was corrected by management:

> Indirect costs allocated to the Health and Social Services CAFR fund were doubled up causing revenue (reimbursements from non-government sources) and expenditures (indirect cost allowance) to be overstated by $4,403,985.

Management's Consultation with Other Accountants
In some cases, management may decide to consult with other accountants about auditing and accounting matters, similar to obtaining a “second opinion” on certain situations. If a consultation involves application of an accounting principle to the State of Nebraska’s financial statements or a determination of the type of auditor’s opinion that may be expressed on those statements, our professional standards require the consulting accountant to check with us to determine that the consultant has all the relevant facts. To our knowledge, there were no such consultations with other accountants.

Written Representations
We have requested certain representations from management that are included in the management representation letter dated December 15, 2016.

Group Audit Communications:

1. **Instances in which the group engagement team's evaluation of the work of a component auditor gave rise to a concern about the quality of that auditor's work.**
   None

2. **Any limitations on the group audit (for example, when the group engagement team's access to information may have been restricted)**
   We encountered no limitations while performing our audit.

3. **Fraud or suspected fraud involving group management, component management, employees who have significant roles in group-wide controls, or others in which a material misstatement of the group financial statements has or may have resulted from fraud.**
   No fraud or suspected fraud involving group management, component management, employees who have significant roles in group-wide controls, or others was identified.

Other Items

<u>New Applicable Accounting Standards by the Governmental Accounting Standards Board (GASB)</u>

Statement No. 74, *Financial Reporting for Postemployment Benefit Plans Other Than Pension Plans.*
The objective of this Statement is to improve the usefulness of information about postemployment benefits other than pensions (other postemployment benefits or OPEB) included in the general purpose external financial reports of state and local governmental OPEB plans for making decisions and assessing accountability. This Statement results from a comprehensive review of the effectiveness of existing standards of accounting and financial reporting for all postemployment benefits (pensions and OPEB) with regard to providing decision-useful information, supporting assessments of accountability and interperiod equity, and creating additional transparency. The requirements of this Statement are effective for financial statements for periods beginning after June 15, 2016.

Statement No. 75, *Accounting and Financial Reporting for Postemployment Benefits Other Than Pensions.*
The scope of this Statement addresses accounting and financial reporting for OPEB that is provided to the employees of state and local governmental employers. This Statement establishes standards for recognizing and measuring liabilities, deferred outflows of resources, deferred inflows of resources, and expense/expenditures. For defined benefit OPEB, this Statement identifies the methods and assumptions that are required to be used to project benefit payments, discount projected benefit payments to their actuarial present value, and attribute that present value to periods of employee service. Note disclosure and required supplementary information requirements about defined benefit OPEB also are addressed. In addition, this Statement details the recognition and disclosure requirements for employers with payables to defined benefit OPEB plans that are administered through trusts that meet the specified criteria and for employers whose employees are provided with defined contribution OPEB. The requirements of this Statement are effective for financial statements for periods beginning after June 15, 2017.

Statement No. 77, *Tax Abatement Disclosures.*
This Statement requires disclosure of tax abatement information about (1) a reporting government's own tax abatement agreements and (2) those that are entered into by other governments and that reduce the reporting government's tax revenues. This Statement requires governments that enter into tax abatement agreements to disclose the following information about the agreements: 1) Brief descriptive information, such as the tax being abated, the authority under which tax abatements are provided, eligibility criteria, the mechanism by which taxes are abated,

provisions for recapturing abated taxes, and the types of commitments made by tax abatement recipients; 2) The gross dollar amount of taxes abated during the period; 3) Commitments made by a government, other than to abate taxes, as part of a tax abatement agreement. The requirements of this Statement are effective for financial statements for periods beginning after December 15, 2015.

Statement No. 78, *Pensions Provided through Certain Multiple-Employer Defined Benefit Pension Plans.*

This Statement amends the scope and applicability of Statement 68 to exclude pensions provided to employees of state or local governmental employers through a cost-sharing multiple-employer defined benefit pension plan that (1) is not a state or local governmental pension plan, (2) is used to provide defined benefit pensions both to employees of state or local governmental employers and to employees of employers that are not state or local governmental employers, and (3) has no predominant state or local governmental employer (either individually or collectively with other state or local governmental employers that provide pensions through the pension plan). This Statement establishes requirements for recognition and measurement of pension expense, expenditures, and liabilities; note disclosures; and required supplementary information for pensions that have the characteristics described above. The requirements of this Statement are effective for financial statements for periods beginning after December 15, 2015.

Statement No. 80, Blending Requirements for Certain Component Units an amendment of GASB Statement No. 14.

The objective of this Statement is to improve financial reporting by clarifying the financial statement presentation requirements for certain component units. This Statement amends the blending requirements established in paragraph 53 of Statement No. 14, The Financial Reporting Entity, as amended. This Statement amends the blending requirements for the financial statement presentation of component units of all state and local governments. The additional criterion requires blending of a component unit incorporated as a not-for-profit corporation in which the primary government is the sole corporate member. The additional criterion does not apply to component units included in the financial reporting entity pursuant to the provisions of Statement No. 39, Determining Whether Certain Organizations Are Component Units. The requirements of this Statement are effective for reporting periods beginning after June 15, 2016.

Statement No. 81, Irrevocable Split-Interest Agreements.

This Statement requires that a government that receives resources pursuant to an irrevocable split-interest agreement recognize assets, liabilities, and deferred inflows of resources at the inception of the agreement. Furthermore, this Statement requires that a government recognize assets representing its beneficial interests in irrevocable split-interest agreements that are administered by a third party, if the government controls the present service capacity of the beneficial interests. This Statement requires that a government recognize revenue when the resources become applicable to the reporting period. The requirements of this Statement are effective for financial statements for periods beginning after December 15, 2016, and should be applied retroactively.

Statement No. 82, Pension Issues an amendment of GASB Statements No. 67, No. 68, and No. 73.
The objective of this Statement is to address certain issues that have been raised with respect to Statements No. 67, Financial Reporting for Pension Plans, No. 68, Accounting and Financial Reporting for Pensions, and No. 73, Accounting and Financial Reporting for Pensions and Related Assets That Are Not within the Scope of GASB Statement 68, and Amendments to Certain Provisions of GASB Statements 67 and 68. Specifically, this Statement addresses issues regarding (1) the presentation of payroll-related measures in required supplementary information, (2) the selection of assumptions and the treatment of deviations from the guidance in an Actuarial Standard of Practice for financial reporting purposes, and (3) the classification of payments made by employers to satisfy employee (plan member) contribution requirements. The requirements of this Statement are effective for reporting periods beginning after June 15, 2016, except for the requirements of this Statement for the selection of assumptions in a circumstance in which an employer's pension liability is measured as of a date other than the employer's most recent fiscal year-end. In that circumstance, the requirements for the selection of assumptions are effective for that employer in the first reporting period in which the measurement date of the pension liability is on or after June 15, 2017.

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This communication is intended solely for the information and use of management, the Governor and State Legislature, and others within the Agency and is not intended to be, and should not be, used by anyone other than these specified parties. This communication is a matter of public record, and its distribution is not limited.

Sincerely,

Philip J. Olsen, CPA
Audit Manager

Schedule of Uncorrected Financial Statement Misstatements
Fiscal Year Ended June 30, 2016

General Fund Opinion Unit			
Beginning Fund Balance Unadjusted	$	2,794,464.78	Overstated
Total Expenditures Unadjusted	$	4,017,113.42	Overstated
Ending Fund Balance Unadjusted	$	(1,222,648.64)	Understated
Highway Fund Opinion Unit			
Beginning Fund Balance Unadjusted	$	173,976.78	Overstated
Total Expenditures Unadjusted	$	173,976.78	Overstated
Ending Fund Balance Unadjusted	$	-	
Federal Fund Opinion Unit			
Beginning Fund Balance Unadjusted	$	2,371,346.63	Overstated
Federal Loans Receivable Unadjusted	$	(1,207,782.00)	Understated
Federal Fund Receipts Unadjusted	$	5,947,905.38	Overstated
Federal Fund Expenditures Unadjusted	$	8,304,385.37	Overstated
Ending Fund Balance Unadjusted	$	(1,192,915.36)	Understated
Health and Social Services Fund Opinion Unit			
Beginning Fund Balance Unadjusted	$	858,459.16	Overstated
Total Expenditures Unadjusted	$	858,459.16	Overstated
Ending Fund Balance Unadjusted	$	-	
Unemployment Compensation Opinion Unit			
Beginning Fund Balance Unadjusted	$	(152,015.70)	Understated
Accounts Receivable Unadjusted	$	67,296.51	Overstated
Accounts Receivable Allowance Unadjusted	$	(863,804.17)	Understated
Total Revenues Unadjusted	$	842,125.24	Overstated
Transfers Out Unadjusted	$	13,663.87	Overstated
Total Expenditures Unadjusted	$	(254,655.01)	Understated
Ending Fund Balance Unadjusted	$	1,862,201.36	Overstated
Permanent School Fund Opinion Unit			
Beginning Fund Balance Unadjusted	$	1,040.00	Overstated
Total Expenditures Unadjusted	$	1,040.00	Overstated
Ending Fund Balance Unadjusted	$	-	
Other Fund Opinion Unit			
Beginning Fund Balance Unadjusted	$	2,409,664.41	Overstated
Accounts Receivable Unadjusted	$	(130,363.08)	Understated
Transfer In Unadjusted	$	13,663.87	Overstated
Miscellaneous Adjustment Unadjusted	$	(144,026.95)	Understated
Total Expenditures Unadjusted	$	2,409,664.41	Overstated
Ending Fund Balance Unadjusted	$	(260,726.16)	Understated

Schedule of Uncorrected Financial Statement Misstatements
Fiscal Year Ended June 30, 2016
(Continued)

Governmental Activities Opinion Unit			
Beginning Net Position Unadjusted	$	6,357,580.70	Overstated
Accounts Receivable Unadjusted	$	(1,338,145.08)	Understated
Transfers In Unadjusted	$	13,663.87	Overstated
Total Expenses Unadjusted	$	13,513,268.08	Overstated
Total Revenues Unadjusted	$	5,803,878.43	Overstated
Ending Net Position Unadjusted	$	(2,676,290.16)	Understated
Business-Type Activities Opinion Unit			
Beginning Net Position Unadjusted	$	(132,349.30)	Understated
Accounts Receivable Unadjusted	$	67,296.51	Overstated
Accounts Receivable Allowance Unadjusted	$	(863,804.17)	Understated
Total Expenses Unadjusted	$	(234,988.61)	Understated
Total Revenues Unadjusted	$	842,125.24	Overstated
Transfers Out Unadjusted	$	13,663.87	Overstated
Ending Net Position Unadjusted	$	1,862,201.36	Overstated