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November 17, 2006

The Board of Regents
University of Nebraska

We have audited the basic financial statements of the University of Nebraska (the University) as of and for the year ended June 30, 2006, and have issued our report thereon dated November 17, 2006. In planning and performing our audit of the basic financial statements of the University, we considered its internal control 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 the internal control structure since the date of our report.

During our audit, we noted certain matters involving internal control and other operational matters that are presented for your consideration. These comments and recommendations, all of which have been discussed with the appropriate members of management, are intended to improve internal control or result in other operating efficiencies and are summarized as follows:

U.S. AID and NASA Letter of Credits

The University of Nebraska – Lincoln maintains letters of credit with two U.S. agencies, AID and NASA, in order to draw down federal funds granted to the University by these agencies. An unresolved reconciling item has been outstanding for several years between the University's records and the agencies' records. We recommend that the University research and resolve the unreconciled amount to ensure ongoing compliance with federal regulations.

Allowance for Uncollectible Student Loans Receivable

The University of Nebraska Medical Center estimates its allowance for uncollectible student loans receivable by multiplying the bad debt historical percentage times the loans not yet due and adding a percentage of past due loans. We believe that the allowance would be more reasonably estimated by using the bad debt historical percentage multiplied by the student loan receivable balance.

Capitalization of Equipment

At the University of Nebraska Medical Center (UNMC), certain equipment purchases involved progress payments that extended over time. The equipment in question was not obtained and placed into service until the final payment was made. The University recorded the progress payments as an asset and began depreciating the balances before the asset was placed into service. We recommend that the University record the progress payment into a work in process account and capitalize and begin depreciating these assets when they have been put into service.

IT Access Controls

During our testing of the Information Technology (IT) general controls over the University's financial and administrative system (SAP software), we noted the following:

- One of our tests disclosed a user with capabilities that are incompatible. This user had both "dialog" and "system" capabilities. Oversimplifying, a dialog user type can perform tasks including processing transactions such as invoices, journal entries, and human resource functions. A system user can update system files. While this dialog user was only authorized to a small section of the system files (the Data Dictionary), this practice increases the risk that a person can hack into the system with authorization to update control files and process transactions, thereby circumventing system controls. We recommend all dialog and system capabilities be segregated.
- For one new hire, the SAP ESS Security Access Form could not be retrieved so that we could verify formal approvals. Unapproved access to users may result in unauthorized access to the application using this account which could lead to potential system abuse or sabotage. We recommend management periodically review access appropriateness.
- One of thirty terminated employees tested had not been deleted from SAP. Terminated employees with access to the system/applications could lead to potential system abuse or sabotage. We recommend that management develop formal termination policies and procedures that require system access of terminated employees be removed on or before the employee's last day. In addition, we suggest the IT Security Department periodically review system assess to identify accounts that have not been accessed in over 90 days or never accessed to determine if users should have access to the system or application.
- Management was unable to provide documentation showing there have been periodic reviews of active users, groups, and roles to identify incompatible access rights. The lack of periodic reviews of access authorities could result in inappropriate personnel having access to the operating systems, applications and data files, resulting in errors or fraud going undetected by management. It is common practice to review user access authorities on a periodic basis to ensure the authorities are commensurate with the employee current job responsibilities. We recommend the IT Department print a list of employees and the access that each has to the various IT systems approximately every six months and confirm that access with the manager of the different areas for validation.

Related-Party Transactions

UNMC has significant transactions with the Nebraska Medical Center and UNMC Physicians every year. Several of these transactions have been recorded as adjusting entries between the entities at the time of statement preparation. Statement preparation is facilitated when entries are recognized and posted to the general ledger for each of the entities at the time the transaction occurs. We recommend the parties involved develop a communication process to ensure such transactions are recorded properly and timely throughout the year.

New Standards

The Auditing Standards Board of the AICPA issued Statement on Auditing Standards (SAS) No. 112, *Communicating Internal Control Related Matters Identified in an Audit*, which supersedes SAS No. 60, *Communication of Internal Control Related Matters Noted in an Audit*. SAS No. 112 establishes standards and provides guidance on auditors' responsibilities for evaluating the severity of control deficiencies identified as part of the audit and communicating matters related to an entity's internal control over financial reporting identified in an audit.

In a financial statement audit, the auditor is not required to perform procedures to identify deficiencies in internal control over financial reporting or to express an opinion of the effectiveness of the entity's internal control. SAS 112 requires the auditor communicate control deficiencies that are significant deficiencies or material weaknesses in writing to management and those charged with governance within 60 days following the report release date.

We would be pleased to discuss these comments and recommendations with you at any time. We appreciate and thank the University's employees for the courtesy and cooperation extended to us during the audit. This report is intended solely for the information and use of the State of Nebraska Auditor of Public Accounts, the University's management and others within the organization.

Very truly yours,

KPMG LLP