

June 11, 2004

Mr. Steve Maraman
Department of Roads
State of Nebraska
P.O. Box 94759
Lincoln, Nebraska 68509-4759

Dear Mr. Maraman:

We have audited the basic financial statements of the state of Nebraska (the State) for the year ended June 30, 2003, and have issued our report thereon dated June 11, 2004. 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 opinion on the basic financial statements. An audit does not include examining the effectiveness of internal control and does not 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 certain internal control matters related to the activities of the Department of Roads (the Department) and other operational matters that are presented below for your consideration. These comments and recommendations, which have been discussed with the appropriate members of Department 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 have been satisfactorily resolved.

Our comments and recommendations for the year ended June 30, 2003 are shown on the following pages.

1. Formal Policy for Condition Assessment

According to accounting principles generally accepted in the United States of America, the established condition level at which eligible infrastructure assets are being preserved is required to be documented and approved by administrative or executive policy or by legislative action.

Although evidence exists of the selected condition level, no formal policy has been developed. To ensure compliance, we recommend the Department adopt a formal written policy for condition assessment.

2. System Development Methodology

System development standards, including documentation standards, at the Department are currently informal. Although the IT cabinet performs such functions as authorizing and prioritizing large system development projects, written standards have not been established for:

- Requirement definition
- Cost/benefit analysis
- Conceptual design
 - Make/buy decision
 - Software package evaluation and selection
- Detail design
- Software development, programming, and conversion planning
- Implementation
- Unit testing
- System testing
- Acceptance testing and documentation standards
- Production change control procedures
- Post-implementation review

The use of formalized standards, when properly designed and implemented, helps ensure that:

- Controls within each program are suitably designed and maintained, including control modifications for significant program changes;
- Development of applications and related program changes meet management objectives and operate in accordance with specifications;
- Applications and related program changes are adequately tested; and
- Documentation is suitably prepared and maintained in order to provide adequate understanding of the specific applications.

We recommend the Department formalize a documented system development life cycle procedure.

3. Program Maintenance and Development Authorization

The current program maintenance and development procedure includes users' approval and specifications for the new program or required modification; however, it does not include written user and other management approval of the new system or program changes. This may allow unauthorized and undetected changes to occur for major financial systems.

Written documentation of user acceptance helps ensure the integrity of programs and safeguard against unauthorized alterations.

We recommend the following procedures be evaluated for compliance with existing practices:

- User's written approval on all requested changes and new programs, if not already available;
- Programming supervisor's approval and inspection of coding changes with a comparison to original specifications. During this process, the program should be unalterable by the programmer or supervisor, preferably under access control by a software protection system; and
- Operations manager's approval for transfer from test to production status and only operations' approval allows a changed program to move to production status.

4. No Business Continuity Plan

While the Department is documenting a disaster recovery plan, currently, there is no plan to recover from a significant incident. Although some personnel understand how things would continue to process, departments, including the IS area, do not have documented plans on how to recover from a different location.

Significant events, such as fires or tornadoes, can significantly hamper the operation of the organization. Departments that do not have a good plan to execute in such cases may find themselves without needed supplies, facilities, or information necessary to continue. Any delay in restarting operations may cause lost revenue or increased costs to the Department.

At a minimum, we recommend the Department outline a business resumption plan. Additionally, key departments may want to also outline a business resumption plan to further reduce the risk. At a minimum, the plan should consider the following.

- Objectives and scope of the plan
- Assumptions and recovery strategies including:
 - A business interruption impact assessment
 - Critical application analysis
 - Recovery timing
 - Procedures for damage assessments
- Plan activation procedures
- Notification procedures
- Emergency recovery teams roles and responsibilities
- Insurance coverage
- User interim operating procedures
- Testing procedures
- Plan maintenance responsibilities

5. Service Level Agreement with IMS

No formal service level agreements appear to exist between the Department and the Information Management Services (IMS), which provides the majority of the Department's computer operations.

The lack of formalized service level agreements can potentially lead to discrepancies between the expectations of the Department and the performance of the IMS.

We recommend the Department and IMS develop and implement formalized service level agreements between the groups to set the benchmark for IS to meet the expectations of users.

6. Collections of Accounts Receivable—Other

Several receivables have been outstanding for a year, which increases the risk of uncollectibility. We recommend that the Department review their collection procedures to ensure the procedures are adequate. Further, we suggest the Department regularly review the aging of receivables in order to determine if an allowance is necessary, which should be recorded for any old receivables for which the chance of full collectibility is low.

In addition, there were several receivables for which the corresponding invoice had been cancelled; however, the invoice balance remained as a receivable in the Department's records. We recommend the Department review its procedures to ensure receivables are written-off that are associated with invoices that are cancelled in order to avoid overstatement of the accounts receivable balance.

7. Classification of Earned Unbilled for Pooled Projects

There was a large pooled project for which the State's participation percentage was incorrectly input into the system as 100% instead of 10%. This system error resulted in misclassification of expenses, earned unbilled, and Federal government reimbursements. We recommend the system error be corrected by the Department in order to ensure that these accounts are properly recorded.

8. Subrecipient Monitoring

The Office of Management and Budget (OMB) issued revisions to OMB Circular A-133. The revisions increased the audit threshold from \$300,000 to \$500,000. The revisions to the threshold are effective for fiscal years ending after December 31, 2003. The Department should consider the threshold change when monitoring subrecipients and issuing award contracts.

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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 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.

We would be pleased to discuss these comments and recommendations with you at any time.

This report is intended solely for the information and use of the Department of Roads, the Auditor of Public Accounts, the Governor, and members of the Legislature and management of the state of Nebraska, and is not intended to be, and should not be, used by anyone other than these specified parties.

*State of Nebraska
Department of Roads
Mr. Steve Maraman
June 11, 2004*

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

Very truly yours,

KPMG LLP