Mr. Richard Baier, Director  
Nebraska Department of Economic Development  
301 Centennial Mall South, 4th Floor  
Lincoln, Nebraska 68509-4666

Dear Mr. Baier:

We have audited the basic financial statements of the State of Nebraska (the State) for the year ended June 30, 2006, and have issued our report thereon dated December 21, 2006. We have also audited the State’s compliance with requirements applicable to major federal award programs and have issued our report thereon dated February 6, 2007. In planning and performing our audit, we considered the State’s internal controls in order to determine our auditing procedures for the purpose of expressing our opinions on the basic financial statements of the State and on the State's compliance with requirements applicable to major programs, and to report on internal control in accordance with the Federal Office of Management and Budget (OMB) Circular A-l 33 (the Single Audit) and not to provide assurance on internal control. We have not considered internal control since the date of our report.

In connection with our audit described above, we noted a certain internal control matter related to the activities of the Department of Economic Development (the Department) or other operational matters that is presented below for your consideration. The comment and recommendation, which has been discussed with the appropriate members of the Department’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. 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.

Draft copies of this letter were furnished to the Department to provide them an opportunity to review the letter and to respond to the comment and recommendation included in this letter. The Department declined to respond.

Our comment and recommendation for the year ended June 30, 2006, is shown on the following pages.
COMMENT RELATED TO THE AUDIT OF THE BASIC FINANCIAL STATEMENTS

1. **Residual Receipt Loan Agreements**

   The Department was responsible for the implementation of and is responsible for the continued administration of the Nebraska Affordable Housing Act (Act), which created the Nebraska Affordable Housing Trust Fund (AHTF). This Act was adopted by the Legislature and signed by the Governor in 1996. This Act noted the lack of affordable housing affects the ability of communities to maintain and develop viable and stable economies in Nebraska. A portion of the AHTF is provided to nonprofit entities and profit/nonprofit partnerships as loans or grants to develop low income housing. In addition to AHTF, the Department obtains Federal “HOME” program funding for the same purpose.

   The Department had on its records 79 AHTF and HOME loans which they describe as “residual receipt loans” with a balance of principal and interest of $24,255,696 as of June 30, 2006. Residual receipt loans assert residual receipts or net operating income, if available, must be used to pay off the loans.

   We reviewed in detail 1 of 79 residual receipt loan agreements. However, management of the Department indicated the other residual receipt loan agreements were constructed in a similar manner. Our review of this agreement noted the following:

   - No debt service payments were made on these loans during the fiscal year ended June 30, 2006. Limited residual receipt payments were received; however, these payments only partially covered loan interest due. The Department indicated this was expected since the loans were made to nonprofit entities or profit/nonprofit partnerships.

   - The loan agreement reviewed did not have complete terms of repayment. The loan agreement reviewed stated, “The term of the HOME Loan will be for 35 years. Borrower’s obligation to make debt service payments prior to maturity is limited to the extent of “Residual Receipts” … generated by the HOME project.” The only other reference in the agreement to loan repayment stated, “Residual receipts-generated annual payments to principal and interest on the HOME Loan shall begin on the July 1st following the initial Residual Receipts determination (as above), and shall continue to be paid on the same day and every day thereafter until the entire indebtedness is paid in full.” This loan agreement did not indicate whether the loan would be repaid or whether the loan would be forgiven.

   Sound business practice requires loan agreements to have stated terms of repayment and the intent of those agreements should be clear and concise. Without clear and concise terms, there is an increased risk of loss or misuse of State funds.

   We recommend the Department review all of their residual receipt loan agreements and ensure the terms of repayment are clearly and concisely documented. If the terms of repayment are not clear and concise, the Department should amend the agreements.
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 Department 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 you.

This report is intended solely for the information and use of the Department, the Governor and State Legislature, Federal awarding agencies, pass-through entities, and management of the State of Nebraska. However, this report is a matter of public record and its distribution is not limited.

We appreciate and thank all of the Department employees for the courtesy and cooperation extended to us during our audit.

Pat Reding
Assistant Deputy Auditor

Don Dunlap
Assistant Deputy Auditor