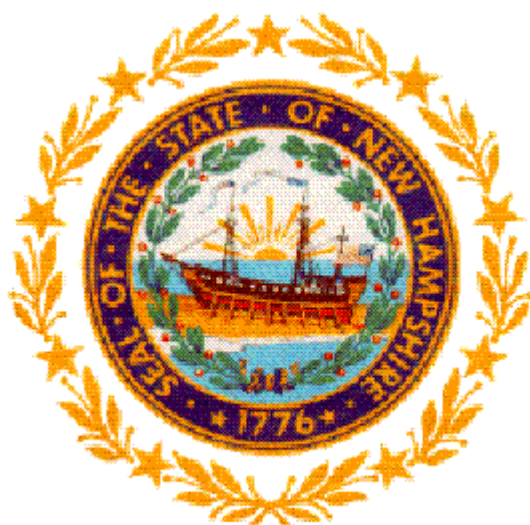


**Management Letter
For the State of New Hampshire**



For the year ended June 30, 2002



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December 16, 2002

To the Fiscal Committee of the General Court
State of New Hampshire
Concord, New Hampshire

We present, for your consideration, our comments and recommendations regarding internal controls and other matters. These comments and recommendations are intended to improve the internal control structure or to result in other operating efficiencies for the State. The factual accuracy of our comments has been reviewed with management so as to obtain their concurrence prior to the development of our recommendations for improvement. Matters commented upon represent findings during the audit and have not been reviewed subsequent to December 16, 2002.

Although the State's financial management system has many positive attributes, a management letter is critical by nature because its purpose is to identify areas where improvements can be made. It is also important to understand that it is generally not practical to achieve ideal internal control in the complex governmental accounting environment.

We would like to acknowledge the courtesy and assistance extended to us by State personnel during the course of our audit.

Very truly yours,

KPMG LLP



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a member of KPMG International, a Swiss association.

**STATE OF NEW HAMPSHIRE
2002 MANAGEMENT LETTER**

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Statewide

Transfers to the Education Trust Fund

Over the past two years, the Education Trust Fund has operated at a deficit of \$16.6 million and \$48.1 million as of June 30, 2002 and 2001, respectively, prior to the general fund transferring funds to the Education Trust Fund. Chapter 158:42, Laws of 2001 states that “ In the event of an education trust fund budget deficit at the close of the biennium ending June 30, 2001... the comptroller shall notify the fiscal committee and the governor of such deficit and request that sufficient funds, to the extent available, be transferred from the general fund operating surplus to eliminate such deficit. For fiscal 2002, no such law authorizing a transfer exists. However, the fiscal 2002 Education Trust Fund deficit was eliminated by a transfer from the general fund, to be in accordance with generally accepted accounting principles.

We recommend the State establish legislation to authorize year-end transfers from one reporting fund to another.

Department of Administrative Services' Response

We concur. Since the funding of the Education Fund is closely linked to the General Fund, we believe that legislation should be proposed to authorize year-end transfers to eliminate any deficit in the Education Fund that may occur.

Health Care Transition Fund

Chapter 351:74, Laws of 1997, states that “If at the close of fiscal year 1998 or any subsequent fiscal year, the commissioner of health and human services determines that net Medicaid revenues for that fiscal year are in excess of amounts budgeted, the commissioner of administrative services shall transfer the amount of any excess from the general fund into the Health Care (Transition) Fund. ”

As in prior years, we noted that only net Medicaid enhancement revenues were considered in the calculation of the excess over budgeted amount rather than all net Medicaid revenues as stated in the Chapter Law. Additionally, there were two instances where the State had difficulty applying the law. In one instance, the interest earnings on the Health Care Fund (HCF) balance were not sufficient to offset program expenses, leaving the account with a deficit balance. Secondly, a question arose how to allocate excess proportionate share revenues, budgeted as both unrestricted and restricted revenue.

We recommend DAS review the legislation applicable to the Health Care Fund to ensure the intent of the law is clearly stated and is comprehensive.

Department of Administrative Services' Response

We concur. Chapter 351:74 does not define "Medicaid Revenue", which has been interpreted to mean Medicaid Enhancement Revenues. However, difficulties arise when specific Medicaid revenues (proportionate share revenue) are applied to fund multiple activities. Further complications arise when the federal government defers or disallows costs claimed by the Department of Health and Human Services (DHHS), which raises revenue recognition concerns. Pursuant to Ch 351:74, the Acting Commissioner of DHHS originally requested that \$5.6 million be transferred to the HCF for fiscal year 2002. However, in October 2002, the federal government deferred all of the proportionate share revenue transactions. During the audit, it was determined that the proportionate share revenue could not be recognized and therefore no funds were transferred to the Health Care Fund.

The Department of Administrative Services has proposed legislation to repeal Chapter 351:74 in order to eliminate this accounting issue.

We further concur that the Department of Health and Human Services needs to monitor revenue generated from Health Care Fund investment earnings and to adjust budgets accordingly.

Enterprise Resource Planning System Evaluation

The State continues to experience increasing external financial reporting requirements, and increased user demands for system integration, accessibility to data, and internal reporting. This demand for more and more frequent financial information cannot continue to be met with the State's existing information systems.

Some of the shortfalls that exist with the State's current financial systems include:

- Significant dependence on paper, rather than electronic workflow;
- Lack of integration of the State's core business systems causing duplicative data entry and processing;
- Lack of e-Government support;
- Inadequate support for agency project accounting and grant reporting needs;
- Inadequate support for cash management;
- Lack of accessibility to data in a useable format; and
- Lack of ability to generate financial statements in accordance with generally accepted accounting principles.

While various agencies continue to request appropriations for new systems or modifications to their existing systems, the State needs to evaluate whether it is cost effective to continue to fund various agency requests or to implement a new enterprise-wide system that can better serve the future needs of the State.

Department of Administrative Services' Response

We concur. In the 2002 Statewide Information Technology Plan (SITP), the ERP upgrade/replacement in conjunction with e-Government initiatives were identified as the very top priorities for the State. Our software vendor has informed the State that the current system will no longer be supported after January 2005. Without vendor support, the State runs the risk that these systems could fail. During fiscal year 2002, the Department of Administrative Services completed an ERP feasibility study, which laid out a course of action for system replacement/upgrade.

In the Governor's capital budget request, a total of \$25 million has been recommended for this critical statewide initiative. The Department will continue to work with all parties involved to move this project forward.

Department of Transportation

Highway Fund – Accounting and Budgeting

Currently, the State appropriates funds in one biennium for a specific project that may take several years to complete. These appropriations are then carried forward year after year without the proper level of review to determine whether the funds are obligated or whether they should lapse to the Highway fund surplus. As of June 30, 2002, such appropriations and encumbrances amounted to approximately \$104 million for the Highway Fund, after lapses made by the Department of Administrative Services (DAS) of approximately \$28 million.

A team, including representatives from DAS, the Department of Transportation (DOT) and the Legislative Budget Assistant's Office, performed a study to examine the accounting and budgeting for the Highway fund and specifically focus on the historical difference between the cash balance and the surplus balance. Adjustments identified were: amounts budgeted by DOT exceeded the amounts obligated by the Federal government, resulting in a corresponding State match of \$6.3 million budgeted too high; DOT's budgeting of matching funds provided by local governments and other states has over time been less than actual revenues creating an adjustment of \$19.5 million; and an additional \$2.5 million in various other projects which lapsed.

We recommend that the DOT budget the State's share of Federal funding based on the Federal appropriation that will be distributed. Additionally, DOT should continuously review encumbrance and appropriation balances to ensure a proper and timely close out of those balances. Further, DOT should review its budgeting process to more accurately budget local share or that portion of a joint project paid for by a third party. If necessary, DOT may need to pursue changes in Legislation to lapse certain accounts.

Department of Transportation's Response

We agree in part with this recommendation, however, the budget is created two years ahead and the Federal appropriation is not known well into the state budget year because the Federal Highway bill is a six-year legislation, subject to appropriation each year. The State budget is submitted based on the six year expected level of Federal funds. This also allows for the state match of Federal funds earmarked by Congress in the appropriations bill or by other Federal bills. There is also a redistribution of Federal appropriation in June or July of each fiscal year that requires a match if a State is to be eligible for these funds.

The Department will review all balances on an annual basis and make the proper adjustments as appropriate.

Fleet Management

The Department of Transportation (DOT), uses a fleet management system called M4 to track work orders, labor, parts, warranties, and scheduled maintenance on each individual vehicle, car and truck. The system also is used to analyze and report on the performance of certain vehicles and aids in determining when to take vehicles out of service. Finally, the system interfaces with the fuel management system to track mileage and fuel usage on each individual vehicle.

The system is currently used to track all DOT vehicles, except those assigned to the Bureau of Turnpikes. Despite having the capability to track all vehicles assigned to DOT's two different divisions, turnpikes and highway, the Bureau of Turnpikes utilizes a separate manual vehicle management system rather than using the M4 fleet management system.

The use of duplicate systems, the manual system and the M4 system, creates inefficiencies within DOT and potential duplication of costs by maintaining these duplicate fleet management systems.

We believe that the efficiencies gained will outweigh the costs of implementing M4 at the Bureau of Turnpikes. Therefore, we recommend that the Bureau of Turnpikes migrate to the M4 system for their fleet management needs, which would result in more efficient operations at the DOT as a whole.

Department of Transportation's Response

The Department is in agreement with this and turnpike vehicles will be reported in the M4 system. The Department is currently working on a maintenance activity tracking system (MATS). All tracking will be done through the M4 when the MATS system is implemented, which is scheduled for full implementation for fiscal 2004.

Department of Revenue Administration

Allocation of Business Enterprise Tax and Business Profits Tax

Per Chapters 77-A:20-a and 77-E:14, the “Commissioner of Revenue shall determine the additional amount of revenue produced by the increase of 1.5% in the Business Profits Tax (BPT) and .50% in the Business Enterprise Tax (BET) and shall certify such amounts for deposit in the Education Trust Fund”.

In an attempt to verify whether the State properly transferred the increases, we noted that the State is unable to accurately calculate the allocation between BPT and BET revenue. Because taxpayers are allowed to group these two taxes together for purposes of making estimated payments throughout the year, makes it impossible to timely determine the precise amount of BPT and BET revenues attributable to the rate increases, as law dictates. Currently, the Commissioner of Revenue Administration estimates the revenue attributable to the rate increases based on the historical split of business taxes between BPT and BET.

The inability to determine the breakout on a timely basis directly impacts the amounts deposited into the Education Trust Fund. Additionally, this inability to breakout the taxes makes tracking the State’s revenue performance difficult and can affect the State’s ability to evaluate both current and prospective tax policies.

We recommend the Department of Revenue Administration (DRA or Department) review its current tax reporting system to determine whether changes can be made to better identify the precise amount of revenue from BPT and BET taxes on a timely basis. Alternately, DRA should review the applicable legislation to determine whether a change in the current statute is necessary. Precision with the allocation will help ensure that proper amounts are being deposited into the Education Trust Fund, that revenue projections are more accurate and may help in evaluating current and devising future tax policies.

Department of Revenue Administration’s Response

The Department’s estimate form combines these two taxes, yet separately identifies the estimated tax applicable to each tax type. It is our belief that taxpayers make an effort to accurately estimate the tax applicable to each tax type. Taxpayers base the estimates on past performance as well as current available information. However, the ultimate tax liability for each tax is generally not known until the returns are filed after the close of the tax period. We feel it would be unfair to penalize taxpayers for making the correct

amount of estimated tax payments but not accurately predicting the actual portion of BET v. BPT. As a result, basing the ETF transfer solely on taxpayers estimated payments has been found to be less accurate than estimates calculated by the Commissioner. Further, it is our belief that overall business tax revenue estimates are not adversely affected by the method of estimation. However, the Department has requested a statutory change to clarify the specific amount of business taxes to be transferred to the Education Trust Fund (ETF) effective for FY 04.

Reconciliation Between Various Tax Systems

The Department of Revenue Administration (DRA) uses the Taxpayer Information Management System (TIMS) to keep records of taxpayer accounts. Daily, tax receipts must be manually entered into the TIMS system and manually recorded in the State's Integrated Financial System (NHIFS) because there is no direct interface between the two systems. Because the systems are not integrated, a reconciliation should be performed between TIMS and NHIFS to ensure the information is properly recorded in each system. Such a reconciliation is not currently being performed and may result in erroneous information being maintained.

The manual process of recording daily tax receipts appears cumbersome and subject to error. The process is as follows:

- After the daily tax receipts are manually input into TIMS, an A-17 report is generated which summarizes the deposit information by revenue account (legacy tax, M&R tax, I&D tax, etc.), the total deposit amount and the total batches for the deposit.
- From this report, the IT department creates an ACCESS based file of daily tax receipts. The data in this file is then copied and pasted in a Lotus based data spreadsheet report ("LOTUS") to enable adjustments to be made for manual refunds, bounced checks, and correction of posting errors. However, these adjustments also must be manually made to TIMS and NHIFS.
- At this point in the process, cash receipts and adjustments have been manually entered two or three times each, respectively, significantly increasing the risk of errors.

To help identify errors, DRA personnel perform monthly reconciliations between LOTUS and NHIFS. However, there are no reconciliations between LOTUS and TIMS, nor TIMS and NHIFS.

Having parallel recording systems, without direct interfaces, seems redundant and inefficient.

We recommend that DRA review its processes to determine how to streamline the tax receipt process to make the best use of technology, for example, review the feasibility of interfacing TIMS with NHIFS, and how to institute reconciliation controls that meet DRA's objectives.

Department of Revenue Administration's Response

The Department concurs with the observation that the current data transfer process for recording cash receipts is inefficient. DRA previously reviewed the automatic electronic transfer of the A-17 information and determined that there were technical constraints at the Department that prevented it. Because of recent systems upgrades, those constraints have been eliminated. A work order has been submitted for this project and it has been assigned a high priority for systems development staff. User requirements, logical design and physical design have been completed.

Our current system does meet our objective to ensure that amounts posted to TIMS and NHIFS are reconcilable. Each month we do reconcile TIMS to NHIFS utilizing a Lotus spreadsheet as our vehicle to perform this reconciliation.

Calculation of the Allowance for Doubtful Accounts

In estimating the allowance for doubtful accounts for business taxes, interest & dividend tax, and meals and rental tax, the Department of Revenue Administration (DRA) devised a methodology based on available historical data. Establishment of the allowance for doubtful accounts was necessary in order to comply with the newly implemented Governmental Accounting Standards Board Statement No. 34.

We noted two issues that hindered the process of calculating a precise estimate.

- The first issue is the lack of sufficient historical data to do so. Some of the necessary prior year data was not available because it was not recorded in the system, or with meals and rental taxes, only one-half of the record was available due to a mid-year system change. Thus, DRA had to estimate prior year amounts used for analyses purposes by backing into them from current year amounts, or calculating an estimated whole year amount from partial year data.
- The second is that some of the hearing cases and abatements will result in eventual collection; however, numerical expression of their collectibility appeared difficult for the DRA to substantiate. When a reasonable estimate could not be made, to be conservative, the entire amount was deemed uncollectible, thereby underestimating the accounts receivable.

We recommend that DRA refine the methodology to calculate the allowance for doubtful accounts. DRA should review and assess the current recording system of tax collections, determine what other data is required, and implement necessary changes to ensure the information needed to record an allowance for doubtful accounts is available.

Department of Revenue Administration's Response

As this was the first year of implementing GASB 34, we are in the process of reviewing and assessing our current recording system of tax collections. This review includes determining what data is required and implementing necessary changes to ensure that the information needed to record an allowance for doubtful accounts is available.

Department of Health and Human Services

Expenditures Should Be Charged to the Correct Accounts and Accounting Periods

The Department on occasion bypasses transfer requests or other provisions for obtaining additional expenditure authority and charges expenditures to accounts with available appropriations, regardless of whether they are the proper budgeted accounts for the expenditure classes. In addition, the Department charged a fiscal year 2003 expenditure to fiscal year 2002 appropriation, reportedly to catch up with contract provisions.

- On June 26, 2002, the Department charged \$1.5 million of fiscal year 2003 Medicaid client managed care premiums to fiscal year 2002 accounts. Approximately \$1.3 million of that amount was charged to a lease account and to other accounts unrelated to the managed care expenditure. Reportedly, the Department wanted to make a catch up payment for the managed care premiums for Medicaid clients however it did not have sufficient appropriations remaining in the budgeted account. As there were available balances in the lease and other class lines, the Department charged the expenditure against those accounts. According to the Department, there was no time to request a transfer of appropriations as it wanted to make this payment prior to year-end.

The prepayment of the fiscal year 2003 liability with fiscal year 2002 appropriations required the State to record an adjustment to its financial statements at June 30, 2002. However, on a budgetary basis, the prepayment by the Department of the fiscal year 2003 premium with fiscal year 2002 appropriations essentially provided the Department with the ability to spend in excess of its fiscal year 2003 budgeted expenditure authority.

- The Division of Behavioral Health (DBH) charges expenditures among its accounts based on budgeted ratios and available appropriations and not on whether the expenditures were actually budgeted from the account. Charging expenditures to accounts based on budgeted ratios and available appropriations, regardless of the nature of the expenditure, avoids budgetary controls and obfuscates the cost of providing DBH services.

The State's Medicaid payment system (NHAIM) categorizes Community Care Waiver and Community and Mental Health claims payments using fund codes K and H, respectively. The Division allocates the payments categorized as K and H into ten budgeted class-line accounts including: family support, case management, emergency intake, community support, and housing for mental health expenditures; and case management, day program, developmentally disabled waitlist, family support, and community residency for community care waiver expenditures. The Division allocates the fund K and H expenditures by applying a percentage of each to its respective class-line accounts regardless of the actual nature of the underlying expenditure. The allocation percentages are based on the relative amounts budgeted for each class line. For example, an expenditure that actually paid for family support services would be allocated to and reported as expenditures in each of the five mental health expenditure class lines. If at anytime during the fiscal year the appropriations in any of the class lines is exhausted, the expenditures are charged to any class line within the Division's accounts that has appropriations remaining, regardless of whether the appropriations were for the purpose of the expenditure or not.

According to the Division, this method of allocating expenditures based on budgetary percentages goes back approximately 15 years to a legislative request to provide additional information on the Division's class 090 program expenditures. The effect of posting and reporting expenditures in this manner is to bypass the budgetary controls requiring approvals prior to transferring budgeted amounts and also causes the management information system to report expenditures not as they occurred but as they were anticipated by the budget.

RSA 9:19 states that no public funds appropriated by the general court shall be used for any other purpose than that for which they were appropriated. As funds are appropriated on the class-line account basis, the effect of the Department allocating expenditures on an available appropriations basis avoids the budgetary controls intended by the statute.

The Department of Health and Human Services should charge expenditures accurately to the proper budgetary accounts. Expenditures should be charged to accounts based on actual amounts spent for budgeted services and not on a prorated amount of bundled services. If appropriations in a class line are not sufficient, the Department should request transfers of appropriations or supplemental appropriations as provided by statute. If sufficient detail information is not available to provide accurate charging of expenditures to budgeted class lines, then the Department should increase the number of fund codes or other information in NHAIM to provide the detail needed. The Department should not continue to post and report financial transactions as if there is a true and accurate determination of expenditures by budgeted class line if there is no true distinction being made in practice. If the Department determines that the level of detail that would be available if accurate postings were made is not necessary or would be too costly to keep track of and report, the Department should request that the expenditures be budgeted at a level that can be supported by available or reasonably obtainable management information.

Department of Health and Human Services' Response

The Department agrees that payments were made from accounts other than the usual account used for making the monthly managed care payment. When funds are available at the end of a fiscal year, there is not sufficient time to request transfers through the Legislative Fiscal Committee and the Governor and Council to allocate the funds to the usual account. A solution to this problem would be to allow transfer requests to be brought forward in the thirteenth month period in order to reallocate the funds to the appropriate accounts.

The Department concurs with the recommendation that expenditures be budgeted at a level that can be supported by available or reasonably obtainable management information. Because the services people receive are individualized and ever-changing to meet their needs, the structure is artificial and does not reflect the way services and supports are delivered and subsequently billed by providers. Changes to the NHAIM system would, even if possible, be difficult and potentially cost prohibitive. Further, changes to NHAIM in all likelihood, do not address the root issue created by the current class structure. There are currently 25 procedure codes covering the types of service provided in Developmental Services alone. While some of these procedure codes map directly to a budgeted line item, i.e. case management, others do not. For example, procedure code X9841 (community support services) can be either a day, residential or family support service depending on the individualized service plan of the person receiving the service. In theory, in order to comply with the audit finding, the Division would have to add new class lines in the agency budget to support each type of service delivered, identify additional procedure codes to map directly to the added class lines and EDS would have to add new fund codes and re-map current codes. A further complication is that current changes to local coding occurring as a result of HIPAA implementation is still not finalized.

Further, this level of detail, while not enhancing the Division's ability to report and manage its resources, based on the adopted budget would require multiple transfers between line items as people's needs and services change frequently. A separate NHAIM reporting system can accomplish the objective.

The Department will seek the authority to collapse the current class lines into an umbrella class account including the appropriate object levels. The Department will work to effect this structural change during the current biennial budget process.

Finally, the Legislative and Executive branch have explained their expectations that the Department avoid pending claims at the end of the year and pay all claims to mitigate the carry over of expenses.

Checks Should Be Restrictively Endorsed Upon Receipt

Checks received by the Department of Health and Human Services (DHHS), Office of Finance, are not restrictively endorsed “for deposit only” by the individual who initially receives the payment on behalf of the Office of Finance. The second person in the receipt process is currently responsible for restrictively endorsing checks.

Checks that are not immediately restrictively endorsed are subject to increased risk of misuse.

All checks received by the DHHS should be restrictively endorsed “for deposit only” by the individual who initially receives the payment on behalf of the Office of Finance.

Department of Health and Human Services’ Response

DHHS concurs with this recommendation. The procedure has been implemented to have the staff person who opens the mail restrictively endorse the checks immediately.

Financial Transactions Should Be Recorded and Processed As They Occur

The Department of Health and Human Services (Department) did not record and deposit in a timely manner drug rebate checks received during the period May 23 through June 28, 2002. Over \$900,000 of drug rebate checks received by the Department during this period were temporarily held in a locked file cabinet until they were ultimately recorded and deposited on July 8, 2002.

Department management did not record and deposit the checks, due to the Department not having complete account information to post the rebates. The effect of not recording and depositing these rebates when they were received was to move the Department’s ability to use the funds from the rebates from fiscal year 2002 to fiscal year 2003. Had the Department recorded the rebates in the proper accounting period, fifty percent of the funds would have been subject to lapsing at the close of fiscal year 2002. As the rebates were recorded and deposited in fiscal year 2003, the funds were available to essentially increase the Department’s fiscal year 2003 available budget for Medicaid drug purchases.

In addition, by delaying the recording and depositing of the rebate checks, the Department did not accurately report the status of the Medicaid program on its June 30, 2002 quarter-end financial status report to the federal Center for Medicare and Medicaid Services.

The Department should record and process all financial transactions as they occur. The recording and processing of transactions should not be intentionally delayed thereby avoiding State controls including the proper safeguarding of assets, cash management

practices, accurate financial reporting, and controls over available budgets. The fact that the Department believed it appropriate to hold these checks unreported and under minimal security for this period indicates a lack of management's appreciation for a proper control environment.

Department of Health and Human Services' Response

This was a special circumstance in which a new system was not fully operational to allow the Department to credit the checks to the appropriate accounts to ensure correct reimbursement to the general fund and to the counties, where the drug rebates apply to long-term care clients. The system to manage this will be fully operational by June 30, 2003.

Effective Change Control Process Should Be Established for the Pharmacy Benefit System

The Department of Health and Human Services (DHHS or Department) has not established an effective change control process over its pharmacy benefits system (PBS) to detect and reduce the risk caused by security features being inadvertently or deliberately omitted or "turned off" allowing processing irregularities or malicious code being introduced.

The Department has contracted with a pharmacy benefits manager (PBM) to provide, operate, and manage a PBS on behalf of the Department. The PBM provides the Department and other customers with a standard PBS that can be amended based on individual customers needs pursuant to the contracts between the PBM and the Department or other customer. According to the Department, the contract does not detail control procedures for system programming changes and the Department has not established a comprehensive understanding with the PBM on how to ensure the Department and provider have an effective change control process over the PBS. While the Department reports that it has initiated certain control procedures with the PBM, including control memos to initiate and approve programming changes to the PBS, the Department reported that there have been instances where the PBM has instituted changes to the PBS without notifying the Department prior to the change. While reportedly most of the unauthorized changes were for issues affecting the standard programming of the PBS, affecting all customers of the PBM's service, some of these unauthorized changes would be considered as having significant control concerns to the Department, for example losing password authorization.

The lack of an effective change control process over the PBS presents a significant risk to the Department that changes that it has not approved may be enacted without its knowledge. The fact that the Department has chosen to contract with a PBM to provide and operate a PBS for the Medicaid program does not relieve management of its duty for effective oversight of the system. During fiscal year 2002, approximately \$60.1 million of payments were processed on behalf of the Department by the PBM.

The Department should establish an effective change control process for its PBS. Policies, procedures, and techniques should be implemented to ensure that all programs and program modifications are properly authorized, tested, and approved and that access to and distribution of programs is carefully controlled. Because the Department is relying on a PBM for many of these functions, the Department will need to ensure that it has an effective system to review and approve the actions of its PBM that affects the integrity of the processing done on behalf of the Department.

Department of Health and Human Services' Response

The Department concurs in part. DHHS implemented change control procedures for the PBM system shortly after its initial deployment in November 2001. DHHS informed the PBM vendor "First Health Services" of a preferred change control process that the State requested to be followed. The PBM vendor was informed that "NO" system changes were to be implemented without express consent from the State project manager responsible for PBM. All change requests to the system are logged and properly prioritized via a "control memo" process that is currently used to monitor all system requests. All State requested modifications are entered by a State resource into this system and any technical changes required by "First Health Services" are also entered into this system and prioritized and tested accordingly prior to being deployed to the Production environment. The PBM vendor is responsible for requesting permission to implement any system change at least 1 week in advance via this process unless the technical change is deemed an emergency situation. In an emergency situation the vendor is still required to contact the State project management responsible for the PBM system in order to explain the detail of the emergency situation. DHHS also requires the vendor to provide fully documented "Flash Reports" that explain the cause of any technical or systems related problems encountered in production in order to properly plan for similar situations in the future.

However, DHHS acknowledges that system updates have been implemented into New Hampshire's PBM production environment by the vendor without express permission from the State project manager responsible for PBM. The vendor's technical solution supports multiple States and on occasion technical requests that were implemented for other States have impacted the New Hampshire production environment. In order to try to prevent this in the future New Hampshire now requires that the PBM vendor inform us of any instance where another State is being brought up in their technical environment and also to inform us of any modifications that may be implemented for other States that may impact our environment. The State will continue to aggressively monitor its existing change control process and will take necessary actions to deter the vendor from implementing any systems changes into New Hampshire's production environment unless appropriately directed.

Monitoring of Drug Rebates Must Be Improved

The Department of Health and Human Services (Department) does not have adequate policies and procedures in place to monitor the collection of rebates on drugs purchased by the N.H. Medicaid program.

The federal Omnibus Budget Reconciliation Act of 1990 (OBRA 90) established the Medicaid drug rebate program under which States are authorized to collect rebates from drug manufacturers for drugs purchases reimbursed under the Medicaid program. In order for a manufacturer's drugs to be eligible for reimbursement under Medicaid, the manufacturer is required by OBRA 90 to enter into a rebate agreement with the federal Centers for Medicare and Medicaid Services and pay quarterly rebates to the States.

Exhibit A, Section 15 of the Department's contract with its pharmacy benefits manager (PBM), directs that the PBM will be responsible for the management of the Department's OBRA 90 drug rebates. A few of the specific responsibilities of the PBM include management of all Medicaid drug rebates and dispute resolution from July 1, 1994 forward, implementation of accounting functions for drug rebates, and implementation of dispute resolution functions.

The PBM manual New Hampshire Rebate Procedures Section 1.1 states in part "...at a minimum [the PBM] generates and forwards rebate invoices, conducts dispute resolution and updates and maintains labeler accounts receivable file." Section 1.7 of the manual details information relating to collection procedures of disputed and past-due amounts. Per the manual, "...it is appropriate for a Dunning Notice to be sent to the labeler reminding the labeler of its account balance and the need to make immediate payment. In the event the labeler does not respond to the first Dunning Notice, a second Dunning Notice is sent to the labeler advising the labeler of its current balance and further collection efforts to be taken by the state." While the manual details that the PBM system generates a list of labelers at 38, 68, 105, and 210 day overdue intervals, the Department reports that it is able to obtain reports at 45, 90, and 210 day intervals.

Neither the Department nor the PBM has actively monitored collection of rebates or pursued overdue labelers. The Department does not monitor the past-due accounts receivable reports available from the PBM. When requested, the Department was unable to provide an aging of its drug rebates receivable. Neither the Department nor the PBM has ever sent out Dunning Notices referred to in Sections 1.1 and 1.7 of the PBM manual. In fact, it is unclear who is responsible for issuing the Dunning Notices.

The Department must establish policies and procedures for collecting drug rebates. The scope (and limit) of the PBM's responsibilities for processing drug rebates on behalf of the Department must be established and understood. The Department must establish policies and procedures within its own organization to both monitor the activities of its PBM contractor on its behalf and also to perform appropriate accounting and reporting of current and past-due drug rebates receivable.

Department of Health and Human Services' Response

The Department concurs with these recommendations. The Department worked with First Health to develop Dunning Letters and has access to Dunning Reports and Dunning form letters from the First Health System. These letters had not been sent to the pharmaceutical manufacturers. The Department is now in the process of working with First Health to ensure these letters are issued on a consistent basis and will audit that function. Each quarterly invoice sent to pharmaceutical manufacturers does include not only the present quarter's rebate portion but also any past due rebate that is due.

Year-End Medicaid Accounts Payable Calculation Should Be More Efficient

The Department of Health and Human Services' (Department) annual calculation of Medicaid accounts payable is an involved calculation that, while reasonably reliable, is inefficient and subject to clerical-type errors.

For financial reporting purposes, the Department manually estimates the accounts payable liability for Medicaid related medical expenditures as the expected amounts to be paid in the next fiscal year for client services provided in the current or prior fiscal years. The liability is calculated based on the total processed claims paid during the first couple of months of the new fiscal year for claims with dates of service prior to year end. The total of such payments is then increased by a lag factor to estimate the total amount that will eventually be paid for all claims with dates of service prior to the new fiscal year. The actual calculation of the liability involves the input of numerous amounts from several reports onto Department-generated spreadsheets.

Through a review of the Medicaid accounts payable calculation for June 30, 2002, we noted an error in the calculation and an unsupported adjustment amount. The error was corrected when the Department was notified but the Department was unable to adequately explain the necessity for a \$5.6 million adjustment reducing the amount of the payable. It was the Department's contention that the manual calculation returned an inflated amount for one category of service and that an adjustment to reduce the payable was appropriate but the Department was unable to document the appropriateness of the \$5.6 million adjustment amount.

The Department's Medicaid Management Information System (MMIS) generates an "incurred expense report for estimated expenditures" which includes paid amounts and a total estimated incurred amount by claim month of service. While the Department relies upon the report for claims payment information, due to concerns with the historical accuracy of the reported estimated incurred amounts, the Department does not use the reported estimated incurred amount as an estimate of its Medicaid liability.

At June 30, 2002, the Department reported its Medicaid accounts payable for medical services to be \$83 million.

A similar comment was reported in the fiscal year 2001 management letter for the State of New Hampshire. The Department responded to that comment that “it would revisit the possibility of using the system [MMIS] data next year, and will make a concerted effort to uncover any changes in payment trends that would effect the calculations.”

The Department should investigate whether using the MMIS calculated and reported liability amounts to report the payable at year end would result in a more reliable amount being reported.

If the Department decides to continue to calculate the liability for Medicaid manually, someone other than the preparer should review and approve the calculation.

Significant adjustments must be supported by appropriate documentation.

Department of Health and Human Services' Response

The Department concurs with the Observation, but does not concur with the Recommendation. The Department managers and staff who prepare the report met several times and consulted with EDS technical assistance staff on the automated report entitled the 543 report. It was found that the calculated liability information was incorrect. One problem was that the totals on the report were truncated, so that the amounts were not printing correctly. Further the analyst reviewed the source code for the calculations and found that the formulas would most likely not produce a correct liability.

Department management did review the manual calculations a number of times and this was the reason for the adjustment. The liability for the particular category based on the lag factor would have exceeded the historical entire annual expenditure. The staff was unable to prove that this problem was caused by a \$5.6m processing error that was subsequently corrected. However, we believe using the lag factor would have produced an overstated accounts payable liability.

The Department is developing a Management Decision Support System for the Medicaid program. After the implementation of this system during SFY2004, the Department will develop a new automated accounts payable liability calculation using the reporting capabilities of this system. Because the Department of Administrative Services, Financial Reporting developed the current liability calculation methodology, the DHHS will consult with them as changes to the methodology are made.

Disproportionate Share Calculations Should Be Reviewed and Verified

The data and calculations supporting the disproportionate share (DSH) payments made by the Department of Health and Human Services (Department) to the general hospitals in the State are not reviewed and verified by the Department prior to the Department making the payments.

Federal financial participation is available for aggregate payments to hospitals that serve a disproportionate number of low-income patients with special needs. The State Plan must specifically define a DSH hospital and the method for calculating the payment for these hospitals. The Department delegates the task for performing the specific details, methodology, and final DSH calculations to the New Hampshire Hospital Association (NHHA). There is no contract or written agreement related to the work performed on the Department's behalf by the NHHA. The NHHA performs this service on a good-will basis. Neither the NHHA nor the Department verifies the financial information submitted by the hospitals forming the basis of the calculation and the Department does not perform a review of the NHHA calculations to ensure accurate computations.

As part of our review of DSH payments, we obtained copies of the NHHA spreadsheet and hospital data sheets supporting the fiscal year 2002 payments. A review of the supporting documentation revealed certain errors and other inconsistencies that indicate the accuracy of the calculations would have benefited from a more robust review and approval process.

Other problems were noted from a review of a sample of five of the twenty-eight hospital data sheets. One data sheet reviewed was labeled as unaudited information and did not agree to the corresponding data on the spreadsheet. The NHHA could not provide a copy of the revised "audited" data sheet to support the information on the spreadsheet but after some delay was able to locate a copy of an emailed spreadsheet from the hospital that contained the revised amounts. The revised spreadsheet caused an additional \$1.79 million to be paid to the hospital versus the amount that would have been paid based on the original unaudited data sheet calculation (the Medicaid enhancement tax paid by the hospital was unaffected as the revised data did not affect the amount of the tax paid by the hospital). There was no explanation of cause for the revision of the reported amounts or indications that the accuracy of the amounts had been reviewed or verified.

A second data sheet reviewed had errors that resulted in a Medicaid enhancement tax overpayment and DSH overpayment of \$30,663.

During fiscal year 2002, the Department made \$149 million of DSH payments to 28 general hospitals operating in the State.

A similar comment regarding the lack of Department verification of financial data submitted by the participating hospitals has appeared in the management letters for the State since 1999. The Department's responses to these prior comments included a statement that the Department would perform a sample number of reviews annually and follow-up with additional reviews if initial findings warrant it. To date, the Department has not implemented this review and follow-up procedure.

The Department should implement policies and procedures to review and verify financial data submitted by the participating hospitals. The data sheet and spreadsheets documenting calculations should be reviewed and approved by the Department prior to the payments to ensure that payments made by the Department are appropriate and based on accurate information.

If the Department continues to use the services of the NHHA, the Department should formalize its agreement with the NHHA to ensure that the process remains controlled and reliable. Policies and procedures providing controls over the completion, review, and verification of hospital data should be established. Documentation requirements should be established to ensure that the basis for Medicaid enhancement taxes and DSH payments are adequately supported and provide an available and appropriate audit trail.

Department of Health and Human Services' Response

The Department will set up a formal agreement for a review process with NHHA. This process will document requirements to ensure that the basis for the Medicaid enhancement taxes and DSH payments are adequately supported. Completion date is June 30, 2003.

Department of Employment Security

Benefit Overpayment Accounts Receivable

The Department of Employment Security (DES) is responsible for providing unemployment benefits to eligible claimants and requires submission of information from claimants and former employers in order to help determine eligibility. At times during the year, overpayment of benefits occurs due to payments to ineligible individuals or incorrect benefit calculations. DES attempts to recover the overpayments.

As of June 30, 2002, the benefit overpayments to be collected were \$3.4 million, with the age of receivables dating as far back as 1980. Although an allowance for bad debts has been established for much of the old overpayments, the method for calculating the allowance is not adequate. Currently, the allowance is calculated by taking the year-end general ledger receivable balance and subtracting cash received and offsets made against benefit payments during July and August subsequent to year-end.

We also noted the record keeping related to the overpayments not recovered needs to be improved. Currently, the automated benefit system, the New Hampshire Unemployment System (NHUS) does not reconcile to the State's general ledger. The amount in NHUS is approximately \$1.2 million lower than the amount on the State's general ledger. Additionally, the Approach database, used by the Benefit Overpayments Control Department to collect the monies owed, is not reconciled to either NHUS or the State's general ledger.

We recommend DES ensure resources are available to minimize overpayments and maximize the recovery of those overpayments on a timely basis. We also recommend that a better method for calculating the allowance for bad debts be established to help ensure the proper reporting of the accounts receivable and associated allowance.

Further, we recommend that monthly reconciliations be performed between the Approach database, the NHUS system and the general ledger. This will help ensure that collection efforts are made on all outstanding balances and are for the correct amounts, and that the general ledger is properly reported.

Department of Employment Security's Response

We recognize the issues surrounding the Benefit Overpayment process and have continued to work toward minimizing the overpayment of benefits to individuals.

One of the primary mission's of this department is to provide accurate and timely payment of benefits to eligible claimants. Many factors press the ability of the department to reach this goal. These factors include major shifts in unemployment claims levels due to uncontrollable economic factors, federal mandates to incorporate supplemental payment programs, and the inability to control availability of accurate and timely submission of information from claimants and former employers necessary to determine eligibility in an accurate and timely manner.

Although our priority is payment of benefits, we incorporate a myriad of controls and procedures throughout our systems and processes to detect, deter, prevent, and minimize the overpayment of benefits. The effectiveness of these controls and procedures is readily apparent in the comparison of annual benefits paid, overpayments established, and overpayments recovered.

<u>Period</u>	<u>Benefits Paid</u>	<u>Overpayments Established</u>	<u>Overpayments Recovered</u>
FY 2002	\$108,111,506	\$1,251,248	\$696,604
FY 2001	34,332,116	512,274	422,802
FY 2000	34,794,970	602,292	384,080
FY 1999	33,485,170	653,845	367,735
FY 1998	31,092,124	608,784	322,394
FY 1997	<u>39,020,622</u>	<u>716,333</u>	<u>350,672</u>
	\$280,836,508	\$4,344,776	\$2,544,287

The above information shows an average 1.55% overpayment rate to benefits paid, an average .64% non-recovered overpayment rate to benefits paid and an average 58.6% collection rate on established overpayments.

The Department feels that it already provides sufficient resources to minimize overpayments and to maximize the recovery of overpayments on a timely basis.

We do agree that record keeping related to the overpayments, both recovered and non-recovered needs to be improved. Through the coordinated efforts of the Benefit Overpayment Control section, the DES Treasurer, the DES cashier and the Information Systems section, daily/monthly reconciliation procedures can be developed to assure the accuracy and integrity of the Benefit Overpayment Recovery system. Concurrent with those issues we also need to establish an accurate overpayment trial balance report and an aged overpayment trial balance report with the assistance of the Department's information systems section. Once these procedures can be established we will be able to consistently monitor this information between NHUS, the Benefit Overpayment recovery system and the general ledger system.

We plan to concentrate efforts on resolution of these issues in the coming year within the limitations of budgetary, staffing and priority of mandated projects.

New Reporting Requirements

Beginning in fiscal 2002, with the implementation of a new governmental accounting standard, the Unemployment Trust Fund is now reported as a proprietary fund in the State's Comprehensive Annual Financial Report. This new classification changes the method of accounting required for this fund. Proprietary funds are reported using the accrual basis of accounting. Because the Department of Employment Security (DES) essentially makes payments to claimants on a biweekly basis, a liability needs to be calculated for those valid claims incurred and reported to DES that have not been paid prior to the State's fiscal year-end.

We recommend that DES determine the accessibility of this data, and devise a method to calculate the liability to properly report its financial statements under the full accrual basis of accounting.

Department of Employment Security's Response

We agree that a liability needs to be calculated to recognize valid claims for benefits incurred prior to the State fiscal year end that have not been paid prior to the fiscal year end. Had we been made aware of this requirement earlier, a method could have been developed to more accurately report the liability for this fiscal year end. We plan to work with our information systems staff to develop a methodology in the coming year that will significantly address the reporting requirements. Due to a large number of variables, which factor into the claims process, it is for all practical purposes an impossible task to fully identify the true liability. Our staff has discussed these issues with the audit staff. We feel we can develop a process that will identify the bulk of the liability in order to report that amount in a reasonably accurate and timely manner in the future.

Department of Education

Local Education Authority Changes to the Special Education Information System

The Special Education Information System (SPEDIS) is utilized by the State to track special education student counts and statistics related to the \$1 billion in Federal and State aid provided to New Hampshire school districts. The State relies on this data to make Federal allocations under the Individuals with Disabilities Education Act (IDEA) Part B and Preschool grants. Additionally, certain State allocations, including Catastrophic Aid and certain Adequacy grants, also rely on SPEDIS data.

The SPEDIS data is continuously updated by the Local Education Authority (LEA) for changes made to student counts and statistics. The system is closed to LEA's on certain dates in order to finalize student counts used to make Federal allocations. Although, for State aid, the LEA's continuously update the student counts in order to receive the entitled amount of special needs funding. Because the student counts are continuously updated by the Department of Education (Department) and the LEA's, it was difficult to verify the accuracy of the counts.

Currently, the Department does not have documented policies and procedures in place for edits made by LEA's before and subsequent to closing the SPEDIS. This creates a risk that student counts used by the State to calculate Federal and State aid will be inaccurate, causing certain LEA's to receive less funding than entitled and other LEA's to receive more funding than deserved.

We recommend that the State document policies and procedures for edits made to the SPEDIS to ensure that counts are accurate and properly supported. These policies may include closing the system on certain dates to finalize the counts. Additionally, any changes made that originated by the Department should be documented, retained, and approved by the LEA, while edits originated by the LEA should be maintained by the LEA. If the LEA requests changes after the closing date, the changes should be submitted to the Department as a means of controlling the accuracy and appropriateness of the student counts. Finally, the Department should perform periodic reviews of LEA maintained support.

Department of Education's Response

The Department of Education is in the process of developing an RFP for a new data system. With this new data system, the LEA's will be the only parties who can make changes to their respective district's data. Currently, LEA's do not have access to all data cells. The current data system would need considerable reprogramming to allow all data cells to be accessed by the LEA's. Additionally, in an effort to ensure reliability of data collection and to control the amount of changes to the database, the Bureau has limited the number of employees that have access to the system. Any transaction that results in a change to the database, requires the notification to the LEA for agreement, with a documented paper trail. This paper trail will be maintained on file by the school district.

State Per Pupil Expenditure Data

Each year, the Department of Education (DOE or Department) is required to submit its State per pupil expenditure (SPPE) data to the National Center for Education Statistics. The SPPE data is used by the U.S. Department of Education (ED) to make allocations under several Elementary and Secondary Education Act (ESEA) programs, including Title I, Part A and Class Size Reduction. Additionally, the SPPE data is used for allocations of State aid, including Adequacy grants.

Additionally, the Department must determine that the combined fiscal effort per student or the aggregate expenditures of the Local Education Authority (LEA) from State and local funds for free public education for the preceding year was not less than 90% of the combined fiscal effort or aggregate expenditures for the second preceding year for each LEA.

In order to collect the necessary data to meet the above two requirements, the Department collects DOE-25 reports from each school district. DOE-25 reports detail the districts revenues, expenditures, and attendance data. Upon inquiry, it was determined that the Department does have certain checks and balances in place over the DOE-25 report, including many accuracy verifications. However, there is still a risk that data submitted by school districts could be incomplete or inaccurate. Inaccurate data submitted by the school districts in the DOE-25 may cause non-compliance with certain requirements and may cause the ESEA allocations to be inaccurate.

We recommend that the Department of Education implement policies and procedures, such as on-site verifications of the DOE-25 data on a regular basis, to ensure that the data submitted by school districts is accurate and complete.

Department of Education's Response

The DOE-25 is carefully reviewed by a qualified staff person. There are nearly 40 built-in edit checks in place to ensure the validity of the data within the DOE-25.

We concur with the finding and will implement policies and procedures such as on-site verifications to ensure validity of the DOE-25 data.

Lack of System Integration

The Department of Education Bureau of Business Management (BBM) is responsible for the accounting and record keeping of the Department's many Federal grants, including, but not limited to, Special Education, Title I – Grants to LEA's, Vocational Rehabilitation, Vocational Education, and Class Size Reduction.

Currently, the BBM accounts for federal programs through four separate accounting systems including: the Form 2 system, the Federal Ledgers, the Grant Control Ledgers, and the state financial accounting system (NHIFS).

The Form 2 system tracks subrecipient grant awards using project numbers within each grant. Expenditures made through this system are manually posted to NHIFS and a weekly report is generated to post expenditures to the Federal Ledgers.

The Federal Ledgers are used to track federal expenditures and requests for funds by NHIFS organization code and grant number. All entries are manually keyed into the Federal Ledgers that are reconciled to NHIFS on a monthly basis.

These four systems were developed independent of each other and are not integrated resulting in transactions being required to be posted multiple times and a duplication of effort on the part of the State's employees.

The lack of integration leads to tremendous inefficiencies in posting transactions, increases the risk of errors and increases the cost to the State by virtue of having a duplication of efforts. The lack of integration also creates difficulties in providing information requested by the DOE's internal and external users on a timely basis.

We recommend that the DOE consider integrating the existing systems or implementing a new integrated management system, which would include a grants management module, that will meet the current and future needs of the DOE and their external users.

Department of Education's Response

We concur with the finding. It has been a priority of the Department to implement an integrated financial management system in the Office of Business Management. We have been working with the Department of Administrative Services Office of the Commissioner and their Division of Information Technology Management (DITM) to design and implement a management information system for federal grant record keeping. Funding of \$650,000 has been provided in the current Capital Budget for a grant's management system. Further, \$500,000 is requested for the FY2004/05 Capital Budget for computer automation in the Office of Business Management.

Department of Safety

Motor Vehicle Registration Fees

The Department of Safety, Division of Motor Vehicles, is responsible for assessing and collecting multiple motor vehicle related fees and fines, including registration fees, and depositing them into the State's Highway fund. These fees are collected through a network of twenty-nine substations and 190 municipal agents throughout the State. Of the 190 municipal agents, approximately 61 agents are considered 'on-line' agents. The remaining municipal agents are considered 'off-line' agents.

Substations and municipal agents submit their transactions to the Department of Safety as follows:

- Substations and on-line municipal agents key their transactions directly into the State's motor vehicle database. Once these transactions are balanced with the deposits, the revenue is then credited to a revenue source in the general ledger. For the sub-stations and on-line municipal agents, this takes a few days for the revenue to be processed and recorded.
- Off-line municipal agents send their transactions to one of the 29 substations or the main office in Concord to be manually keyed into the motor vehicle database.

Currently, there is a two-month backlog of transactions from the off-line agents to be keyed into the State's motor vehicle database. This backlog results in inaccurate 'revenue by source' information that is used by management to make financial decisions.

We recommend that the Department of Safety implement procedures to ensure that all off-line municipal agent transactions are keyed in a timely manner or an effort is made to bring all off-line agents "on-line", especially those municipalities with significant transactions.

Department of Safety's Response

The Director of the Division of Motor Vehicles and the Commissioner are very aware of the backlog and are trying to reduce as much as possible the amount of time it takes to distribute the revenue to the proper source.

As mentioned, there are approximately 190 municipal agents throughout the state. There are now 69 on-line with more in the planning stages to come on-line. As more and more come on-line, this will greatly reduce the backlog. However, it should be noted that due to fiscal restraints at this time, the process may require additional time to complete.

Insurance Department

Insurance Reserve Certification

According to section 4.5 of the Turnpike System Revenue Bond Resolution, the "Department of Insurance shall annually review the kinds and amounts of insurance policies and self-insurance maintained by the State, with respect to the Turnpike System, and no later than sixty days after the end of each fiscal year, deliver to the Treasurer, a report describing the insurance then in effect and a certificate from the Commissioner of Insurance setting forth the Insurance Reserve Requirement for the next fiscal year".

The purpose of the Insurance Reserve is to self-insure the Turnpike assets in the event of loss or damage to those assets. In the event of such loss or damage, the Bureau of Turnpikes uses this insurance reserve to repair, reconstruct, or replace the damaged property.

During our review of the Turnpike System's compliance with the Revenue Bond Resolution, we noted that the certificate from the Commissioner of Insurance setting forth the Insurance Reserve Requirement was more than fifty days late in being delivered to the Treasurer.

We recommend that the State implement policies and procedures to ensure that the Insurance Commissioner submits the above report to the Treasurer within the required sixty-day timeframe, in order to remain in compliance with all debt covenants.

Insurance Department's Response

We concur that the Insurance Reserve Certification for fiscal 2002 was more than fifty days late. Though the process was started in a timely manner there were attendant delays in the exchange of information between and amongst Departments. After careful and complete review, our opinion was sent to the State Treasurer's office.

EXHIBIT A

Outstanding Prior Year Comment

The following represents a comment identified in our previous management letter that was reexamined during this year's audit and may require further attention by State management. The full text of the finding is included in the applicable prior year management letter.

Department of Administrative Services

Reports on Processing of Transactions by Service Organizations (2001 management letter)

The Department's Bureau of Risk Management contracts with a third party to provide claims administration, and accumulate financial and statistical data for the State's workers' compensation program. The State places a great deal of reliance on the controls in place at the third party service bureau to input, process, track and expedite claims accurately and properly.

To gain comfort over the controls in place at the service bureau, the State should request a service bureau audit report in accordance with Statement on Auditing Standards (SAS) No. 70 *Reports on the Processing of Transactions by Service Organizations* and include SAS No. 70 provisions/ requirements in future third party service bureau contracts.

Department of Administrative Services' Response

The contract with our third party service bureau was extended through July 1, 2004 with the same terms and conditions that exist now. Bid specifications have been prepared for the next contract and require that vendors offering proposals shall provide the State with a SAS No. 70 report on an annual basis. Therefore, the SAS 70 requirement will not be resolved until fiscal 2005.