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December 22, 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, 2004, and have issued our report thereon dated December 22, 2004. We have also audited the State's compliance with requirements applicable to major federal award programs and have issued our report hereon dated December 22, 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 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 Office of Management and Budget (OMB) Circular A-133 and not to provide assurance on internal control. We have not considered internal control since the date of our report.

In connection with our audits 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 the Department management, are intended to improve internal control or result in other operating efficiencies. Comments related to internal control and compliance with requirements applicable to federal award programs are reported in the schedule of findings and questioned costs, which is included in the statewide single audit report. We encourage the Department to review this report.

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, 2004 are shown on the following pages.



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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



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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.



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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.



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6. Cash Reconciliations

The Department performs a monthly reconciliation of cash per the Department of Road's system to NIS. In the two tested cash reconciliations, an unreconciled difference between the NIS balance and the Department balance was noted. The difference is mainly due to the transfer from the Nebraska Accounting System to NIS in March of 2003, however, the specific causes could not be identified. We recommend the unreconciled difference be researched and eliminated.

7. Contractor Retention Coding

The Department retains certain percentages of payments to contractors through the life of projects. During our testwork, we noted that the retention for one contractor was coded incorrectly which caused the balance of several different accounts to be misstated. We recommend contract retention information be reviewed to ensure it is entered correctly into the system.

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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.

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