NEBRASKA AUDITOR OF PUBLIC ACCOUNTS

Mike Foley
State Auditor

Mike.Foley@nebraska.gov
PO Box 98917
State Capitol, Suite 2303
Lincoln, Nebraska 68509
402-471-2111, FAX 402-471-3301
www.auditors.nebraska.gov

December 19, 2014

Randall Peters, Director
Department of Roads
1500 Nebraska Hwy 2
Lincoln, Nebraska 68502

Dear Mr. Peters:

We have audited the basic financial statements of the State of Nebraska (State) as of and for the year ended June 30, 2014, 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, and have issued our report thereon dated December 16, 2014. 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 for the purpose of expressing our opinions on the basic 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 Roads (Agency) or other operational matters that are presented below for your consideration. These comments and recommendations, which have been discussed with the appropriate members of the Agency's 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 (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 and, therefore, material weaknesses or significant deficiencies may exist that were not identified. However, as discussed below, we identified a certain deficiency in internal control that we consider to be a significant deficiency.

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. We did not identify any deficiencies in internal control that we consider to be material weaknesses.

A significant deficiency is a deficiency, or combination of deficiencies, in internal control that is less severe than a material weakness, yet important enough to merit attention by those charged with governance. We consider Comment Number 1 (Management Maintenance System Inventory) to be a significant deficiency.

This comment will also be reported in the State of Nebraska's Statewide Single Audit Report Schedule of Findings and Questioned Costs.

Draft copies of this letter were furnished to the Agency to provide management with an opportunity to review and to respond to the comments and recommendations contained herein. All formal responses received have been incorporated into this letter. Responses have been objectively evaluated and recognized, as appropriate, in the letter. Responses that indicate corrective action has been taken were not verified at this time, but will be verified in the next audit.

The following are our comments and recommendations for the year ended June 30, 2014.

1. Management Maintenance System Inventory

The Department of Administrative Services State Accounting Division (State Accounting) prepares the Comprehensive Annual Financial Report (CAFR) and requires all State agencies to determine and report inventory balances at the end of the fiscal year on an accrual response form. State Accounting required all State agencies to report their accruals by August 6, 2014. A good internal control plan requires agencies to have procedures for the reporting of accurate financial information to State Accounting in a timely manner. Additionally, a good internal control plan requires procedures to ensure inventory counts and prices used are accurate and properly supported. Furthermore, there should be written policies and procedures to reconcile physical inventory counts to system records.

The Agency reported road maintenance inventory for shale, gravel, and rock to State Accounting at year end. The Agency did not submit its accrual response form until September 15, 2014, and did not provide documentation to the APA until November 4, 2014, some 55 days after first requested by the APA.

The Agency performed its inventory counts on April 1, 2014, at several sites across the State. Each of the seven districts then compiled the site inventories and reported the balances to the Agency's accounting division. The Agency used the site counts from April 1, 2014, along with purchases and usage recorded in the Management Maintenance System (MMS) for April 1, 2014, through June 30, 2014, to calculate the balance reported in the CAFR for $6,016,327.

During testing, the APA determined the inventory balance was understated by $199,308. The following issues were noted:

- The Agency did not have support for the prices used to convert the April 1 inventory counts to dollar values. After the APA inquired, the Agency provided new prices that were supported by contracts; however, there were still six prices that the Agency could not support. The use of incorrect prices caused an understatement of the April 1 inventory balance by $219,485.

- Usage recorded in MMS from April 1, 2014, to June 30, 2014, was valued using incorrect prices. This caused an overstatement of the June 30, 2014, balance by $23,384.

- The APA attended two districts' physical inventory counts on April 1, 2014. The purpose was to ensure counts reported to calculate the June 30, 2014, balance agreed to what the APA had observed. However, there were several variances ranging from an overstatement of 429 tons or $5,700 to an understatement of 577 tons or $8,762. The incorrect counts caused a net understatement of the April 1 inventory balance by $3,207. It is unknown why there were differences between the APA-observed inventory counts and what was reported to the Agency's accounting division. Therefore, it is unknown if the other district counts were accurately reported because site inventory documentation was not retained. Only the final calculated tons were submitted.

Furthermore, the Agency lacked both procedures for reconciling inventory counts to system balances and policies on when to adjust system balances. The Agency recorded inventory purchases and usage during the fiscal year into MMS to track inventory. After the physical inventory counts were performed on April 1, the Agency did not compare the inventory balance in the system to the results of the inventory counts to determine whether system adjustments were necessary. Starting with the prior year's ending balance reported in the fiscal year 2013 CAFR and adjusting for purchases and usage recorded in MMS during the fiscal year 2014 (with adjusted prices), the ending inventory would have been $5,080,884, a difference of $935,443.

Without adequate policies and procedures to ensure inventories are accurate and reconciled to system balances, there is an increased risk inventory balances will be misstated on the financial statements.

> We recommend the Agency establish policies and procedures to ensure inventory counts and prices used to value inventory are accurate and supported, reconciliation procedures are performed between physical counts and system records, and inventory balances reported to State Accounting are reasonable and accurate.

Agency Response: The Department of Roads recognizes the issues with maintaining an accurate inventory balance. Materials are located at over 175 locations across the state that are accessed by several hundred employees. Materials are purchased by the truck loads, dumped into stock piles, then issued out by the payloader. The inventory value is calculated by estimating the measurement of the remaining pile. This results in the potential for a variance from accounting inventory levels. Therefore, NDOR is currently researching a change in the accounting practices to be able to direct cost these materials items. The goal is to eliminate the inventory by June 30, 2015.

2. Terminated User Access

NITC Standards and Guidelines, Information Security Policy 8-101, Section 4.7.2, User Account Management, states:

> *A user account management process will be established and documented to identify all functions of user account management, to include the creation, distribution, modification and deletion of user accounts. Data owner(s) are responsible for determining who should have access to information and the appropriate access privileges (read, write, delete, etc.). The "Principle of Least Privilege" should be used to ensure that only authorized individuals have access to applications and information and that these users only have access to the resources required for the normal performance of their job responsibilities . . . .*
>
> *Agencies or data owner(s) should perform annual user reviews of access and appropriate privileges.*

A good internal control plan includes a process to ensure terminated users' access is removed timely.

We tested 18 terminated employees' access to the Agency's network and noted:

- One employee was terminated on May 8, 2014, and still had access on August 20, 2014, when testing was performed.
- Two terminated employees' access was not removed in a timely manner. One had access removed 13 business days after termination; the other had access removed 33 business days after termination.

Additionally, we identified a temporary employee who terminated on July 19, 2013, but was then rehired in a permanent capacity on August 19, 2013. The user retained access to the Agency's network during the month when not employed there.

When access to networks and applications is not terminated timely, it creates the opportunity for inappropriate access to State resources, as well as unauthorized processing of transactions.

> We recommend the Agency implement procedures to terminate user access in a timely manner (within three business days). We also recommend the Agency periodically review user access to ensure it is appropriate.

Agency Response: The Department of Roads Information Technology Division has worked with the Human Resources Division and developed a procedures to ensure notifications are received in a timely manner to terminate user access as appropriate. This plan has been reviewed with the Controller Division and shared with NDOR management. It is on file in the IT Division.

3. RBS Audit History

NITC Standards and Guidelines, Information Security Policy 8-101, Section 4.7.10, System Access and Use, states, in part:

> *Activities of information systems and services must be monitored and events logged to provide a historical account of security related events. Agencies will implement appropriate audit logs to record events, exceptions and other security-related events.*

The Roads Billing System (RBS) is utilized to process accounts receivable and related receipting for the Agency.

RBS did not record which user completed the receipting process, including the ability to add, adjust, or cancel amounts for "non-storefront" receipts. Non-storefront refers to entities with accounts in RBS that are billed by the Agency on a regular basis. Non-storefront receipts are applied to those specific accounts when entities make a payment. A similar finding was noted during the prior audit.

Without an audit function to record the users who create, update, and approve receipts in RBS, there is a lack of accountability.

> We recommend the Agency establish controls to capture the user ID used to complete each phase of an accounting process.

Agency Response: The Department of Roads RBS system is a very old system with many limitations that has impacted how NDOR does our business. This system is currently undergoing a major rewrite / upgrade which will address these limitations and will provide enhanced accountability with user ID and date tracking functionality. The software upgrade is being developed by NDOR IT staff and, if it goes according to schedule, will be implemented in spring 2015.

4. <u>Risk Assessment</u>

NITC Standards and Guidelines, Information Security Policy 8-101, Section 4.5.1, Physical Security Perimeter, states, in part:

> *Agencies will perform a periodic threat and risk assessment to determine the security risks to facilities that contain State information . . . .*

NITC Standards and Guidelines, Information Security Policy 8-101, Section 4.9.3, Risk Assessment, states:

> *Security requirements and controls must reflect the value of the information involved, and the potential damage that might result from a failure or absence of security measures . . . The framework for analyzing the security requirements and identifying controls to meet them is associated with a risk assessment, which must be performed by the data owner(s) and Agency management. A process must be established and implemented for each application to: address the business risks and develop a data classification profile to understand the risks; identify security measures based on the criticality and data sensitivity and protection requirements; identify and implement specific controls based on security requirements and technical architecture; implement a method to test the effectiveness of the security controls; and identify processes and standards to support changes, ongoing management, and to measure compliance.*

A good internal control plan requires a risk assessment to be completed and updated periodically.

The Agency did not have a formalized risk assessment plan for all applications within the Agency.

When a formal risk assessment is not documented, there is an increased risk that security vulnerabilities, which could have been prevented or monitored, could be exploited. This could cause downtime, loss of productivity, unauthorized access, or interference with State and/or Federal systems.

> We recommend the Agency complete a risk assessment on a periodic basis.

Agency Response: The Department of Roads is reviewing options to implement a risk assessment plan. We are currently meeting with several other agencies to check for best business practices. We are also working with the State Security Advisory Work Group to develop standards / guidelines for all state agencies. Through these efforts, it is anticipated a risk assessment plan will be in place by the end of calendar year 2015.

* * * * *

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.

Pat Reding

Pat Reding, CPA, CFE
Assistant Deputy Auditor