NEBRASKA AUDITOR OF PUBLIC ACCOUNTS

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January 30, 2019

David Rippe, Director
Nebraska Department of Economic Development
301 Centennial Mall South, 4th Floor
Lincoln, Nebraska 68509

Dear Mr. Rippe:

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, 2018, 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 January 4, 2019. 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 Nebraska Department of Economic Development (Agency) or other operational matters that are presented below for your consideration. This 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.

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.

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. Given these limitations during our audit, we did not identify any deficiencies in internal control that we consider to be material weaknesses or significant deficiencies. However, 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. Any formal response received has been incorporated into this letter. Such response has been objectively evaluated and recognized, as appropriate, in the letter. A response that indicates corrective action has been taken was not verified at this time, but it will be verified in the next audit.

The following is our comment and recommendation for the year ended June 30, 2018.

1. Accounts Payable Accrual Incorrectly Calculated

We noted three payments for Rural Workforce Housing Fund grants made after June 30, 2018, were incorrectly included as fiscal year 2018 expenditures. Per the grant agreements, the recipients had to provide support that they had the required matching funds prior to payment. None of the recipients had secured all matching funds as of June 30, 2018, and, therefore, the Agency had no obligation to pay as of fiscal year end. This resulted in expenditures and liabilities being overstated by $2,042,515. The Auditor of Public Accounts' proposed adjustment was not posted by the Department of Administrative Services – State Accounting.

Sound business practices and good internal controls require adequate policies and procedures for accurately identifying and recording payables in the accounting system.

When expenditures are not properly recorded in the accounting system, there is an increased risk that the Comprehensive Annual Financial Report (CAFR) financial statements will be materially misstated.

> We recommend the Agency establish adequate policies and procedures to ensure expenditures are properly recorded in the accounting system.

Agency Response: The department included the Rural Workforce Housing transactions as encumbrances due to the fact that the contracts were signed during the 2017-2018 fiscal year creating the financial obligation to the department for payment. These funds could not be granted to other recipients and were being reserved for those grantees. The matching requirement was fulfilled after July 1, 2018 but the funds were obligated prior to the end of the fiscal year according to the definition below. Due to the fact that this was mid-biennium, sufficient cash fund appropriation existed in either year for these payments.

Additionally, although the matching funds were a condition precedent to drawing the funds, the matching funds could have been evidenced and grant funds could have been drawn immediately as of the date of signing. DED had to operate under the assumption that funds could have been requested at any time after contract signing and therefore, the encumbrances were included using the following definition. The fact that the request and evidence of matching funds ultimately came after July 1, 2018 is a coincidence and irrelevant to the nature of the department's necessary fiscal planning.

Neb. Rev. Stat. § 81-138.01 ( ) Valid encumbrance; what constitutes, states, in relevant part:

> *For appropriation and expenditure purposes, encumbrances represent financial obligations which are chargeable to the current biennium's appropriation and for which a part of that appropriation is reserved. Encumbrances which are established in one biennium to be liquidated in a subsequent biennium shall be limited to the following types of transactions:*
>
> *(5) A written agreement for a grant or award to distribute aid was signed but was not paid during the same biennium.*

APA Response: An encumbrance is not always a payable. All grant conditions for payment were not met during the fiscal year, and as such, should not have been recorded as a payable in the CAFR financial statements.

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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.

Philip J. Olsen

Philip J. Olsen, CPA, CISA
Assistant Deputy Auditor