STATE OF NEW HAMPSHIRE
DEPARTMENT OF TRANSPORTATION

MANAGEMENT LETTER
FOR THE FISCAL YEAR ENDED JUNE 30, 2005

To The Fiscal Committee Of The General Court:

We have audited the financial statements of the New Hampshire Turnpike System and Highway Fund, as of and for the fiscal year ended June 30, 2005 and have issued our reports thereon dated March 3, 2006 and March 16, 2006, respectively.

This management letter, a byproduct of those audits, contains an auditor's report on internal control over financial reporting and on compliance and other matters including related audit findings. Also attached to the letter are two appendices. Appendix A provides a summary of the status of observations presented in the prior, fiscal year 1994, audit report of the New Hampshire Department of Transportation (Excluding the Bureau of Turnpikes). Appendix B is a letter from the Commissioner of the Department of Transportation.

Copies of the New Hampshire Turnpike System Comprehensive Annual Financial Report and The Highway Fund Audited Financial Statements can be obtained from the New Hampshire Department of Transportation, 7 Hazen Drive, P.O. Box 483, Concord, NH 03302-0483.

Office Of Legislative Budget Assistant
Office Of Legislative Budget Assistant

May 11, 2006

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STATE OF NEW HAMPSHIRE
DEPARTMENT OF TRANSPORTATION
2005 MANAGEMENT LETTER

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Auditor's Report On Internal Control Over Financial Reporting And On Compliance And Other Matters

To The Fiscal Committee Of The General Court:

We have audited the financial statements of the New Hampshire Turnpike System and The New Hampshire Highway Fund as of and for the fiscal year ended June 30, 2005, and have issued our reports thereon dated March 3, 2006 and March 16, 2006, respectively. We conducted our audits in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States.

Internal Control Over Financial Reporting

In planning and performing our audits, we considered the internal control over financial reporting for the Turnpike System and Highway Fund in order to determine our auditing procedures for the purpose of expressing our opinions on the financial statements and not to provide opinions on the internal control over financial reporting. However, we noted certain matters involving the internal control over financial reporting and its operation that we consider to be reportable conditions. Reportable conditions involve matters coming to our attention relating to significant deficiencies in the design or operation of the internal control over financial reporting that, in our judgment, could adversely affect the ability of the management of the Turnpike System and Highway Fund to record, process, summarize, and report financial data consistent with the assertions of management in the financial statements. Reportable conditions are described in Observations No. 1 through No. 26 of this report.

A material weakness is a reportable condition in which the design or operation of one or more of the internal control components does not reduce to a relatively low level the risk that misstatements caused by error or fraud in amounts that would be material in relation to the financial statements being audited may occur and not be detected within a timely period by employees in the normal course of performing their assigned functions. Our consideration of the internal control over financial reporting would not necessarily disclose all matters in the internal control that might be reportable conditions and, accordingly, would not necessarily disclose all reportable conditions that are also considered to be material weaknesses. However, of the reportable conditions noted above, we consider the matters described in Observations No. 1 through No. 5 to be material weaknesses.

Compliance And Other Matters

As part of obtaining reasonable assurance about whether the Turnpike System and Highway Fund financial statements are free of material misstatement, we performed tests of its compliance with certain provisions of laws, rules, regulations, contracts, and grant agreements, noncompliance with which could have a direct and material effect on the determination of financial statement amounts. However, providing an opinion on compliance with those provisions was not an objective of our audit, and accordingly, we do not express such an opinion. The results of our tests disclosed no instances of noncompliance or other matters that are required to be reported under *Government Auditing Standards*. However, we noted certain matters which are described in Observations No. 27 through 30 of this report.

This auditor's report on internal control over financial reporting and on compliance and other matters is intended solely for the information and use of the management of the Turnpike System and Highway Fund and the Fiscal Committee of the General Court and is not intended to be and should not be used by anyone other than these specified parties.

Office Of Legislative Budget Assistant

Office Of Legislative Budget Assistant

March 3, 2006 for Turnpike System
March 16, 2006 for Highway Fund

Internal Control Comments
Material Weaknesses

Observation No. 1: Internal Controls Must Be Improved

Observation:

Material deficiencies in the Department's internal controls over its financial management and reporting activities resulted in the need for extraordinary efforts to prepare the fiscal year 2005 Highway Fund and Turnpike System financial statements. Significant weaknesses exist in each of the five generally recognized interrelated internal control components of control environment, risk assessment, control activities, information and communication, and monitoring. The lack of an effective system of internal controls puts the Department's objectives of achieving efficient and effective operations, reliable financial reporting, and compliance with laws and regulations at significant risk.

Control Environment
The control environment encompasses a number of factors that have a pervasive influence on the way business activities are structured, objectives are established, and risks are assessed. The control environment influences employees' control awareness and instills an enterprise-wide attitude of integrity and control consciousness. Factors affecting the control environment include the integrity and ethical values under which an organization operates, its commitment to the competence of its employees and operations, and its management philosophy and operating style.

A well-established control environment enables an organization to operate in a manner that minimizes the deleterious effects of operating in crisis conditions. Well-trained and supported employees are able to carryout their usual responsibilities and react appropriately to unusual circumstances such as unexpected changes in procedures and personnel. During fiscal year 2005, the Department experienced difficulties that indicated deficiencies in its control environment.

The lack of trained, competent financial accounting and reporting staff at the Department presented a critical challenge to the operations of the Department during fiscal year 2005.

- The Department has historically relied upon the knowledge and experience of key Bureau of Finance and Contracts employees to keep the Department's current bill system operating. The experience of these key employees enabled them to recognize and resolve problems with the current bill system as the issues occurred. However, in fiscal year 2004, several of these key employees retired or were reassigned and the Department did not ensure that employees who assumed the duties of these key employees adequately understood and appreciated the need to perform these critical current bill responsibilities. The lack of attention paid to the operation of the current bill system in the fall of 2004 allowed the situations described in Observation Nos. 2, 4, 6, and 9. This situation of employees being inadequately trained to perform their assigned job responsibilities was compounded by the Department's lack of attention to the other four categories of internal control of: control activity; risk assessment;

information and communication; and monitoring as noted in the following sections of this comment.

- The lack of trained financial accounting and reporting staff at the Department exasperated the difficulties experienced by the Department in the accounting and financial reporting of the Turnpike System's roll-out of the electronic toll (E-ZPass) system. The Department's analysis of the financial implications and accounting results of various E-ZPass operational decisions also suffered from the lack of trained financial accounting and reporting staff, increasing the risk that management decisions made regarding the E-ZPass system could be based on inaccurate information.

Risk Assessment
An entity's performance can be at risk due to internal or external factors. These factors can affect the entity's ability to reach and maintain adherence to its stated or implied objectives. External factors include economic changes having an effect on decisions related to financing, capital expenditures, changing customer needs or expectations, new legislation, natural catastrophes, etc. Internal factors including disruption of information systems, quality of personnel hired and methods of training and motivation, and change in management responsibilities of the entity can also affect the way certain controls are effected. Risks increase at times of change including changes in personnel and changes in procedures.

As noted in Observation No. 25, the Department does not have a formal risk assessment and mitigation mindset. While the Department experienced significant change during fiscal year 2005 including, as mentioned above, considerable reassignment of responsibilities due to retirement of key employees as well as the implementation of the E-ZPass system, the Department did not demonstrate that an effective planning process was in place that properly considered and reacted to the risks it faced. As noted in the following observations in this report, the Department generally operated in a reactive mode, reacting to problems once they occurred and not in a proactive mode where it could anticipate problems and act to mitigate their impact.

Control Activities
An entity's control activities are the policies and procedures used to ensure that the entity's objectives are attained and that management's directives identified as necessary to address risk are carried out. Controls are categorized as preventative, detective, manual, computer and management controls.

- As noted in Observation Nos. 4, 8, 23, 29, and 30, the Department's control activities are generally informal and are not supported by documented polices and procedures. As is often the case with informal policies and procedures, the control activities were not consistently performed or were performed with insufficient care to provide a level of assurance necessary to have reasonable confidence that the control objectives were being met during fiscal year 2005. As noted in the following observations in the report, revenue reports were not prepared and analyzed, error reports were not reviewed, reconciliations were not performed, and segregation of incompatible functions was not established and maintained. Each of these control failures, as discussed in the following observations in the report, increased the risk that the Department would not reach and maintain its operating objectives during fiscal year 2005.

Information and Communication

Information is needed at all levels of an organization to run the business and to move toward achievement of the entity's objectives. Financial information is used not only in developing financial statements for external reporting but is also used as a basis for operating decisions, such as monitoring performance and allocating resources.

As reported in Observation Nos. 4 and 7, the Department's primary information system, the current bill system, does not meet the Department's current needs for a robust accounting system. Many of the difficulties experienced by the Department during fiscal year 2005, as noted in the observations in this report, were compounded by limitations in the current bill system.

- The current bill system, originally designed in the 1950s, was considered by many to be inadequate by the late 1980s. Yet, it continues to be the primary information system used by the Department to account for federally assisted and other projects managed by the Department.

As one of the most significant departments of State government, the Department is regularly required to provide information for the use of policy makers and others on the status of Department projects and programs. Limitations in the Department's information systems, especially the current bill system, contributed to the Department's inability to accumulate sufficient financial information to prepare fiscal year 2005 financial statements in the timeframe that would allow timely audit.

The Department's continued reliance on a system with known limitations would normally necessitate additional attention on the part of the Department to ensure that information generated by the system was reliable, accurate, and complete. Based on the results of the fiscal year 2005 audit work performed at the Department as noted in the observations in this report, it does not appear that the Department was providing that additional attention to the operation of the current bill system and the information that the system generated.

Monitoring

Monitoring ensures that internal controls continue to operate effectively and as intended by management. This involves assessments by appropriate personnel of the design and operation of the controls in a suitably timely basis and the taking of necessary actions.

As noted in the observations in this report, the Department did not actively monitor the performance of its internal controls. Action was not taken, as noted in Observation No. 13, when toll audits were not performed during the period March through October 2005. Action was not taken, as noted in Observation No. 14, when toll revenue reconciliations were determined to be unreliable during the entirety of fiscal year 2005. As noted in Observation Nos. 6 and 9, action was not taken to review and react to current bill error and other management reports that indicated problems developing in the Department's federal programs. Management's lack of effective monitoring and reaction to internal control concerns raises questions about the overall effectiveness of the Department's control structure.

Recommendation:

The Department must take steps to establish and maintain appropriate internal controls to safeguard its operations. The Department should review the fundamentals of internal controls to understand how effective controls would assist the Department in establishing and meeting its objectives.

- The Department must adequately staff its financial accounting and reporting functions with trained accountants who bring to the positions the knowledge and experience to assist the Department in properly accounting for and reporting the financial activity of the Department. The Department should not become overly dependent upon key employees and should not regard key accounting positions as being suitable for on-the-job training of non-accounting personnel.

- The Department must review its control activities and establish formal policies and procedures to ensure the Department's objectives are attained. The Department should not become dependent upon employees' experience and judgment to perform Department controls. Critical controls must be documented to provide reasonable assurance that the controls will be performed as management intends regardless of the experience of the employee that fills the control position.

- The Department must improve its communication and information systems. The effects of the limitations of the current bill system should be mitigated as much as possible pending the replacement of the system to be reasonably certain it provides complete and accurate information for the needs of the Department and others.

- The Department must improve its control monitoring efforts to ensure that the Department's controls are operating as intended. Management should attend to problems evidenced through monitoring efforts in a timely manner to demonstrate to employees its concern for controlled operations.

Auditee Response:

We concur.

The Department acknowledges the need to improve the system of internal controls over the financial management and reporting functions. As discussed in the responses throughout this report and in the Commissioner's attached letter [Appendix B], the Department is taking a systematic approach in responding to each issue cited in the report and further taking long-term actions to restructure the financial management functions of the Department.

Observation No. 2: Core Financial Accounting And Reporting Personnel Resources Must Be Strengthened

Observation:

The Department has not established the proper control environment over the Department's financial accounting and reporting activities.

A primary component of an entity's overall control system is its control environment. An entity's control environment includes, among other things, its commitment to competence, its organizational structure, and its assignment of authority and responsibility. The control environment has a pervasive influence on the way an entity's business activities are structured and controlled. Weaknesses in the Department's control environment, especially limitations in the Department's financial accounting and reporting expertise, has caused or allowed significant problems to occur in the Department's financial activities that negatively impacted the Department's operations during fiscal year 2005. These limitations resulted in:

- Erroneous information being used as a base for public testimony and Department decision making. For example:
    - Capitalizing instead of expensing the cost of transponders sold to customers,
    - Monthly cost for each E-ZPass account erroneously stated at $5 per month,
    - Confusion regarding renewal and replacement expenditures, and
    - Adjustment to Highway fund balance in fall of 2005 being based on inaccurate information. While the amount of the adjustment may be reasonable, the calculation overstated the accrued unbilled amount and understated errors in coding participating federal costs as non-participating by as much as $7.6 million.
- Inability to timely recognize and respond to problems that developed in the current bill processing. When detected, the Department had to bring former employees out of retirement to correct problems. Problems included failure to:
    - Notice or effectively react to a failure in the current bill process. The Department did not bill federal participation amounts during the period of October through December 2004 due to a previously unrecognized limitation in the current bill system. This failure in the billing process resulted in an unusual increase in the accrued unbilled balance during that period of time.
    - Notice or effectively react to lack of project close outs (final vouchers). While, per the Federal Highway Administration's *Fiscal Year 2005 Financial Integrity Review and Evaluation Program Review* report, the Department normally closes out an average of 60 projects per year, the Department closed out six projects through May 11, 2005.
- Inability to timely recognize and correct billing errors related to Highway's cross billing of Turnpike's share of the Granite Street Project. Errors included:
    - Cross billing Turnpikes at 100% of project cost instead of 20% including Turnpike's year-end accounts payable to the Department.
    - Failing to depreciate toll equipment funded by federal assistance.
- Inability to prepare timely and accurate Turnpike financial statements including:
    - Requiring excessive assistance from Department of Administrative Services and auditors to prepare fiscal year 2005 Turnpike financial statements, and

- Not preparing interim Turnpike financial statements for the six months ended December 31, 2005.

Recommendation:

The Department must establish the proper control environment over financial accounting and reporting.

The Department must strengthen its core financial accounting and reporting personnel resources. While the Department has taken the first step of hiring a Director of Finance, the Department must also provide adequate, skilled, and competent staff to support the Director's position. The Department must also clearly define the authority of the Director's position in the organization structure of the Department. The financial activities of the Department, especially as it looks forward with the rest of the State to a conversion to a new State-wide accounting system, are sufficiently complex to require a professional, trained financial accounting and reporting organization to assist in the operation of the Department.

Auditee Response:

We concur.

The Department with guidance from the newly hired Finance Director has identified plans to bolster the Department's financial accounting and reporting capacity. The current plan is to utilize consultant expertise and/or reclassified vacant positions to senior level financial analysts staff. Further, the Department is reviewing the organizational structure of the Bureau of Finance and Contracts in order to build clearer lines of authority and responsibilities and to provide for appropriate backup support for the various work functions. These changes along with the other audit recommendations are being pursued through the legislative process as well as through the internal reorganization process. Given the need, it is expected that such changes will receive favorable reviews. During the development of the Fiscal Years 2008/2009 budget, additional resource needs will be evaluated.

Observation No. 3: Regular Analysis Of Highway Fund Balances Must Be Performed

Observation:

The Department does not periodically analyze the Highway Fund fund balance to determine and report the balances appropriated for, and committed to, specific construction projects and the amounts originally appropriated that are now available to fund additional projects.

Such an analysis was performed pursuant to Chapter 176:9, Laws of 2005 as of June 30, 2005 and resulted in a $26.6 million transfer to the Highway Fund Surplus Account.

Due to limitations in the Department's information systems as well as lack of consideration for this reporting in prior fiscal years, the Department does not maintain the information necessary to perform this analysis. Accordingly, the analysis performed as of June 30, 2005 had to rely upon amounts reported by the Federal Highway Administration as available for New Hampshire highway projects as well as assumptions made by the Department related to those available federal dollars.

Pursuant to RSA 228:11, highway construction accounts are nonlapsing, resulting in unused appropriations and estimated revenues being carried forward (reserved) year after year, even after the point when the original project for which the appropriation was made has been completed. This problem is compounded by the fact that the actual federal/state match rate generally differs from the amounts budgeted for the Department's federally-assisted construction projects. Using a higher budgeted match rate causes excess State Highway Fund amounts to be budgeted and ultimately carried forward indefinitely, sometimes long after the underlying projects have been completed, rather than being transferred to surplus and made available to fund future projects.

While the analysis performed as of June 30, 2005 was a reasonable initial attempt to determine the amount of excess, unneeded appropriations, concerns remain about the assumed federal reimbursement rate used in the analysis by the Department. The Department does not currently have a procedure in place for determining a reasonable federal reimbursement rate to apply to its federal construction activity when analyzing appropriations and estimated revenue. Using an inaccurate federal reimbursement rate for highway projects could materially affect any needed adjustments. For example, at June 30, 2005, an 80% federal reimbursement rate was used to arrive at the $26.6 million transfer amount. A 5% difference in the assumed federal reimbursement rate would cause a swing in the transfer amounts of plus or minus $20 million. Based on the relative significance of this percentage to the calculation, it is critical that the Department have a reasonable and documented methodology for determining an assumed federal reimbursement rate.

Recommendation:

The Department must perform a regular and formal analysis of its fund balances and provide this information to policy makers and others dependent upon accurate information of the Department's activity and the status of the Highway Fund.

Excess appropriations should be made available for future use. To accomplish this, the Department should request that RSA 228:11 be amended to provide for the transfer to surplus of excess appropriations and estimated federal revenues for highway construction.

To provide for the analysis, the Department must begin to develop and capture the necessary information that will allow for an understanding of the fund balances.

Auditee Response:

We concur in part.

During the last year, pursuant to Ch 176:9 Laws of 2005 the Department participated in the Highway Fund Review Team to analyze the account balances in the Highway Fund and to develop the new financial reporting model for reporting of Operating activities and the Construction activities of the fund. The review process required extensive project analysis, which required pulling data from numerous sources. The Department is committed to performing this project analysis on a periodic basis to include the following: authorized funding limits and percentages by source; expenditures to date; encumbrance balances; revenues earned to date; and committed state share. The next reconciliation is set for the period ending June 30, 2006. The outcome of the analysis will be used to determine if a year-end adjustment is required. The Department looks forward to the implementation of the new Enterprise Resource Planning (ERP) System to allow for an integrated view of the data to enhance analysis capabilities.

The Department has prepared the Highway Surplus Schedule for the Operating Account using the new reporting model. The Department believes that the recommendations regarding the lapsing of long-term appropriations should be incorporated during the budget process for the fiscal year 2008/2009 biennium. During this budget analysis, a more thorough evaluation of the project data and the Highway Fund can occur relative to amending RSA 228:11.

Observation No. 4: Controls Over Classification Of Participating Costs Should Be Improved

Observation:

Department controls over categorizing a cost as federal participating or non-participating did not appear to be operating as intended during fiscal year 2005 and the Department was not able to effectively react to that failure in controls.

As noted in the Federal Highway Administration's (FHWA) *Fiscal Year 2005 Financial Integrity Review and Evaluation Program Review* report, due to computer, administrative, and personnel issues, the Department did not bill eligible costs to FHWA from October to December 2004. As a result, approximately $23.5 million of federal funds due the Department were not received until the first quarter of calendar year 2005. The erroneous coding of federal participating costs as non-federal participating in the Department's current bill system accounted for most of the $23.5 million delayed draw of federal funds.

Audit testing identified another $7.7 million of cost categorization errors as described below.

Audit tests of 32 charges to federal programs revealed two transactions where the Department had identified costs as non-participating, even though the associated work class codes indicated the costs could be participating. In both instances, upon further review, the Department confirmed that the costs should have been classified as participating and subject to federal funding. In one instance, the error apparently was caused by inaccurate data entry, and, in the other instance, the error was apparently caused by an error in data coding (use of the incorrect work class code). The effect of these errors was a delayed federal draw of $319,000.

To further understand the scope of the problem, a separate sample of 12 projects that included non-participating costs coded with participating work class codes was tested. Testing of this sample revealed 48% of the tested sample costs ($137,000 out of the $287,000 tested) were incorrectly identified as non-participating in the current bill system. These errors were caused by errors in data coding (use of the incorrect work class codes). The effect of these errors was a delayed federal draw of $109,600. ($137,000 * 80% federal participation rate related to these costs.)

A joint Department and auditor review was undertaken of non-participating costs reported in seven of the Department's projects with large balances of non-participating costs at June 30, 2005. This review identified $7.3 million of federal funds receivable to the Department related to costs erroneously recorded as non-participating. Based on this review and the other errors noted, it is apparent that some of the problems that existed at the time of the FHWA report regarding the coding of costs continued at the Department through the end of fiscal year 2005.

Recommendation:

The Department should improve its controls over classifying costs as federally participating or non-participating. Policies and procedures to assist employees in accurately coding costs should provide guidance and direction. The policies and procedures should incorporate aspects of the five components of internal control including control environment, risk assessment, control activities, information and communication, and monitoring to increase the likelihood of timely detection and correction of errors, frauds, and other matters.

Auditee Response:

We concur.

Improper coding due to staff turnover and a lack of understanding of the billing system resulted in costs being improperly charged relative to participating and non-participating.

The Department has been diligent in reviewing the billing process. Two retired staff members and another employee previously on extended leave have returned over the last several months to insure the Department will be current with the billing function by the end of Fiscal Year 2006. Procedures with special attention to internal controls are being developed to keep this situation from reoccurring in the future.

Further, the Department is reviewing the organizational structure of the Bureau of Finance and Contracts in order to build clearer lines of authority and responsibilities and to provide for appropriate backup support for the various work functions.

Observation No. 5: Understanding Of General Bond Resolution Requirements Should Be Improved

Observation:

A lack of full understanding of the State's obligations under the General Bond Resolution compounded the financial reporting difficulties experienced during fiscal year 2005. Pressures on Turnpikes cash position during fiscal year 2005 made a clear understanding of the State's obligations under the General Bond Resolution critical to ensure that the State complied with the covenants contained in the Resolution.

The General Bond Resolution supporting the State's issuance of Turnpike System Revenue Bonds contains a number of requirements upon the Turnpikes including 12 covenants between Turnpikes and the bondholders. The covenants include conditions upon the Turnpikes to operate the Turnpike System in a reasonable, responsible, and prudent manner, including specific conditions on toll revenues needed to support the System and amounts needed to be expended on renewal and replacement (R&R) projects to maintain the condition of the System. Each year, Turnpikes is required to support compliance with the covenants by filing a certification of compliance with the State Treasurer. Compliance with the covenants is also a subject of the annual audit of the Turnpikes financial statements, itself one of the covenant requirements.

During the fiscal year 2005 audit of the Turnpikes, questions were raised regarding the covenant requirements, including definitions and applications of definitions in the covenant requirements. Neither Turnpikes nor the State Treasury had definitive answers to some of the questions, which resulted in concerns as to Turnpikes compliance with certain covenants.

While ultimately it was determined that the Turnpikes was in compliance with all of the covenants except for the requirement for audited financial statements to be available within 180 days of the end of the fiscal year, certain questions remain relative to the application of the General Bond Resolution and covenants that need to be answered to ensure Turnpikes' ability to remain in compliance.

Recommendation:

Turnpikes, the State Treasury, and bond counsel should continue to review and resolve the outstanding questions related to compliance with the General Bond Resolution and covenants. Clear definitions as to the calculation of the net revenue requirement, including consideration of the R&R requirements and the reporting of R&R budgets in general, must be agreed to. Other questions, such as how working capital impacts net revenue, also need to be answered.

Once agreed to, Turnpikes will need to establish appropriate controls to ensure that it continues to operate in compliance with the Resolutions and covenants.

Auditee Response:

We concur in part.

Fiscal Year 2005 was a very challenging year both operationally and financially with the implementation of the new toll collection system and the introduction of electronic tolling. The Department feels strongly that during this period, prudent operational decisions were made to appropriately manage the Turnpike System and to also manage the financial bottom line to ensure the coverage ratios were met.

The Department with advice from Treasury will consult with Bond Counsel to review the covenant requirements. The most important issue involves the Renewal and Replacement Requirement and whether the State should use the budgeted amount or the historically used actual amount.

Other Reportable Conditions

Observation No. 6: Monitoring Controls Need To Be Strengthened

Observation:

As noted in the Federal Highway Administration's (FHWA) *Fiscal Year 2005 Financial Integrity Review and Evaluation Program Review* (FIRE) report, "the Department did not bill eligible costs to FHWA from October to December 2004 due to computer, administrative, and personnel issues. As a result, approximately $23.5 million in federal funds due the Department was not received until the first quarter of calendar year 2005. The Department lost interest revenue on State funds that would have accumulated if the funds were billed to FHWA and deposited as normally would have been the case."

The memorandum of understanding between the Department and the FHWA provides for a weekly billing by the Department to draw federal participation in project costs. The delay in billing noted by the FIRE report represents approximately eight sequential failed billing cycles.

While the Department's response to the comment in the FIRE report cited inaccurate data coding and limitations in the Department's current bill system as contributing to the billing problems, the fact that the Department was delayed in recognizing the developing problem and in correcting the problem when it was ultimately identified raises concerns over the Department's ability to react effectively to recognized problems. An effective system of controls has value only if the entity is able to act upon the information provided by the system. In the above situation initially recognized in the FIRE report, the Department was unable to act in a timely manner.

Recommendation:

The Department must review the circumstances surrounding its failure to bill the federal participation amounts during the last quarter of calendar year 2004. The Department must look beyond the incipient causes of the problem to determine what prevented the Department's timely and effective reaction to those problems. While a better understanding of the limitations of the current bill system pending the future replacement of the system is a first step, the Department must also establish policies and procedures to promote the timely detection and correction of problem situations as they develop.

Auditee Response:

We concur.

The Department struggled in the accounting and allocation of federal funds during this time period. Turnover of staff, the lack of written documentation of the process, and an insufficient knowledge of the quirks of a very old billing system led to a number of billing complications.

The Department has been diligent in reviewing the billing process. Two retired staff members and another employee previously on extended leave have returned over the last several months to insure the Department will be current with the billing function by the end of Fiscal Year 2006. Procedures are being developed to prevent this situation from reoccurring in the future.

Further, the Department is reviewing the organizational structure of the Bureau of Finance and Contracts in order to build clearer lines of authority and responsibilities and to provide for appropriate backup support for the various work functions.

Observation No. 7: Current Bill Limitations Related To Changes In Federal Participation Rates Should Be Reviewed

Observation:

Department practices to get around limitations in its current bill system have caused the Department to draw federal funds using inaccurate participation ratios for certain projects.

According to the Department, its current bill system cannot accommodate more than one federal participation rate for a federal appropriation code even though, over the course of a project, the federal participation rate may change several times. The Department's workaround for its system's limitation is to keep the participation rate relatively constant and to adjust the total federal participation amount. For example, if a $100 federal participation project that was originally 80% federal participation is adjusted to become a $200 project with $100 at 80% participation and $100 at 100% participation, the current bill system could be adjusted to a $180 federal participation project at 100% federal participation. In this example, the Department would cover the first $180 of project expenditures with federal funds and cover the final $20 of expenditures using State funds. The effect is that, over the life of the project, the total dollar amount of federal participation drawn is accurate, but during the course of the project, which may be several years, the amount of federal participation drawn for each reimbursement is not in accordance with the true participation ratios. The Department's final voucher process at the close of a project reviews the history of the entire project to ensure that, in total, the allocation of project costs between the Department and federal grantor was properly accounted for by the time the project is closed.

Recommendation:

The Department should review the limitations in its current bill system that prevent it from accurately reflecting changes in federal participation over the course of a project. The Department should further review alternatives that would allow for the accurate billing of federal participation projects over the life of the projects.

Auditee Response:

We concur.

Due to the limitations of the current bill system, the system does not allow the Department to bill more than one federal participation rate per appropriation code at a time. The current process used by the Department to bill costs one rate at a time has been accepted by the FHWA due to the reconciliation process at the end of the project. The Department generally applies a neutral rate that does not penalize either party from a cash flow perspective during the life of a project. As explained in other audit findings, the rate selection process will be documented in our billing procedures guide.

The Department and the Office of Information Technology has been aggressive to make sure the selected ERP vendor will have the capability to bill multiple funding sources.

Observation No. 8: Controls Must Be Established For Summary Level Transfer Adjustments

Observation:

The Department does not require the basis for adjustments made to its current bill system to be documented. The lack of documentation of the propriety of the adjustments makes an effective review and approval of the adjustments impossible.

The Department prepares summary level transfers (SLTs) to adjust amounts previously recorded in its current bill system. The SLTs are manual adjustments similar to accounting journal entries. The Department regularly processes SLTs transferring tens of thousands to millions of dollars of project costs without requiring the propriety of the SLT adjustments to be explained and documented. SLTs are also used to reallocate federal appropriations within Department projects. Because the SLTs regularly do not include any supporting information, there is no opportunity for a reviewer to determine the propriety and accuracy of the adjustments.

The problems related to this lack of documentation were evident when the Department could not readily provide the support and basis for a number of SLT adjustments it made during October and November 2005 to close certain Department projects. The support and basis for these SLTs were critical in the Department's determination of the June 30, 2005 accrued-unbilled accounts receivable.

According to the Department, there are no current written policies and procedures to explain the Department's SLT process.

Recommendation:

The Department must establish controls, including policies and procedures, for its SLT adjustment process. All adjustments processed by SLTs should be accompanied by supporting documentation that establishes the need for the adjustment and the accuracy of the amounts. All adjustments processed by SLTs should be subject to an effective review and approval function that includes reviewing the documentation supporting and accompanying the SLT to establish the propriety and accuracy of the adjustments.

Policies should also require a regular high-level review of the SLT activity to determine the situations that required correction by the use of an SLT adjustment. This review should ensure that the underlying system or other problems are detected and corrected in a timely manner and are not allowed to remain disguised by regular SLT adjustments.

Auditee Response:

We concur.

The use of the Summary Level Transfer (SLT) documents has not been properly controlled. The Department has established procedures and has redesigned the SLT form to capture the required information. The new procedures include:

- The documents are recorded on a log and secured in a binder;
- Documentation supporting the adjustment is attached to the SLT;
- Signatures of preparer, keyer, and approver are secured on the SLT; and
- System reviews of the transaction before and after processing are required to verify the transaction is recorded as planned.

Observation No. 9: Error Reports Must Be Reviewed And Acted Upon

Observation:

The Department did not effectively utilize its *Bill Processing Error Report* during fiscal year 2005. Had the error report been effectively reviewed, problems that existed in the current bill system at June 30, 2005 may have been detected and corrected in a more timely manner.

The *Bill Processing Error Report* is periodically generated and reports expenditures that were scheduled for payment that, due to edit checks in the current bill system, were not processed or recorded as planned in the current bill system. While payments are made, error items are generally bucketed incorrectly into an accrued and unbilled account, or categorized as federal non-participating when they should be federal participating costs.

Unattended errors included on the *Bill Processing Error Reports* during fiscal year 2005 compounded the difficulty experienced by the Department in determining the federal accounts receivable and the available fund balance in the Highway Fund at June 30, 2005.

Recommendation:

The Department must monitor and respond to errors noted in its internal controls including its management information reports such as the *Bill Processing Error Report.* Monitoring management information reporting is especially important with a system like the current bill system, a system that the Department places so much reliance upon and, even with its known limitations, is integral to the Department's continued operations.

Auditee Response:

We concur.

The error reports will be reviewed with staff from the Office of Information Technology (OIT) to determine the source of the error conditions for items on the report and to further explore why costs are not being processed properly. Changes in process or programming will be implemented in order to minimize these error conditions. Further, the Bureau of Finance and Contracts will work with the various internal department users to educate them as to importance of accurate coding of transactions.

Observation No. 10: Procedures To Ensure Complete Reporting Of Capital Assets Need To Be Improved

Observation:

Lack of specific procedures and communication within the Bureau of Finance and Contracts prevented the timely detection of errors in the Department's accounting for constructed assets during fiscal year 2005.

Department procedures to identify Construction In Progress (CIP) projects for capital asset reporting purposes failed to identify and report as assets three Highway Fund projects with accumulated costs of $21.7 million at June 30, 2005. The reported total CIP at June 30, 2005 for the Highway funded projects, including the $21.7 million adjustment, was $223.9 million. The total at June 30, 2005 of all Highway funded capital assets was $1.4 billion.

According to Department personnel, during fiscal year 2005, the scope of each of these three projects changed from betterment/rehabilitation to construction projects. The change in scope should have triggered a reclassification of the project costs from betterment to CIP capital assets. According to the Department, one section of the Bureau should have notified another section of the change in the scope of these projects but did not. Neither section confirmed the status of Department construction projects at year end.

The effect of not reporting the capital construction costs as CIP is to overstate period expenses on the government-wide financial statements and thereby to understate change in net assets. If a similar problem occurred in the Turnpike Fund, net income would be understated. In addition, at the close of each fiscal year, in accordance with State accounting policy, the Department reports its capital assets to the Department of Administrative Services for Statewide financial reporting purposes. Understating CIP understates the Department's capital assets.

Recommendation:

The Department should improve its communications and establish procedures within the Bureau of Finance and Contracts regarding capital assets and CIP. Procedures should be established to ensure changes in the scope of construction projects are properly evaluated to determine whether the scope changes have an effect on capital asset reporting. The procedures should promote communication within the Bureau and support a complete and accurate reporting of financial information for the Department's purposes as well as for Statewide financial reporting purposes.

Auditee Response:

We concur.

The Department understands the importance of identifying Construction in Progress projects for capital asset reporting, both at the inception of a project and throughout the life of a project when significant changes in scope may result in reclassification. The Bureau of Finance and Contracts has initiated program changes to identify when project scope changes may have an impact on capital asset reporting. These programming changes are being tested and will be finalized and documented prior to June 30, 2006.

Observation No. 11: Encumbrance Controls Should Be Used For All Project Expenditures

Observation:

The Department does not use encumbrance accounting for certain State Aid and Municipal Bridge Program projects. Therefore, the Department does not take advantage of the benefits and additional control provided by encumbering appropriations for these projects.

Currently, the Department uses encumbrances to control expenditure commitments for most project expenditures, though the Department does not use encumbrances for certain State Aid and Municipal Bridge Program projects. When the Department manages these specific projects, encumbrances are used. In projects managed by the municipality, encumbrances are not used.

Encumbering funds at the point in which a commitment is made is intended to ensure funds will be available when payment is due and reduces the risk for over-committing appropriations. Since the Department does not use encumbrances for municipality-managed State Aid and Municipal Bridge Program projects, the Department does not receive these appropriation control benefits provided by encumbering appropriations for project commitments.

Recommendation:

The Department should encumber commitments of State appropriations for all State Aid and Municipal Bridge Program projects.

While encumbering appropriations for these projects may cause the Department difficulties in the instances where municipal projects may not proceed as quickly as originally planned, the added control over appropriations provided by encumbrance accounting should outweigh those occasional difficulties. In addition, tracking unused encumbrances can provide an additional control over the progress or lack of progress of projects.

Auditee Response:

We concur.

The Department understands the importance of budgetary control through the encumbrance process. Effective July 1, 2006, the Department will start encumbering the contracts under the State Aid Highway Program and the Municipal Bridge Program.

Pursuant to the approval by the Governor and the Executive Council, State Aid funds contracts will be encumbered. Municipal Bridge funds will be encumbered when the Department issues the authorization for the municipality to proceed with construction.

Observation No. 12: Program Policies And Procedures Should Incorporate Financial Requirements

Observation:

The Department's current operating practices do not consistently incorporate the Department's financial requirements.

The Department operates its pavement-marking program on a calendar-year basis and typically requests federal participation/reimbursement for its eligible costs annually, after the end of the calendar year. At June 30, 2005, the Department recorded a $1.6 million account receivable reflective of its unbilled amounts due from its calendar year 2004 pavement-marking activities. Reportedly due to oversight, the Department had not submitted that amount for federal participation prior to June 30. Reportedly due to the Department considering the program a calendar-year program, the Department did not consider including an accrual at June 30, 2005 for the unreimbursed pavement-marking costs associated with the work performed during the period January 1 through June 30, 2005. It was not until the auditors questioned the lack of an accrual that a $578,000 revenue adjustment was prepared by the Department. The Department submitted the amount for federal participation in November 2005.

By not incorporating the Department's financial requirements to report revenues on a fiscal year basis into the Department's practices of reporting pavement-marking activities on a calendar-year basis, the Department has increased the likelihood that errors or omissions will occur in the Department's financial reporting.

Recommendation:

The Department should establish policies and procedures that are consistent with its operations as well as its financial reporting responsibilities. If there are valid reasons requiring the pavement-marking program to be reported on a calendar-year basis, the Department should document the appropriate policies and procedures that will also prompt the responsible employees to accumulate and report the financial activity on a fiscal year basis for financial reporting purposes. If reporting the pavement-marking activity on a calendar-year basis is not necessary, the Department should consider revising its reporting period.

The Department should review the reasons why the calendar year 2004 pavement-marking costs had not been submitted for federal participation more than ten months after the work had been performed. More timely submission of participating costs would provide better cash flow to the Department and lessen the likelihood of errors or omissions in the billed amounts.

Auditee Response:

We concur.

Billing to the Federal Highway Administration in connection with the Bureau of Traffic's pavement marking program has not been performed in a timely manner. In June 2006, the Department will transition this program into its billing system to be treated like any other project with funds drawn weekly based on expenditures and the related estimated federal participation. The Department will keep this program on the Dec 1 to Nov 30 basis in order to accurately account for painting activities and costs for the entire construction season. At the end of the period, a final voucher will be prepared to reconcile the "estimate to actual" billing. The new process will be explained in the Bureau of Finance and Contracts billing procedures documentation.

Observation No. 13: Controls Should Be Established Over Toll Collection Receipts Processed On New Automated Toll Collection System

Observation:

Turnpikes did not adequately plan and test its new toll collection system prior to the implementation of the system in March 2005 to ensure that reporting necessary to validate toll revenue collections would be available. Even after Turnpikes subsequently recognized developing problems in its new toll collection system, it did not establish alternative procedures to ensure the revenue collected during the period March through October 2005 was accurate.

Reported problems with Turnpikes' new toll collection system prevented Turnpikes from ensuring accurate tolls were collected and deposited into the Turnpikes' accounts during the period of March through October 2005. Reportedly, problems experienced since the implementation of the new toll system in March 2005, including unreliable traffic counts and revenue reporting, prevented Turnpikes from performing its normal toll revenue auditing procedures during this period.

A primary Turnpike revenue control under the prior toll collection system was the toll revenue audit function performed by Turnpikes' audit section. Utilizing reports generated from the toll collection system, the audit section compared toll revenue calculated by the automated toll collection system to deposited toll revenue and investigated discrepancies. Since the new toll system was implemented in March 2005 through the end of October 2005, Turnpikes was not able to perform the audits of the toll collections citing unreliable data from the toll collection system. Reportedly, Turnpikes was unable to verify the accuracy of the tolls collected and relied upon the accuracy of the contracted armored car service and bank to account for and deposit toll collections. Turnpikes did not count or otherwise have reliable knowledge of the cash collected at its tollbooths until the amounts appeared as deposits in the Turnpikes' bank account.

Reportedly, system software and programming problems, sensor issues with the axle counts, and continuing to process business charges and certain classes of recreational vehicles on the old system made the audit reports generated from the new system unreliable. Turnpikes was unable to design and perform alternative procedures to work around the limitations in the new system. The State's accounting system (NHIFS) reported that approximately $46.6 million of toll revenue was collected by the Turnpikes during the eight-month period March through October 2005.

A software upgrade was installed in July 2005, and Turnpikes worked with the new toll collection system vendor to resolve the system problems that rendered the audit reports unreliable. Turnpikes stated it considered the system corrected in November 2005 and began regular audits of toll collections.

Recommendation:

Turnpikes should continue to work with the vendor to correct any remaining problems in the new toll collection system, including requiring reliable reporting of toll collection activity necessary for an effective toll audit process.

Turnpikes should review the implementation of the new toll collection system to determine where the problems developed in the process and what controls should have been in place to provide a more timely recognition and response.

Auditee Response:

We concur in part.

With the implementation of the new toll collection system and the introduction of E-ZPass, the Turnpike System did encounter problems in processing traffic counts. We disagree with the comment that adequate planning and testing did not occur. The new toll collection system was designed utilizing the services of two consultants. The system received design approval, passed factory acceptance tests and went through two iterations of a field acceptance testing before approval was given to begin installation. However, the following problems were not anticipated and created implementation challenges:

- The newly installed treadles pads were found to be defective and required replacement. The treadles are the devices in the roadways that count the vehicles;
- The system implementation was designed to be a turnkey system, however actual implementation incurred using a phased approach. The plan did not call for consolidating

data from the old system with the new system and therefore the ability to perform a whole audit was compromised; and
- When conversion was complete in September 2005, further issues were detected in the audit, which required minor software updates to be deployed by the vendor.

While there were shortcomings in the auditing process during the installation of the new toll collection system and the implementation of E-ZPass, the magnitude of the changes virtually assured that unanticipated problems would crop up and management would have to continuously review options and issues, and balance the resources available to minimize risk to the entire operation. Management was aware of these specific problems, considered the risks, and took actions to fix them as soon as possible. While controls were compromised in terms of securing traffic counts, other offsetting methods were utilized to provide confidence that revenue was not being lost. The actual receipts in hand were in keeping with expected revenue.

The Department is in the process of hiring two consulting firms. The consulting services will include design and analysis of toll collection issues to facilitate ongoing revenue reporting and reconciliations requirements.

LBA Rejoinder:

The fact that Turnpikes was unable to respond timely to significant problems in the new system during the eight-month period March through October 2005 indicates limitations in the effectiveness of its planning.

As discussed in the Department's response, planning for a turnkey implementation when implementation occurs in a staged approach also may be indicative of inadequate planning. Design approvals and factory and field acceptance testing that failed to detect treadle, computer software, and other problems sufficiently debilitating to prevent the auditing of toll revenues during the four months prior to the E-ZPass implementation also raises question of adequacy and effectiveness of planning and testing.

Despite repeated inquiries during audit fieldwork, Turnpikes did not describe any alternative controls or processes it used to audit toll revenues during the period in question.

Observation No. 14: Toll Revenue Reconciliation Control Procedures Must Be Improved

Observation:

Turnpikes did not have an effective toll revenue reconciliation process in place during fiscal year 2005. Turnpikes represented that the reconciliations of the State accounting system (NHIFS) revenue accounts that were completed during the first eight months of the year were reliable and no reconciliations of any revenue reporting systems were prepared during the last four months of fiscal year 2005. Turnpikes recorded $66.6 million of toll receipts for the year ended June 30, 2005.

Monthly reconciliations of Turnpike's Income Register to NHIFS for the period July 2004 through February 2005 were not performed with sufficient care to allow reliance on the results of the reconciliations. As noted in Observation No. 13, because of reported problems in the toll collection system, there was also no revenue reconciliation process in place for tolls collected and deposited during the period of March through October 2005.

According to Turnpikes, there was a vacancy in the position normally responsible for performing the account reconciliation. The employee temporarily assigned to perform the reconciliations was not sufficiently trained and simply completed the reconciliation spreadsheets without fully understanding their responsibilities. Due to pressures caused by that and other vacant Turnpikes business office positions, the supervisor who would normally review the completed reconciliations did not. Without an effective reconciliation process in place during the fiscal year, there was no system in place to ensure that toll receipts were correctly posted to the appropriate NHIFS revenue accounts.

The failure of the revenue reconciliation control was a significant weakness in Turnpikes operations during fiscal year 2005. Without an effective revenue control activity, such as account reconciliation, and control effectiveness monitoring, such as an effective reconciliation review and approval process, Turnpikes faced a significant risk that errors, frauds, or other matters could occur and not be responded to in a timely manner. This risk is especially important in the Turnpike system operations, which rely upon toll revenues for funding current operations and also covering bonded debt subject to covenant requirements.

Recommendation:

Turnpikes must establish and maintain effective internal controls over toll revenue to ensure that the correct toll fare is collected, processed, deposited, and recorded. An effective toll revenue reconciliation process is central to an effective revenue control system. Reconciliations review and compare what should be similar information to ensure that expected relationships exist and unexpected relationships are timely investigated and appropriately resolved.

Department management should regularly remind Turnpikes and other Department functional areas of the need to maintain control processes such as reconciliations. Controls should not be allowed to deteriorate without management being made aware of the situation and understanding the increased risks faced because of the diminished state of control procedures. Where appropriate, mitigating procedures should be put in place when, for reasons outside the Department's power, controls are compromised.

Auditee Response:

We concur.

Due to the freeze on positions and the resultant lag in time in filling positions, the Department did not have the necessary staffing to accurately perform the desired reconciliations. In addition, the senior management staff had to dedicate significant amounts of their time and attention to ensuring the successful implementation of the new E-ZPass system.

The Department has initiated monthly meetings involving staff from the Bureau of Finance and Contracts, Operations, and the Bureau of Turnpikes to review the financial performance of the system and to further discuss operational challenges. The Department is also preparing organizational changes in the Bureau of Finance and Contracts in order to better serve the needs to monitor and assist with controls of toll revenue collections.

Observation No. 15: Internal Controls Over Federal Participation In Turnpike Construction Projects Should Be Improved

Observation:

The number and extent of problems noted in a fiscal year 2005 federally assisted Turnpike construction project indicate that there was not an effective system of internal controls in place at the Department to ensure that the contract was accounted for correctly and that costs were accurately charged to organizations participating in funding the construction.

The Department entered into a $10 million construction contract as part of the larger Granite Street Project for the relocation of Allard Drive in Manchester. The Allard Drive Project was to be funded 80% by the U.S. Department of Transportation (USDOT) and 20% by the Turnpikes Fund. Certain documentation related to this project was reviewed as example documentation during the planning phase of the audit.

Review of the project documentation and subsequent discussion with Department personnel disclosed:

- The Department charged 100% of the project costs ($2,876,000) incurred during fiscal year 2005 to the Turnpike Fund and also billed 80% of the costs to the federal program. Upon auditor discussions with the Department, it was determined that the original allocation was in error and the Turnpike Fund should only have been charged 20% of the costs ($575,000).

- In establishing an accounts payable at June 30, 2005, the Department continued in its allocation error and also did not recognize that a $1.18 million accounts payable was posted once by the Department and once by the Department of Administrative Services, resulting in an erroneous double posting.

During the audit period, it appears that the Granite Street Project was not monitored to ensure it was correctly recorded in NHIFS and the current bill system. Reportedly, when the project was set up in the Department's current bill system, errors were made in establishing project numbers.

Recommendation:

If the Department is going to continue to fund Turnpike construction projects with federal participation, the Department must implement controls including polices and procedures to properly account for federal participation in those Turnpike construction projects. Appropriate training must be presented to employees responsible for the accounting for federal assistance programs to ensure that projects are correctly recorded in the current bill system and the State's accounting system.

Once a control system is established, it must be monitored to ensure it continues to work effectively.

In addition, there should be coordination of accounting efforts within the Department for the Highway Fund and the Turnpike Fund as well as coordination with the Department of Administrative Services. Errors such as the double posting of an interfund payable should be detected and corrected when a corresponding entry is not found in the related fund.

Auditee Response:

We concur.

Procedures to ensure the proper transfers of funds between the various funding sources on Turnpike construction projects will be completed by July 1, 2006. Knowing that the Department's Current Billing System does not track multiple funding sources effectively, requires compensating controls to be implemented and analytic reviews of the balances to ensure transactions are being processed correctly. In addition to documenting these processes, the Bureau of Finance and Contracts is in the process of filling a vacant Accountant I position. The Accountant I will be able to assume some of these duties and allow the Accountant IV to focus on the higher level accounting tasks associated with preparing accurate and reliable financial statements.

Observation No. 16: Reconciliation Controls Should Be Utilized

Observation:

Lack of effective financial reporting controls, including reasonable reconciliation policies and procedures, made Turnpike's tracking of the cash position in its Construction Account problematic during fiscal year 2005 to the point of Turnpikes attempting to transfer approximately $770,000 more than it had in its Construction Account.

The Department has not established adequate controls and policies and procedures to ensure the bond proceeds deposited into the Construction Account are used to fund authorized projects, and the correct amounts are being transferred from the construction account. The lack of established procedures makes it difficult for Turnpikes to monitor its cash position.

Pursuant to a fiscal year 1999 Turnpike bond issue, $82 million of bond proceeds were deposited into a Construction Account to be used to pay construction costs for the respective bonded projects. The Construction Account was accounted for in a State accounting system (NHIFS) cash account. In December of 2004, Turnpikes attempted to transfer $1.88 million, the reported NHIFS balance in the account, out of the Construction Account to reimburse the Operating Cash Account for related construction activities. The transfer did not occur as intended when it was determined that only $1.11 million remained in the Construction Account. Turnpikes was not able to document why the reported NHIFS balance was not correct or how it was determined that the adjusted balance of $1.11 million was correct.

While accounting for the Turnpike Construction Account became a moot point when the account was exhausted in December 2004, future bond issues may anticipate similar account structures.

Recommendation:

Turnpikes must establish appropriate controls for its cash and other accounts. Reconciliations should review and compare reported balances and activities to expected values and provide for complete and timely resolution of detected differences and unexpected values. Adjustments made to accounts or transactions resulting from account differences should be reviewed and approved at an appropriate level of management and sufficiently documented to establish the need and accuracy of all adjustments made to transactions and balances.

Auditee Response:

We concur.

Procedures are being developed to document all of the Turnpike Cash Transfer requirements. Reconciliations will be conducted to prove the transactions are recorded properly and the impact on the balance sheet accounts is as planned. These procedures will be in place by June 30, 2006.

Observation No. 17: Accounting For Equipment Purchased With CMAQ Funding Must Be Improved

Observation:

Electronic toll equipment purchased with federal participation was not accurately recorded and reported by Turnpikes in fiscal years 2004 and 2005.

During fiscal year 2004, Turnpikes began the purchase and installation of a new electronic toll collection system. The $13.5 million project cost was funded with a federal Congestion Mitigation and Air Quality (CMAQ) grant, which paid 80% of the project cost, with the remaining 20% paid by the Turnpike Fund. Turnpikes began using a portion of the new electronic toll system equipment in March 2005 with the remaining E-ZPass component coming on-line early in fiscal year 2006. A review of the Turnpikes accounting for the new toll equipment revealed the following.

Turnpikes erroneously reported fiscal year 2004 depreciation expense on a portion of the new toll system equipment. Because depreciation should not be recorded until equipment is placed into operation, no depreciation should have been taken on the new toll equipment purchased during fiscal year 2004 and not utilized until fiscal year 2005. In addition, Turnpikes only calculated depreciation on the Turnpikes funded portion of the equipment.

Turnpikes erroneously calculated depreciation expense on the equipment during fiscal year 2005. In addition to the carry-forward effect of the fiscal year 2004 error, Turnpikes, again, erroneously took depreciation expense **only** on the Turnpike share of the cost of the equipment during fiscal year 2005. Depreciation expense should have been calculated on the total cost of the equipment, regardless of the funding source.

It was apparent from the problems experienced by Turnpikes in depreciating toll system equipment during fiscal years 2004 and 2005 that there were not effective controls over calculating and reporting certain Turnpike financial activity. While Turnpikes has policies and procedures to account for and report equipment and depreciation on equipment, the fact that problems were experienced in both 2004 and 2005 without detection and correction by either Turnpikes or the Department indicates a failure in the control system over that accounting.

Recommendation:

Turnpikes must improve controls over its accounting for equipment. Turnpikes must make certain that employees are appropriately trained to implement existing policies and procedures and that policies and procedures are comprehensive and cover changing operations such as equipment purchased with non-Turnpike funds.

The Department should take responsibility for reviewing significant Turnpike financial accounting and reporting efforts to ensure that Turnpikes is accurately reporting its financial operations.

Auditee Response:

We concur.

Fixed Assets partially acquired with Federal Funds led to confusion and incorrect recording of Depreciation Expense. Additional closing instructions regarding the recording of fixed asset related transactions will be documented and will be reviewed with staff. Further controls will be implemented to document these entries more thoroughly, which will require supervisory review and approval.

Observation No. 18: Controls Over Verifying Time Worked Should Be Clarified

Observation:

Department policy requires most employees to complete timesheets to positively account for hours worked. Department policy also requires employees and their immediate supervisors to sign the timesheets to attest to their accuracy.

Recent changes in time accounting practices, including filing electronic timesheets, raise questions as to employee and supervisor accountability for work-time reporting. Data on electronic timesheets is not easily verifiable as to the source of the postings. Current technology limitations at the Department do not easily provide for electronic signatures or other accountability measures.

It is not clear that the Department has resolved the inherent conflict between the Department's policy requiring accountability for time-worked and limitations in the Department's electronic timesheet process.

Recommendation:

As part of its continued automation efforts, the Department should review the risks faced from losing accountability over employee work-time accounting. The Department should consider whether additional reporting or other procedures might be appropriate to mitigate any increase in risk caused by electronic reporting and record keeping. Upon the completion of this review, the Department should revise, as appropriate, its policies to ensure the policies remain relevant, and employees are able to adhere to the policies.

Auditee Response:

We concur.

The Department will conduct an assessment of its procedures regarding employee time accounting. This assessment will be completed prior to June 30, 2006. The assessment will be reviewed with our technical staff to determine if electronic controls can be instituted in order to maintain accountability over payroll expenditures, or whether other procedures need to be implemented.

Observation No. 19: Computer Access Controls Should Be Reviewed

Observation:

The Department does not have adequate policies and procedures in place to periodically review computer access controls, including continued employee access requirements.

A review of Department employee access to the State's accounting system (NHIFS) revealed that two former employees continued to have user access to the system even though they no longer worked for the Department. One of the employees apparently terminated prior to fiscal year 2003, yet remained a valid user of NHIFS.

Recommendation:

The Department should review its current computer access controls to determine how the access rights for the two above-mentioned former employees were not terminated when they left Department employment.

The Department should make sure its computer access policies and procedures are adequate to ensure computer access rights are limited to employees' current job requirements. Employee computer access rights should be periodically reviewed to ensure the rights remain current and reflect changes in employment status and job responsibilities that may have occurred.

Auditee Response:

We concur.

The Department understands the importance of reviewing current job responsibilities so that computer access rights are appropriate.

Currently all IFS/GHRS [State accounting and payroll systems] computer access rights are requested through the Bureau of Finance and Contracts. During the summer of 2005, the Bureau did require new account forms for all employees and brought all accounts up to date. Finance has started reviewing all accounts quarterly to ensure accuracy. The Department of Administrative Services does have various controls in place including requiring employees to change their passwords every three months.

All other computer access rights are assigned through the Department's Office of Information Technology (OIT) staff. The Department will work with OIT to ensure that adequate notification regarding changes to employee status and responsibility changes affecting their computer access rights are properly communicated.

Observation No. 20: Payments For ROW Activities Should Be Drawn As Needed And Not Drawn Prior To Planned Disbursement

Observation:

The Department appears to regularly draw Right-of-Way Bureau (ROW) payments to property owners in advance of the need for said payments.

ROW held payments for 20 of the 30 ROW disbursements selected for audit testing for an average of 17 business days prior to disbursing the payments to property owners or to other payees. Amounts ranged from $1,050 to $1,886,272. Some of these tested payments had remained on hand at ROW for over 50 business days.

Drawing and then holding payments prior to their disbursement increases the risk of errors, frauds, and other matters affecting the payments and also increases the risk that federal participation in the payments will be drawn too early, raising federal cash management concerns. Because the Department draws federal funds based on average check clearance patterns, the Department drew down the federal participation in these ROW payments prior to the actual disbursement of the State funds, contrary to federal program cash management guidelines.

Recommendation:

ROW should draw payments to be available as close as practicable to the planned disbursement of the payment. Checks should not regularly be held on-hand at ROW.

Auditee Response:

We concur.

A new payment process is being developed and is being coordinated with the Department of Administrative Services to allow for the check to be efficiently generated within a few days of closing. In summary, the Payment Voucher will be processed and audited by the Department of Administrative Services in advance of payment as it is currently being done. However, the Department will withhold the final approval on the document. Within a week of the planned closing, the Bureau of Right of Way will inform the Bureau of Finance and Contracts and the final approval will be applied in the Integrated Financial System (IFS). The check will be cut and be ready for delivery to the Department on the next business day. Procedures are still being drafted to fully document this new process, to define the responsibilities, and to further address any system related issues.

Observation No. 21: Procedures for Processing Employee Terminations Should Be Properly Segregated

Observation:

Department procedures for processing employee terminations in the State's payroll system (GHRS) are not properly segregated.

An employee's supervisor prepares and submits a *Form K* to the Department's human resources office to initiate an employee termination. One Department employee is responsible for preparing, approving, and entering *Personal Action Form* (PAF) data related to employee termination into GHRS. No other Department employee reviews or approves any of the documents or data entry used to effect the termination. No Department employee is notified when the termination process is complete. Apparently, it is the Department's normal process to assume the employee's termination is properly and timely reflected in GHRS and that final pay is proper.

While the State's Division of Personnel (DOP) approves all PAF and resulting GHRS data changes affecting all State employees' employment status, that approval process is far removed from the actual process occurring at the Department. The DOP review and approval only confirms that GHRS changes appear reasonable and are backed by signed PAFs. The DOP approval function does not offer the level of control over employee terminations that an effective Department review and approval could provide, if a Department employee, familiar with Department activities yet independent of the termination process, approved the Department's termination processing.

Proper segregation of duties controls lessen the risk that fraud, errors, or other matters could occur and remain undetected. Certain incompatible payroll functions should be properly segregated, including procedures for terminating employees in GHRS. One employee should not be responsible for preparing the PAFs that authorize the termination of the employee in GHRS, approving the PAFs (no other employee reviews the documents), keying the changes in GHRS, and approving and sending the changes to the DOP. An employee, if responsible for all of these functions, could possibly commit and conceal fraud, errors, or other inappropriate matters.

Recommendation:

The Department should segregate the responsibilities of preparing and approving the processing of employee terminations. Department procedures for processing the termination of employees in GHRS should include a Department review and approval of the PAF and resulting changes in GHRS and a process to monitor that the final pay for a terminated employee is appropriate.

Auditee Response:

We concur.

The Department recognizes the need to have proper segregation of duties relative to incompatible payroll functions including the processing for termination of employees. The Department is reviewing the organizational structure of the Bureau of Finance and Contracts in order to build clearer lines of authority and responsibilities and to provide for appropriate backup support for the various work functions. These changes will allow the payroll functions to be segregated to have a second employee review and approve termination payments and other large payroll transactions.

Observation No. 22: Controls Should Be Established Over Road Toll Revenues Posted To The Department's Accounting Records By The Department of Safety

Observation:

The Department does not have control procedures in place to ensure the accuracy and completeness of the road toll revenues (motor fuel tax) collected on its behalf and posted to the Department's highway bridge and betterment account by the Department of Safety (DOS). Instead, the Department relies upon the internal controls in place at the DOS.

Motor fuel distributors collect the road toll from purchasers and remit the amounts collected to the DOS. The DOS then posts a portion of the receipts to the Department's highway and bridge betterment revenue source account in the State's accounting system (NHIFS) on a monthly basis. During fiscal year 2005, the DOS posted $22.6 million of road toll revenue to this revenue source account.

The Department does not have policies and procedures in place to monitor the accuracy and completeness of the amounts posted to its revenue accounts by the DOS. The Department does not receive any documentation supporting the amounts reported as collected, does not perform any review or analytical procedures to gain any assurance on the reasonableness of the revenue amounts, and has not reviewed the controls in place at the DOS to more fully understand how its revenue is processed and the risk the Department faces in that process.

Recommendation:

The Department's Bureau of Finance and Contracts should establish and implement internal controls over revenue collected on its behalf by the DOS. At a minimum, the Department should establish adequate review procedures so that it has reasonable assurance that revenues posted by the DOS to Department accounts are accurate and complete.

The Department should work with the DOS to institute reasonable procedures that will allow the Department to become more knowledgeable about its revenue process and participate in the controls over that revenue collection. This cooperation with the DOS and the Department's understanding of the DOS' procedures in collecting road toll revenues became even more critical effective July 1, 2005 when the DOS began netting the cost of its collection of this revenue prior to posting the net to the Department's revenue accounts.

Auditee Response:

We do not concur.

The Department does not feel that it has authority to establish and implement controls over the collection of road toll and other motor vehicle fees by the Department of Safety. The Department does receive monthly revenue reports from the Road Toll Division of Safety. The report shows gasoline usage and the related tax collected. Further, the monthly file contains a six-year history and provides for the allocation of revenue by various sources. These reports have been used more for revenue performance purposes rather than for audit control purposes.

The Department will meet with Safety officials to communicate the concern expressed and to gain a further understanding of the revenue collection and distribution process by Department of Safety. The Department will look to expand the documentation included with the monthly reporting in an effort to provide a more complete record of amounts deposited into the Department's revenue accounts.

Observation No. 23: Comprehensive Policies And Procedures Manual Should Be Established For ROW Bureau

Observation:

The policies and procedures manual used by the Right Of Way (ROW) Bureau is not sufficiently comprehensive to clearly outline the specific authority and responsibility of individual employees. As discussed in Observations Nos. 20, 29, and 30, it appears ROW would have benefited had employees responsible for reviewing and approving business reestablishment, contemplated awards, and relocation housing payments had clear direction of the program's goals and objectives and related policies and procedures to reach those goals and objectives. Well-designed policies and procedures include provisions to enable management to establish initial, and monitor ongoing, compliance with program conditions. When effectively implemented, such policies and procedures increase the likelihood that employees will be able to perform their responsibilities in a consistent and controlled manner and that operations will not become overly reliant upon a few experienced individuals.

Recommendation:

A comprehensive and well-designed policies and procedures manual should be established for ROW. The manual should be regularly reviewed and kept current so that it remains relevant and useful to employees in the course of performing their assigned duties. While it is recognized that establishing and maintaining a current and comprehensive policies and procedures manual is a time-consuming task, the manual should be regarded as a critical component in the ROW's control structure as well as a potential source of increased efficiency in the long-term as employees become accustomed to performing their duties according to management's plans and objectives.

Auditee Response:

We do not concur.

The ROW Bureau recently developed a comprehensive Right-of-Way Manual and adopted the manual with approval of the Federal Highway Administration on June 21^{st} of 2005. This manual describes the ROW process and refers to the Uniform Relocation Act (CFR 49 Part 24) for further definition as needed. The manual is intended to be a living document and be revised as warranted to better define ROW procedures.

LBA Rejoinder:

Our comment on the ROW manual concerns the level of detail direction provided in the manual. To be most effective, a manual should be tailored to the needs of its anticipated users and provide sufficient, clear guidance for the users to gain understanding and assistance in operations and to provide control over covered activities. A manual that is not sufficiently descriptive, for example a manual that references complex federal regulations requiring regular interpretation of policies and procedures, can increase the risk of inconsistent and incorrect application of program guidelines.

Observation No. 24: Formal Fraud Prevention, Deterrence, And Detection Program Should Be Established

Observation:

The Department has not established a formal fraud prevention, deterrence, and detection program.

Fraud encompasses an array of irregularities and illegal acts characterized by intentional deception. Persons outside or inside the organization can perpetrate it for the benefit or to the detriment of the organization. Fraud runs the spectrum from minor employee theft and unproductive behavior to misappropriation of assets, fraudulent financial reporting, and intentional noncompliance with a law or rule leading to an undue benefit.

Management is responsible for assessing the risk of fraud and implementing measures to reduce the risks of fraud to an organization. Fraud assessment, prevention, deterrence, and detection are crucial to the controlled operations of an organization.

- Assessment is critical since risks can only be effectively managed if identified. The risk of fraud can be reduced through a combination of prevention, deterrence, and detection measures.

- Prevention reduces opportunities. Preventative methods are typically part of the organization's internal control – tone at the top and control procedures. Management of an organization "sets the tone" for the whole organization by signaling that fraud will not be tolerated and establishing control procedures including, but not limited to, adequate segregation of duties and formal accounting policies and procedures intended to limit the opportunity for fraud.

- Deterrence consists of those actions taken to discourage the perpetration of fraud and limit the exposure if fraud does occur. The principal mechanism for deterring fraud is the establishment of effective controls that persuade employees that frauds will be detected and perpetrators punished. Management has the primary responsibility for establishing and maintaining these controls, which may include written codes of conduct that apply to all employees, periodic employee trainings, monitoring of employee compliance, and an effective fraud reporting mechanism.

- Detection consists of identifying indicators of fraud sufficient to warrant recommending an investigation. These indicators may arise as a result of controls established by management, tests conducted by internal auditors, and other sources both within and outside the entity. Detection can be difficult because fraud often involves concealment through falsification of documents or collusion among management, employees, or third parties. If fraud is detected, the organization should contact legal counsel. Legal counsel has the expertise to advise as to the extent of any necessary investigation.

Generally, prevention and deterrence measures are less costly in time and expense than fraud detection and investigation efforts.

Recommendation:

The Department should perform a fraud risk assessment and develop and implement a formal fraud prevention, deterrence, and detection program to help limit the Department's exposure to fraud and promote early detection of fraud that may occur. The Department should take measures to foster a high degree of control consciousness among its employees and ensure that its employees understand that adhering to controls is a primary concern of management. Fraud risk assessment and the establishment of a prevention, deterrence, and detection program are critical activities for the State, especially in an organization with as many varied operations as the Department.

Auditee Response:

We concur.

We understand that the Department of Administrative Service is working with the Office of the Attorney General to establish a fraud prevention, deterrence and detection program. Once these guidelines are established, the Department of Transportation will tailor them to address its specific areas of concern. Also as part of our risk assessment program, the Department will identify the potential for fraud and consider steps that can be taken to minimize this risk.

Observation No. 25: Formal Risk Assessment Policies And Procedures Should Be Established

Observation:

The Department does not have formal risk assessment policies and procedures in place for recognizing and responding to risks potentially affecting its operations.

Management's assessment of and response to risks facing the organization is an integral component of internal control. The purpose of an entity's risk assessment efforts is to identify, analyze, and, where appropriate, respond to risks and thereby manage risks that could affect the entity's ability to reach its objectives. Effective risk assessment practices should be a core element of management's planning activities and should be an ongoing activity.

The Department does not have formal policies and procedures in place for periodically reviewing its operations for risks that could jeopardize its ability to continue to function as management intends. Currently, when risks are identified, the Department may respond with a change in procedure or other action; however, there are no formal policies and procedures to continuously review operations for risks. A lack of understanding of risks generally pushes an entity toward a reactive mode when significant risks are realized or occur. A reactive mode may compromise the efficiency and effectiveness of a response due to the lack of prior identification and understanding of the risks and ramifications.

An entity faces many risks. Risk can be defined as the threat that an event or action will adversely affect an entity's ability to achieve its objectives. Risk can be classified in many ways. For example:

External risks - threats from broad factors external to the entity including changes in the political arena, statutes and rules, competition from other sources, and illegal activity external to but affecting the organization.

Operational risks - threats from ineffective or inefficient processes for acquiring and providing goods and services as well as loss of physical, financial, or information assets.
Information risks - threats from the use of poor quality information for operational, financial, or strategic decision-making within the entity and providing misleading information to others.

A continuous review of Department processes and activities using a risk-based mindset would promote effective planning and assist in resource allocation decision-making. Risks identified should be analyzed to determine whether current internal controls mitigate risk to a level desired by management or whether other actions are required in response to the risk.

Recommendation:

The Department should formalize its risk assessment process. A formal risk assessment process is a necessary tool the Department needs to assist in the effective management of risks. Identifying risks significant to Department operations and strategies to mitigate those risks should enhance the effectiveness of the Department's planning and resource allocation processes and its control processes.

Auditee Response:

We concur in part.

The Department does have extensive risk assessment programs and has taken affirmative steps to mitigate the risks associated with its operations. These programs include preserving the State's highways and bridges, maintaining safe transportation systems for the traveling public, designing and building new transportation systems to ensure safe and efficient travel in the future, and providing a safe work environment for Department employees. Safety is incorporated into the employees' everyday life at the Department. Safety policies and programs are documented and are constantly upgraded and employees are required to attend training based on a predefined schedule.

The Department can improve in assessing and documenting risk associated with the various business functions. A potential risk for the State will be the implementation of the new Enterprise Resource Planning (ERP) System. The Department is currently identifying internal resources to dedicate to this initiative. With guidance from the Department of Administrative Services, the Department of Transportation will over the next year adopt a formal risk assessment program over the various business functions as part of its on-going strategic planning initiative.

Observation No. 26: Fees Should Be Based In Statute Or Rule

Observation:

There is no apparent statutory or administrative rule authority for a $35 fee the Department charges to entities requesting copies of bid specifications. While the Department intends the fee to recover the cost of preparing related documents, there is no cost analysis or other support to establish a relationship between the fee charged and the Department's costs.

The Department charges prospective bidders a $35 nonrefundable deposit for copies of project-related documents. The $35 flat-rate fee is reportedly intended to recover the Department's costs for preparing and printing the project plans and specifications necessary for vendors to understand the scope of the project to be bid. According to the Department, there is no statutory or administrative rule authority to allow the Department to charge this fee other than RSA 91-A:4, IV, which provides for public inspection and copying of public records and allows "If a photocopying machine or other device maintained for use by a body or agency is used by the body or agency to copy the public record or document requested, the person requesting the copy may be charged *the actual cost of providing the copy*…." [Emphasis added.]

RSA 91-A:4, IV appears to apply to the public's request for public documents and not the Department's regular production and sale of bid-related documents. The fee charged by the Department is the same regardless of the number of pages or complexity of the bid documents and has remained at $35 per copy for a number of years. During fiscal year 2005, the Department collected less than $2,500 of these fees.

Recommendation:

The Department should review its current practice of charging a fee for bid-related documents. If, in the Department's view, it remains appropriate to continue to collect a fee, the Department should request a statutory or administrative rule change to authorize the Department's collection of a standard fee or charge the actual cost of providing the copy as required by RSA 91-A:4, IV.

If the fee is continued, the Department will need to periodically review its related costs to ensure the fee adequately covers the costs associated with printing project plans and specifications for prospective bidders.

Auditee Response:

We do not concur.

The Department has the authority to charge a reasonable fee for copying under RSA 91-A:4 and therefore further authorization is not necessary. The actual costs to produce a bid specification package can vary depending on the size of the paper and the number of pages per package. The $35 charge per bid package appears to be an acceptable overall average by the contracting community. The Department will revisit the basis for this fee and determine if an adjustment is appropriate.

State Compliance

Observation No. 27: Compliance With State And Department Meal Reimbursement Policies Should Be Improved

Observation:

The Department allows employees who attend after-hours business functions to have a dinner meal reimbursed, regardless of whether the meal is associated with the after-hours business function or whether the meal reimbursement received prior authorization by a Department supervisor.

Per the State's Collective Bargaining Agreement (CBA), an employer may authorize meal reimbursement for an employee who is required or who requests to attend an official function, banquet, dinner, or meeting associated with a meal, provided that authorization is given in advance and in writing.

Per the Department's internal policy for in-state meal reimbursements, whenever an employee is required to attend an official evening function, banquet, dinner, or other meeting, the cost of the meal shall be paid by the Department. The policy requires advance approval by a supervisor.

Two in-state meal reimbursements were included in the sample of expenditure audit tests. In both instances, an evening meal was reimbursed even though the meal was not associated with a meeting/function nor had the employees requested or received prior authorization. Total costs tested were $64 representing meals for four individuals.

Because these costs were included in federal reimbursement requests, we question $52. ($64 * 81% average federal participation rate related to these costs.)

Recommendation:

The Department should adhere to the CBA and its own meal reimbursement policies and only reimburse in-state meals when associated with a meeting/function and when the reimbursements have been previously approved.

Auditee Response:

We concur.

Both the Internal DOT Policy and the Collective Bargaining Agreement require that the reimbursements for meals at after hour functions require prior approval by the supervisor and in these cases written approval was not secured in advance. We have reviewed the documentation in support of these costs and the costs incurred were appropriate and justifiable.

The Department has issued a directive to all Bureaus to clarify the policy on meal reimbursements. Finance staff personnel responsible for auditing and approving meal reimbursements will also receive further instruction regarding this policy.

Observation No. 28: Compliance With Administrative Rules Requirements Should Be Improved

Observation:

The Department does not have an effective control structure to ensure compliance with State statutes requiring administrative rules. Lack of attention to administrative rules has resulted in the following.

The Department is not in compliance with twenty-seven specific statutory requirements that call for the adoption of administrative rules. In sixteen cases of noncompliance, the required rules do not currently exist. In nine cases, the required rules have expired and, in two cases, rules have not been amended to reflect changes made to statute subsequent to the adoption of the rules.

The failure to have current administrative rules required by statute can prevent the Department from fulfilling its statutory responsibilities.

Recommendation:

The Department should establish an effective control structure to ensure that the Department is in compliance with statutory requirements for administrative rules.

The Department should draft for adoption all administrative rules required by statute.

The Department should establish controls to ensure that existing rules are regularly reviewed for continued applicability. Rules nearing expiration should be renewed on a timely basis. Changes in statutes affecting rules should be reflected in the administrative rules in a timely manner. If, upon review of rules and statutory requirements, certain rules appear no longer relevant, the Department should pursue changes in the law to remove the requirement for those unnecessary rules.

Auditee Response:

We concur.

In the cases where the required rules do not currently exist, have expired, or have not been amended to reflect changes made to statute subsequent to the adoption of the rules, the Department has hired a new contract employee to draft rules and assist throughout the rulemaking process.

Priorities for rulemaking include the following:

- Tra 100, Organizational rules. Although these rules are not expired, reorganization to the Bureau of Public Works requires that we update them. These rules will be drafted within the next six months and will be submitted for the regular rulemaking process at that time.
- Tra 501 and Tra 502 (21-L:12, VI and VII relative to State Bridge Aid and State Highway Aid Programs.) These rules will be drafted within the next six months and will be submitted for the regular rulemaking process at that time.

The following list refers to rules identified during the field audit and summarizes the Department's efforts towards resolution:

- Findings relative to Relocation Assistance, Tra 503 have been drafted and will be submitted for the regular rulemaking process within the next six months.
- Findings relative to the New Hampshire Aeronautics Act, and rules shall be drafted and introduced into the rulemaking process within the next 6 months to 1 year.
- Findings relative to the Sponsor-A-Highway Program (RSA 230:83) and rules shall be drafted and introduced into the rulemaking process within the next 6 months to 1 year.
- Findings relative to Reasonable Access for Twin Trailers (RSA 265:108 and Tra 303) shall be drafted and introduced into the rulemaking process within the next 6 months to 1 year. The finding relative to disassembly or assembly of double trailers will be part of the same rulemaking effort.

Federal Compliance

Observation No. 29: ROW Payments Should Be Based On Actual Costs And Not Estimates

Observation:

The Department has not implemented policies and procedures to ensure that the Right-of-Way Bureau (ROW) is making payments in accordance with federal and State statutes, which limit payments to actual, incurred re-establishment costs.

Two out of a sample of 30 ROW expenditures selected for audit testing related to business re-establishment assistance. As noted in this observation and in Observation No. 30, there were errors noted in both test items. This observation notes the Department paid $56,525 of business re-establishment expenses based on an estimate and not on actual re-establishment costs.

The Department paid $56,525, the lower of two estimates, to assist in relocating a business displaced by Department land acquisition. ROW did not obtain the actual cost of the re-establishment expenses after the related work was complete to ensure that the Department paid the appropriate, actual amount. Federal CFR 49 Part 24.304 and State RSA 124-A:3, I(d), provide payments are to be based on actually incurred expenses.

Because these costs were included in federal reimbursement requests, we question $50,873. ($56,525 * 90% federal participation rate related to these costs.)

Recommendation:

The Department should implement policies and procedures for ROW that include controls to promote compliance with federal and State statutes, including basing payments on actual costs and, not estimated costs. The policies and procedures should incorporate aspects of the five components of controls including control environment, risk assessment, control activities, information and communication, and monitoring. ROW policies and procedures should stress the importance of compliance with program requirements and provide employees with responsibilities and procedures reasonably certain of promoting compliance.

Auditee Response:

We concur.

As of March 9, 2006, all ROW Agent staff has been notified that business reestablishment payments will only be approved if they are based on "actual incurred expenses". Requests for checks for reimbursement of re-establishment expenses will require a paid invoice be attached to the request for backup documentation before such a request will be approved. The Department Right-of-Way Manual will be revised to include this procedure.

Observation No. 30: ROW Payments Should Be Based On Actual Allowed Costs

Observation:

The Department has not implemented policies and procedures to ensure that the Right-of-Way Bureau (ROW) is making payments in accordance with federal and State statutes.

ROW authorized $21,352 for business re-establishment payment for new equipment even though new equipment is not an authorized expenditure under federal statute. ROW could not provide an explanation as to why it authorized the purchase of new equipment. ROW stated the program should have assisted in moving the equipment from the acquired property instead of purchasing new equipment.

For this same business re-establishment, ROW authorized the construction of a $32,081 drive-thru facility. New construction is not an allowed expenditure under the federal statute. While ROW contends the drive-thru could be classified as an allowed building modification, it is not clear that a drive-thru meets the statute's definition of a modification as "…the addition of necessary facilities such as bathrooms, room partitions, built-in display cases and similar items…."

The amounts noted above were only partially reimbursed by ROW, as the total requested for reimbursement exceeded statutory limits. In accordance with RSA 124-A:3, I, there is a $100,000 maximum reimbursement for business re-establishment expenses. Total costs submitted by the displaced business exceeded the $100,000 maximum and the business received the $100,000 maximum payment amount. Of the $100,000 reimbursed, only $58,948 appeared eligible for reimbursement. The remainder of the claimed costs did not appear to comply with program criteria. Because these costs were included in federal reimbursement requests, we question $32,842. ($41,052 * 80% federal participation rate related to these costs.)

In one instance of a relocation housing payment, ROW used the asking price of a home in its calculation of its payment instead of the actual selling price of the home. This error in the calculation resulted in a $900 overpayment. Because these costs were included in federal reimbursement requests, we question $720. ($900 * 80% federal participation rate related to these costs.)

Recommendation:

As recommended in Observation No. 29, the Department should implement policies and procedures for ROW that include controls to promote compliance with federal and State statutes, including basing payments on actual allowed costs and not estimated costs. The policies and procedures should incorporate aspects of the five components of controls including control environment, risk assessment, control activities, information and communication, and monitoring. ROW policies and procedures should exhibit the importance of compliance with program requirements and provide employees with responsibilities and procedures reasonably certain of promoting compliance.

Auditee Response:

We do not concur with the two issues listed below that relate to the authorization of business reestablishment payments.

As a result of the displacement created by the State's highway project, the owners relocated and moved into an existing vacant restaurant, which was in inferior overall condition. The building suffered from deferred maintenance and would not pass fire and health code inspections without substantial improvements.

In order to make the site functional and viable as a replacement business location, modifications were required to the existing site. It was determined that booths and benches would need reupholstering to meet Board of Health Code. These expenses are the subject of the $21,352 observation. In addition the owners felt a drive-thru window would be required to make the business viable at this new location. This is the subject of the $32,842 observation.

CFR 24.304.(a) defines Eligible expenses as "Expenses that are reasonable and necessary, as determined by the Agency."

CFR 24.304(a)(1) allows "Repairs or improvements to the replacement real property as required by Federal, State or Local law, code or ordinance."

CFR 24.304(a)(2) allows "Modifications to the replacement property to accommodate the business operation or make replacement structures suitable for conducting the business."

Although these regulations do not specifically list "booths and benches" or "drive-thru windows" it is the intent of the Uniform Relocation Act (CFR 49 Part 24) to incorporate these types of modifications to a replacement site to allow a displaced business to be successful at the new location and minimize undue hardship.

Based on the above regulations, many years of experience working with the Uniform Relocation Act, and multiple training courses that focus on business relocation eligibility, the "Agency" (DOT ROW Bureau) made the determination that the above re-establishment expenses were eligible for reimbursement. We contend that this determination is consistent with the spirit and intent of the Uniform Relocation Act.

We do concur, with the $900 overpayment.

This issue relates to a relocation housing payment (RHP). It appears that when the Agent calculated the RHP they assumed the asking price for the replacement home was the actual selling price of the new home, ($299,900 asking price vs. $299,000 selling price). This error appears to have created a $900.00 over payment.

This issue has been reviewed with the Agent who processed this claim to insure that similar errors are prevented in the future. In addition the approval process for RHP awards has been revised to include a review of this calculation by the Chief Agent and ROW Engineer prior to submission of the RHP. These steps will be put in effect immediately.

LBA Rejoinder:

We continue in our position that the expenditures for equipment and for the addition of a drive-thru are questioned costs for this program. We have reviewed these expenditures with the Federal Highway Administration whose preliminary response indicates concurrence with our position.

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APPENDIX

Current Status Of Prior Audit Findings

The following is a summary of the status, as of March 16, 2006, of the observations contained in the audit report of the Department of Transportation (Excluding the Bureau of Turnpikes) for the fiscal year ended June 30, 1994. A copy of the prior audit report can be obtained from the Office of Legislative Budget Assistant, Audit Division, 107 North Main Street, State House, Room 102, Concord, NH 03301-4906.

			Status
Internal Control Comments			
Material Weakness			
*	1.	Documentation Of DOT Land And Buildings	● ○ ○
Reportable Conditions			
	2.	Weekly Payroll	● ● ●
	3.	Holding Checks For The Acquisition Of Right-Of-Way Land *(See Current Observation No. 20)*	○ ○ ○
	4.	Controls Over Revenue Receipts	● ● ●
*	5.	Controls Over The Special Permits Account	● ● ●
	6.	Bureau Of Mechanical Services Checking Account	● ● ●
*	7.	Allocation Of Administrative Overhead Costs	● ● ●
*	8.	Private Car Travel Reimbursement	● ○ ○
	9.	Business Recovery Plan	● ○ ○
*	10.	Equipment: Lack Of Physical Inventory	● ● ●
*	11.	Equipment: Controls	● ○ ○
*	12.	Equipment: Recording And Reporting	● ● ●
	13.	Consumable Inventory: Bridge Maintenance	● ● ●
	14.	Consumable Inventory: Motor Fuel	● ● ●
	15.	Consumable Inventory: Bureau Of Traffic	● ○ ○
	16.	Right-Of-Way Rental Income	● ● ●
Federal Compliance			
	17.	Federal Cash Management: Right-Of-Way Reimbursements *(See Current Observation No. 20)*	○ ○ ○
	18.	Additive Rate For Materials And Research Lab	● ● ●
	19.	Allocation Of Costs *(See Current Observation No. 4)*	○ ○ ○
	20.	Maintenance Of Effort	● ● ●
	21.	Documentation Supporting Right-Of-Way Properties	● ● ●
	22.	Administrative Settlement-Calculation Errors *(See Current Observation No. 8)*	○ ○ ○
	23.	Review Of Subrecipient Reports	● ● ●
	24.	Identification Of Equipment Purchased With Federal Participation	● ● ●
	25.	Incorrect Federal Participation Rate *(See Current Observation No. 7)*	○ ○ ○

State Compliance

	26.	Expired/Unadopted Administrative Rules *(See Current Observation No. 28)*	○ ○ ○
*	27.	Aeronautical Fund	● ● ●
*	28.	Requirement For DOT To Collect And File Information	○ ○ ○
*	29.	Establishment Of Boards Created By Statute	○ ○ ○
*	30.	Written Agreements For Division Of Public Works Design And Planning Work	● ● ●
*	31.	Transfer Of Administrative Rules To Department Of Safety	● ● ●

* Comment is related to areas outside the scope of the fiscal year 2005 audit. Status is as reported by Department management.

Status Key		**Count**
Fully Resolved	● ● ●	18
Substantially Resolved	● ● ○	0
Partially Resolved	● ○ ○	5
Unresolved	○ ○ ○	8
		31

New Hampshire DOT

THE STATE OF NEW HAMPSHIRE
DEPARTMENT OF TRANSPORTATION

CAROL A. MURRAY, P.E.
COMMISSIONER

May 9, 2006

The Honorable Frederick W. King, Chairman
Fiscal Committee of the General Court
State House
Concord, New Hampshire

Dear Chairman King,

This letter is in response to the fiscal year 2005 audit of the New Hampshire Department of Transportation by the Office of the Legislative Budget Assistant (LBA).

I would like to thank the LBA field auditors for their professionalism and assistance extended to the Department during this audit. The additional work involved with assisting us in the preparation of the Turnpike financial statements and verifying our federal billing receivables is particularly appreciated.

The audit findings are significant and ultimately will prove to be very helpful as we incorporate the recommendations provided. The Department is moving forward to resolve all of the findings as expeditiously as possible. I have directed our Finance Director to report to the Assistant Commissioner every two weeks to document progress on each issue. We will follow up with the Department of Administrative Services to verify that corrective actions are being taken. With the exception of a couple of the findings, my target completion date for resolution of the findings is June 30, 2006. Beyond June 30, there will be monthly progress reports documenting the long-term improvements in our financial reporting and analysis bureau. This audit provided a pivotal opportunity to clarify objectives and needs, and to direct resources to better meet those goals. From this perspective, the audit is very much welcomed.

While I am pleased with the progress to date in response to the audit issues, there is work remaining to improve the Department's financial reporting and analysis capabilities. I am committed to improving the financial communications that the Department has with its various stakeholders. The Department appreciates the support from Legislative leadership as we confront many challenging issues including:

- Continuation of the electronic tolling program and assessing the adequacy of tolls in support of the Turnpike Construction Program;
- I-93 Financial Plan and the issuance of GARVEE bonds;
- Conversion to the financial systems to the new Enterprise Resource Planning System (ERP); and
- Highway Operating Fund Reporting and improved Project Status reporting.

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THE STATE OF NEW HAMPSHIRE
DEPARTMENT OF TRANSPORTATION

CAROL A. MURRAY, P.E.
COMMISSIONER

If you have further questions or concerns, please don't hesitate to contact me.

Sincerely,

Carol A. Murray

Carol A. Murray, PE
Commissioner

cc: J. Brillhart, Assistant Commissioner
J. Marshall, Director of Administration
T. Martin, Director of Finance

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