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March 21, 2006

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

We have audited the financial statements of the State of New Hampshire for the year ended June 30, 2005, and have issued our report thereon dated March 21, 2006. In planning and performing our audit of the financial statements of the State of New Hampshire, we considered internal control in order to determine our auditing procedures for the purpose of expressing our opinions on the financial statements. An audit does not include examining the effectiveness of internal control and does not provide assurance on internal control. We have not considered internal control since the date of our report.

A material weakness is a reportable condition in which the design or operation of one or more internal control components does not reduce to a relatively low level the risk that errors 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 internal control would not necessarily disclose all matters in internal control that might be reportable conditions and, accordingly, would not necessarily disclose all reportable conditions that are also considered to be material weaknesses as defined above. However, we noted no matters involving internal control and its operation that we consider to be material weaknesses as defined above.

Our audit procedures are designed primarily to enable us to form opinions on the financial statements, and therefore may not bring to light all weaknesses in policies or procedures that may exist. We aim, however, to use our knowledge of the State gained during our work to make comments and suggestions that we hope will be useful to you.

This report is intended solely for the information and use of the Fiscal Committee, management, and others within the State and is not intended to be and should not be used by anyone other than these specified parties.

Very truly yours,

KPMG LLP

STATE OF NEW HAMPSHIRE
2005 MANAGEMENT LETTER

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Department of Administrative Services

New Financial Reporting for Postretirement Benefits

In addition to pension benefits, the State provides other postemployment benefits (OPEB), including postemployment healthcare as part of the total compensation offered to attract and retain the services of qualified employees. At June 30, 2005, the State reported that approximately 8,200 retirees and covered dependents were eligible to receive such benefits. In fiscal 2005, the gross cost of these benefits was over $40 million.

The Governmental Accounting Standards Board (GASB) issued Statement No. 43, *Financial Reporting for Postemployment Benefit Plans Other Than Pension Plans* and the related Statement No. 45, *Accounting and Financial Reporting by Employers for Postemployment Benefits Other Than Pensions*. Those Statements establish the standards for the measurement, recognition, and display of OPEB expense/expenditures and related liabilities (assets), note disclosures, and, if applicable, required supplementary information in the financial reports of state and local governmental employers, with the distinguishing factor being whether the State establishes a trust fund to accumulated assets to pay OPEB benefits (Statement No. 43). The Statements also require an actuarial valuation to be performed at least biennially.

In current practice, most OPEB plans – including the State's – are financed on a pay-as-you-go basis, and financial statements generally do not report financial effects of OPEB until the promised benefits are paid. As a result, current financial reporting generally does not:

- Recognize the *cost* of benefits in periods when the related services are received by the employer;

- Provide information about the *actuarial accrued liabilities* for promised benefits associated with past services and whether and to what extent those benefits have been funded; or

- Provide information useful in assessing potential demands on the employer's future cash flows.

Given the breadth of benefits offered, employee groups covered and dollar magnitude of annual benefits paid under the State's OPEB plans, the measurement of OPEB under the new standards will significantly impact the State's financial statements. Perhaps just as importantly, for the first time ever, the State will have the information and ability to evaluate the *long-term financial implications* of its OPEB transactions. This project, including dealing with the ramifications of potential funding decisions, will constitute a significant effort for the State. Accordingly, senior management should begin now to familiarize itself with the available literature, evaluate and compile census data, select an independent actuary to assist in calculating initial estimates, and analyze the results to prepare for future implementation.

Department of Administrative Services Response

DAS understands the significance of this new standard and as such, senior management in both the accounting and risk management offices are currently working with an actuarial vendor on the OPEB requirements. In addition, we have been involved with several training conferences to educate ourselves on the impacts of OPEB.

New Economic Condition Reporting in the Statistical Section

In May 2004, GASB issued Statement No. 44, *Economic Condition Reporting: The Statistical Section.* GASB 44 (an amendment of NCGA Statement 1) requires entities who prepare a Comprehensive Annual Financial Report (CAFR) to report specific information in the statistical section of their CAFR. The Statement will require statistical section information to be presented in five categories:

- Financial Trends Information;
- Revenue Capacity Information;
- Debt Capacity Information;
- Demographic and Economic Information; and
- Operating Information.

The goal of the Statement is to provide financial statement users with additional historical perspective, context, and detail to assist them in using the information in the financial statements, notes to the financial statements, and required supplementary information to understand and assess a government's economic condition. The provisions of GASB No. 44 are effective for the State for the fiscal year ending June 30, 2006.

The Statement will require the State to present information in their statistical section that has not been previously reported. Much of the new information is required to be presented for the previous ten fiscal years. Although not required by the Statement, we encourage the State to apply this Statement retroactively, thereby including all new statistical information for the previous ten fiscal years. This will enhance the readability of the statistical section; however it will require the State to compile the required schedules for the previous ten fiscal years, as opposed to just the implementation year. We recommend that the State familiarize itself with the new requirements and begin to compile the necessary information to update the statistical section.

Department of Administrative Services Response

Over the last few months we have participated in several educational sessions to familiarize ourselves with the requirements of the new statistical standard. We have also begun to gather data and prepare the new schedules that will be included in the CAFR. Where information is available, it is our goal to implement this standard retroactively for the previous ten years, although not required by the standard.

Succession Planning

We noted that the State has not established formal policies for ensuring that institutional knowledge is retained when long-time or otherwise key employees leave the State's employment.

The lack of formal procedures to transfer knowledge between departing employees and either their replacements or other individuals in their department has resulted in a demonstrable loss of institutional knowledge at several agencies during fiscal 2005.

We recommend that the State establish formal policies and procedures for ensuring that institutional knowledge is retained when long-time or otherwise key employees leave the State's employment. Further, we recommend that the State review current policies addressing job sharing to allow for the transfer of knowledge from departing employees to their replacements.

Department of Administrative Services Response

Although the Department does not have legislative authority to promulgate formal rules or enforce agency specific rules which would require agencies to cross-train and adopt succession planning, we understand the importance and risks associated with turnover and retirement. As with many organizations, the state will face a 'brain drain" from the retirement of long-term, key employees in the near future. At this year's annual closing meeting, time was dedicated on this specific topic. In addition, the Department will send a memo to agencies to encourage them to formally document their procedures, especially those that only occur once a year at a closing, to ensure the continuity of operations in the event of turnover.

Financial Reporting

The State's general ledger, New Hampshire Integrated Financial System (NHIFS), reports results of the State's operations on a budgetary basis of accounting. In order to properly report the State's financial position and results of operations in accordance with Generally Accepted Accounting Principles (GAAP), the Bureau of Financial Reporting is required to compile manual journal vouchers and post these GAAP entries to the financial reporting system, which is a series of Excel spreadsheets.

During the current year audit, we again noted an instance where a GAAP entry was incorrectly posted to the excel spreadsheets. In this instance, the journal voucher did not agree to the final amount of encumbrances liquidated by approximately $3.4 million. This error occurred because the journal voucher was not based on final amounts. This error originally caused encumbrances to be overstated by $3.4 million. This error was subsequently corrected in the financial statements, however, it is evidence that the manual process in which the financial statements are compiled can be improved to incorporate additional controls that would prevent or detect such an occurrence.

We understand that the financial reporting process will change significantly when the new Enterprise Resource Planning (ERP) system is implemented. However, we recommend that until that time, the Division of Accounting implement policies and procedures to ensure that a similar error would be prevented and/or detected. Such policies and procedures may include a final review of the journal vouchers compared with applicable support and a reconciliation of the net affect of the manual entries to that posted to the Excel spreadsheets.

Department of Administrative Services Response

As with any manual system, data entry errors can occur. It is our hope to mitigate these types of errors as we implement our new ERP system. However, it is the policy of the Division to review all entries and spreadsheets prior to transmittal to the auditors. This error occurred as a result of using a spreadsheet that was revised later in the audit and as a result the entry still reflected the original estimate. We have implemented an additional procedure to label all documents with "date completed" as well as "final version" on each document/spreadsheet. We will also clearly communicate to each other if any changes are made to spreadsheets that were previously transmitted to the auditors.

Budgetary Basis Reporting Methodology

Included in the State's Comprehensive Annual Financial Report are Budgetary Basis schedules for each of the applicable funds. Currently, these documents are prepared by one individual without additional review or without review from someone in the Comptroller's office. Additionally, presentation changes have been made to the budget to actual statement each year, and no formal policy exists for either making these changes or for compiling the data.

We recommend that the Comptroller's office be more involved in the completion of the budgetary basis statements, that a written policy be developed and agreed-upon by Management to ensure the consistent presentation of the statements. Additionally, someone other than the preparer should be responsible for the review of the State's budgetary basis schedules.

Department of Administrative Services Response

Currently there are 2 employees that prepare the budgetary schedules. One management employee has been involved for several years and has been the point person on policy decisions and documenting the process. A second employee has been working on learning the process over the last 2 years to aid in the transition of the schedule preparation. In the future, the Comptroller's office will review the Budgetary Basis Schedules and develop a more formal policy to ensure consistent presentation of the statements. Any changes to the budget formulas that are used to create the statements will be approved by the office and the auditors before finalizing the change.

Transfers to/ from the Education Trust Fund

In fiscal 2002, the Education Trust Fund (ETF) operated at a deficit of $16.6 million prior to General Fund transfers. The ETF deficit was eliminated by a transfer from the General Fund, in accordance with generally accepted accounting principles. However, we observed that there was no legislation authorizing transfers from the General Fund operating surplus to eliminate such a deficit. In fiscal 2003, 2004 and fiscal 2005, the ETF had a surplus from operations of $5 million, $7.8 million and $22 million, respectively, that was transferred to the General Fund as of June 30, 2003, 2004 and 2005 despite no legislation authorizing such a transfer.

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

Department of Administrative Services Response

During the fiscal 2006 legislative session, a bill was introduced to clarify the funding requirements and transfers between the education trust fund and the general fund. As of May 19, 2006, the legislation had failed and was not adopted. We will work again with the legislative budget office during the next session to clarify this issue.

In addition, the Attorney General has issued an opinion on the appropriateness of these transfers, dated April 7, 2006. In summary it states that as a result of their review the Department of Administrative Services has acted in accordance with both State laws and legislative intent.

Calculation of BPT/BET Revenues Transferred to the Education Trust Fund

At year end, a calculation is performed to determine the amount of tax revenue to be allocated to the Education Trust Fund. In reviewing the calculation, we determined that the amount transferred for Business Profits Tax (BPT) and Business Enterprise Tax (BET) from the General Fund to the Education Trust Fund was less than it should have been by approximately $1 million. This was because the amount transferred was not calculated based on revenues recorded through to the end of the year. It should be noted that because the Education Trust Fund had a surplus, the surplus funds, as is general practice of the State, would have been transferred back to the General Fund.

We recommend that this calculation be performed when all of the tax revenues are recorded thus ensuring that BET and BPT revenues are transferred at the appropriate amounts and recorded in the proper fund.

Department of Administrative Services Response

This calculation is performed and entered into the State's accounting system annually by the Department of Revenue (DRA). During fiscal 2005, the calculation was performed on June 29th. In previous years having a cut-off earlier than June 30th did not result in a material difference to the transfer calculation. However, as noted in the observation, by excluding revenue collected on June 30th the transfer was understated by $1.0 million. The Department of Administrative Services will work with the DRA to review any revenue collected on the last day of the month and adjust the calculation as needed.

Timely Reporting of Accounts Payable

DAS reviews all disbursements made after year-end to determine which fiscal year the expenditure related to. In certain cases, such as with (longer-term) construction projects, expenditures can relate to more than one fiscal year. In these instances, DAS determines the number of days the project was ongoing in each period and allocates the entire amount of expenses to the period with the most (days of) activity.

The effect of allocating the entire amount of contract costs to the period with the most activity rather than allocating costs proportionately to their respective period could result in the material overstatement or understatement of expense.

We recommend that DAS establish a policy to either *(a)* allocate *all* costs to their respective period based on the number of days of activity in each period or *(b)* establish a materiality threshold above which costs are allocated to their respective period and below which costs are allocated to the period with the most activity (to ensure that expenditures/liabilities are not materially misstated).

Agencies are requested to submit to DAS an exhibit, which details cumulative payments greater than $150,000, that were processed after an early August cut off date. In addition, DAS receives warehouse reports of expenditures greater than $150,000 that were made after year-end. Included on these reports are expenditures marked with a double asterisk ("**") by the agency inputting the payment voucher information. The double asterisk is used to report that the expenditure relates to the previous fiscal year, and should be included in the amount accrued as of June 30th. DAS reviews the reports to determine whether the expenditures are properly coded with double asterisks and determines which amounts should be included in accounts payable. However, based on our audit, we noted that certain expenditures marked with a "**" by the agency but not included on an Exhibit I, were not properly reflected in accounts payable or accruals, understating expense and payables through June 30th.

We recommend that DAS strengthen controls over ensuring that expenditures coded with a double asterisk are properly reflected in accounts payable or accrued expenses.

Department of Administrative Services Response

DAS concurs and will work with the auditing staff and agencies to ensure that expenditures are properly coded as accounts payable, and reported and charged to the appropriate fiscal year. During the annual closing meeting, agencies were notified that improper coding of accounts payable had become a more significant audit issue. Agencies were encouraged to spend additional time reviewing payments to ensure their correct treatment. In addition agencies were told to split their payments for contracts that span multiple fiscal years so that the charges can be prorated by month and charged to the appropriate fiscal year. We will carefully monitor payments made during June through August to validate the accounting treatment.

Accounting Information Provided to Department of Administrative Services from Various Agencies

During the State's year end closing process the Comptroller's office relies on many agencies and departments to provide it with the information needed to properly report the State's finances. We noted in certain instances the departments are providing information only requested from them and do not always understand the purpose for which the Comptroller's office needs this information. The lack of understanding may cause out dated information to be reported to the Comptroller's office. Two specific examples noted were with the Department of Revenue Administration (DRA) and with the State Treasurer's Abandoned Property Division.

The DRA has, in some instances, updated its systems or enhanced reporting capabilities; however, information provided to DAS continues to be in the same format year after year. Another example is with outdated information provided to DAS by the Abandoned Property Division because the department did not fully understand the purpose of the information requested by DAS. Abandoned Property continued to provide the same information year after year without updating prior year amounts as amounts changed.

We recommend that at least annually DAS meet with the Departments that provide it with key information used to prepare the State's financial statements to review with the departments the purposes of the requests. Once the requirements are understood, the departments should be better able to inform DAS of any new system or new reporting capabilities which may enable them to provide information which is more useful and is in a more precise format.

Department of Administrative Services Response

DAS does meet with several agencies at a minimum every year-end at closing to go over the information needed for the audit and preparation of the CAFR. However, in upcoming years we will also focus those meetings on data and reporting enhancements. We will also include KPMG in those meetings to ensure the information we are gathering will satisfy their audit needs.

Department of Corrections

Controls Over Leave Time Accounting and Reporting are Insufficient

The New Hampshire Department of Corrections is responsible for the accounting and record keeping of its 1,100 employees. However, there appears to be several weaknesses in internal controls over the reporting and accounting for leave time. The current process is manual, time consuming and prone to error.

At the correctional facilities, leave slips are to be completed by the employee and signed off by a Supervisor, approving leave time to be taken. However, this approval occurs prior to a determination of whether the employee has the time available. From the leave slips and the employee's time sheet, someone at the facility manually records this information on to a green time card. The green card is then forwarded to the Department's central office to be input into the GHRS payroll system. The information from the green card is input without any verification of what the leave slips report.

During our internal control testwork, we chose a sample of 12 Department employees to ensure that their leave slips agree with the amounts input into the State's GHRS payroll system. From this sample, 11 employees had variances between the amount of time reported on their leave slips for annual, compensation, sick, fiscal year bonus and/or floating holiday. The variances ranged from 1 hour being over reported to 138 hours of compensation time being under reported when comparing the leave slip with what was input into GHRS. Additionally, in many instances leave slips were missing. In fact, for one employee chosen, no leave slips could be found for the entire year. Management could not explain why the leave slips did not reconcile to GHRS or why leave slips were missing.

Further, there is no analysis performed on the time taken. One employee took 267 hours of compensatory time in one year, which seems unusual.

We recommend that the Department strengthen controls over leave time accounting and reporting. The Department may want to research investing in an on-line time and leave reporting system, if feasible. Because there is no one person responsible for leave time at the facilities, the Department should consider hiring a payroll administrator(s) for the larger facilities to oversee the reporting and authorization of time and leave taken at these correction facilities. This individual(s) would be responsible for ensuring that leave time is available prior to being taken and that leave time is authorized and in accordance with State policies.

In the mean time, the Central Office should receive biweekly original source documents, signed by the employee and supervisor to be used to input the information into GHRS. Additionally, the Department should strengthen controls over the reporting and approval of time taken at the District offices. Analysis should be performed on a test basis to ensure that any leave time taken is in accordance with State's policies. Further, management should investigate and resolve any current variances between leave reporting and the GHRS system.

Department of Correction's Response

We acknowledge that an internal control weakness exists in the current reporting and accounting of leave time and agree that improvements in internal controls are warranted to improve this reporting function. The addition of payroll administrators at the larger facilities and the acquisition of a leave time computer system will be considered for our SFY 2008 – 2009 operating budget request. With these additional resources, we feel that we would be able to strengthen our overall payroll reporting controls at the facility level.

We agree that ideally the Department should be entering data into the GHRS system directly from original source documents such as the individual daily time sheets and application for leave sheets versus inputting data from a second generation summarized document, the green time card. However recognizing our current staff resource limitations at the Central Office, we are presently unable to input data for our 1,100 employees in the manner suggested. We will consider requesting for our SFY 2008 – 2009 operating budget sufficient additional payroll data entry clerks to perform this function.

In order to introduce the review, approval and variance analysis functions at the Central Office location, we will also consider reassigning the payroll administrator/coordinator located at the Central Office location to coordinate and oversee these functions and be a conduit for the payroll administrators being requested at the larger facilities and to assist clerical staff at the smaller facilities.

Department of Health and Human Services

Medicaid Liability Calculation

During fiscal year 2004, the State completed their implementation of the Medicaid Decision Support System (MDSS), which was designed to increase the functionality of the Medicaid Claims Database. This included developing a report which will calculate the Medicaid Liability at any one point in time. The calculation of the liability is based in part on 'lag factor' tables maintained in the system. These tables compute a lag factor based on date of service of the claim compared to when the claim paid. To ensure the Medicaid liability calculation is including the most recent payment trends, the lag factors should be recalculated annually.

Although it was difficult to determine the effect of not updating the lag factors had on the calculation, if any, we recommend the Department update lag factors annually to ensure that the liability is based on the most current payment trends and is in line with industry standards.

Department of Health and Human Services Response

The MDSS completed a product release in May 2006. The Department of Health and Human Services will perform a rebuild of the lag factor before May 31, 2006.

Reconciliation of Medicaid Payments

Quarterly the Department of Health and Human Services (DHHS) submits Medicaid expenditures on a CMS 64 report. Medicaid expenditures incurred during the year are also downloaded into the Medicaid Decision Support System as the basis for developing the Medicaid Incurred But Not Reported liability. These expenditures are reported on the MARS 544 report.

To ensure completeness and accuracy of the expenditures utilized in the MDSS system, we recommend that the Department perform monthly reconciliations of the expenditures on the MDSS system to those reported to the Federal Government on the CMS 64 report. Prior to our audit, a reconciliation did not exist; however, the Department was able to reconcile the amounts with approximately a $500,000 difference.

Department of Health and Human Services Response

The DHHS is working on incorporating this reconciliation into our quarterly CMS 64 federal filing.

Controls over the Proportionate Share Calculation Needs to be Improved

According to the Medicaid State Plan, Attachment 4.19D, the New Hampshire Department of Health and Human Services (the Department) has recognized that non-State operated governmental (county) nursing facilities provide care to many severely medically involved patients requiring an extraordinary and costly level of care and have a very high Medicaid proportion of their patient census. The Department has ensured continued access to this level of care through proportionate share (proshare) incentive adjustment payments to each non-State operated governmental nursing facility.

The payment to the counties is based on the difference between the Medicare and Medicaid rate for each nursing home, by Resource Utilization Group (RUG). The Medicare rates are obtained from the Centers for Medicare and Medicaid Services (CMS) fiscal intermediary for NH. Medicare rates are set yearly to coincide with the Federal fiscal year, therefore, two different Medicare rates, for each RUG, were in effect during the State fiscal year. The Department determines the weighted average of the Medicare rates in effect during the State fiscal year to use in the proshare calculation.

During our review of the State fiscal year 2005 proshare calculation, we noted an error in the Department's calculation of the average Medicare rates for 11 of 86 (13%) RUGS. The miscalculation appeared to be the result of a spreadsheet formula error. The effect of this error caused the payment to the counties to be understated by $970,504, of which 50%, or $485,252, was under-reimbursed by CMS.

As this was an under-reimbursement, there are no questioned costs. However, findings surrounding the State's proshare calculation have been in the State's single audit report since fiscal year 2002, many of which have questioned millions of dollars in costs. This is further evidence that the Department needs to improve the controls surrounding the review and approval of this annual calculation.

We recommend that the Department implement policies and procedures in order to ensure the accuracy of future proshare payments. Additionally, we recommend that the Department correct the mathematical error by revising future proshare payments.

Department of Health and Human Services Response

There was an error in the calculation of the average Medicare rate used in the Proshare calculation. Items related to this error are currently being reviewed. To avoid this error in the future, two individuals, independent of each other, will prepare the Proshare calculation worksheets. The reconciled worksheets will then be reviewed by two independent individuals for accuracy of formula application and verification of calculations that are subject to management approval.

Internal Service Fund

Policies and Procedures

In fiscal year 2005, the Department added resources (personnel) and rectified a number of control deficiencies; however, the Department has still not established written policies and procedures (controls) for the following areas:

1 Risk Assessment and Operation of the Health Benefits Plan

2 HIPAA compliance

3 COBRA billings

4 Retiree and dependent eligibility

5 Retiree health benefits and contributions funding

The effect of not establishing written policies and procedures for the areas noted above, includes potentially subjecting the fund to (a) fraud, waste and abuse; (b) non-compliance with HIPPA regulations; (c) inappropriate COBRA billings; (d) unnecessary expenditures due to the coverage of ineligible participants, and; (d) improper funding.

We recommend that management implement policies and procedures related to each of the areas above.

Department of Administrative Services Response

We concur in part.

The Department, through its enrollment vendor, Choicelinx, has implemented a reporting and review procedure for agency HR directors to confirm enrollee eligibility. Further, the Department has embarked upon a project to update all retiree data, utilizing information from the New Hampshire Retirement System and its several health benefits program vendors. The Department has developed a number of policies and procedures for the program, including those with respect to COBRA enrollment and payment, former legislator enrollment as well as vendor payment and expenditure posting.

Finally, while the Department has not yet fully implemented a HIPAA compliance program, it has taken steps to ensure such compliance by its program vendors. The vast majority of HIPAA-protected health information associated with the program is within the exclusive possession and control of the external vendors. Each of the Department's medical, pharmacy, enrollment and dental administrators and insurers are HIPAA compliant as represented in their respective service contracts.

Health Insurance Contract

We observed that the State's contract with Cigna includes a Performance Guarantee between Cigna and the State. The Performance Guarantee outlines specific commitments in the areas of financial accuracy, payment accuracy, and processing accuracy and provides for a penalty in the amount of 3% of the Administrative Services Only (ASO) fee in the event that any of the performance guarantees are not met.

As in the prior year, the Department contracted with Segal to audit claims paid by Cigna. Segal's audit includes procedures to determine whether Cigna met performance guarantees. In their report, Segal noted that it appeared that Cigna did not meet the performance guarantee related to financial accuracy. Cigna disputed Segal's finding citing the fact that Segal used a different methodology for calculating the performance guarantee when the agreement between Cigna and the State dictates that Cigna will determine the audit methodology. Segal countered that Cigna's methodology is inconsistent with industry standards. Based on its own calculation, Cigna conceded that financial accuracy results were below the performance guarantee but could not be used to invoke the penalty due to the margin of error in the calculation.

The effect of allowing Cigna to dictate the methodology for calculating performance guarantees is that misunderstandings may arise regarding whether performance guarantees are being met.

We recommend that the Performance Guarantee Agreement be amended to include provisions which establish: (1) The State's right to conduct an independent review to confirm performance achievements and applicable penalties due; (2) Guidelines regarding the reporting and treatment of any variables between the Proclaim and PMHS systems, and; (3) Goals for overall processing to capture the number of claims free from all error.

Department of Administrative Services Response

We concur in part.

The performance guarantee provision of the agreement between the State and the Third party administrator (TPA) authorizes the TPA to determine the audit methodology for computing satisfaction of performance guarantees. All performance guarantees under the two agreements have been satisfied for each audit period, when computed under the TPA's methodology, taking into consideration a standard margin of error.

The Bureau's employee benefits consultant applied a different methodology in its calculation of performance guarantees and concluded that both the Financial and Payment Accuracy categories declined and do not meet the associated performance guarantees. The consultant initially advised the Bureau to amend the in-force performance guarantee provision. Later, the consultant stated that a preferable approach (and we tend to agree) might be to address the issue in the next RFP process.

Further, we point out that under the State's current agreement with the TPA, the State may elect to arbitrate any outstanding disputes, controversies or questions. See Section 11. Resolution of Disputes – Arbitration. Currently, the State is informally disputing the TPA's performance measure methodology. The Bureau has had on-going discussions with the administrator as well as its benefits consultant and continues to pursue a resolution of this matter to the satisfaction of the Bureau. To this end, the Bureau will consider all available options to bring about a conclusion to this issue.

Treasury Department

Conversion of Escheated Stock

We noted that the Treasury Department has not established a formal written policy for converting escheated stocks into cash. Treasury typically converts stocks to cash after an arbitrary period of 3 years, rather than seeking to maximize returns to the State.

The Department's policy of converting stocks to cash after 3 years, regardless of market conditions, may result in unnecessarily lower returns to the State.

The Department should establish policies and procedures to be performed that seek to maximize the State's return on sales of escheated stock. This may include hiring an investment advisor to assist in the determination of what may be the best time for the stock to be sold or the Department may want to institute procedures for in-house analysis to be performed.

Treasury Department's Response

We do not concur.

The current practice, in compliance with the applicable provisions of RSA Chapter 471-C:24 Public Sale of Abandoned Property, is to hold securities, in share form for at least one (1) year. Typically, this allows time for completion of other statutory requirements (e.g. for notification to be mailed to the apparent owner and for advertisement in the newspaper) thereby affording a claimant sufficient notice and an opportunity to recover the securities in share form. Subsequently the owner information is made accessible and remains available by web search. Unclaimed shares are identified and liquidated prior to the annual escheatment at the prevailing stock exchange or market price at the time of the sale, also in compliance with the provisions of Chapter 471-C:24.

New Hampshire’s unclaimed and abandoned property law, as currently written is a purely custodial statute. Essentially, it is intended to preserve the owner’s interest. Claim to the property is always available to the lawful owner. The provisions of Chapter 471-C:24 give consideration to the protection of an owners’ interest in the property and the recovery thereof, but the statute does not provide for “maximiz(ing) the State’s return on sales of escheated stock ”.

Applying a “prudent man” standard, which we do today, to custodial shares would best preserve the property of the owner in a form and a value closest to that which was delivered to the State on the owner’s behalf.

EXHIBIT A

Outstanding Prior Year Comments

The following represents comments identified in our previous management letter that were 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

***Implementation of Government-wide Enterprise Resource Planning System* (2003 and 2004 Management Letters)**

The State has appropriated approximately $18.8 million to procure and implement a new financial accounting system or, enterprise resource planning (ERP) system, to replace the existing legacy system, New Hampshire Integrated Financial System (NHIFS) and the Government Human Resources System (GHRS). An ERP system is an integrated information system that is intended to serve all departments in an organization, enhance reporting capability and provide additional system functionality.

The ERP system implementation is an extremely complex, time consuming and expensive process and can severely impact continuing business activities. The State has dedicated a team of State employees to head up the procurement and implementation of the ERP.

We recommend that the State carefully consider its IT needs and goals. This is addressed by a due diligence process that should include a needs assessment, both present and future, across all aspects of the State's operations. Specifically, the State should:

- Develop a detailed timeline, including milestone dates, associated deliverables, and estimated time to achieve each milestone and be agreed to by the team, participating State agencies, and the ERP vendor.

- Ensure that the project plan and deliverables are clearly defined. A proposed work plan with appropriate detail for State management review should be properly addressed.

- Develop a reporting mechanism to make sure the team has access to the highest levels of State government for decision-making purposes.

- Ensure that the vendor implementation methodology fits the State's culture and management expectations.

- Ensure that all members of the organization are adequately trained to utilize the new systems and its capabilities and have access to system support after implementation.

- Establish a contingency plan in case of unexpected delays in implementation.

Overall, the State should recognize that the failure to adequately plan for and execute fundamental changes to the organization's business processes that will occur as a result of an ERP implementation would impact the outcome. Failures to review and develop future technical and business requirements, job descriptions, organizational structural changes, and adequate documentation of existing legacy systems are common difficulties.

Department of Administrative Services Response

During May 2006, the State entered into a contract with both a software vendor and implementer for a new ERP system. We understand the project's success is contingent upon proper planning, dedicating adequate resources, appropriately training users, and mitigating risks along the way. Due to the magnitude of the project, the State is in the process of hiring an independent project manager, specialized in projects of this complexity. In addition, the Legislature recently approved a bill to allow for additional funds to be allocated for quality assurance and the State is hoping to have a RFP on the street and vendor hired by the early fall.

Department of Environmental Services (Issued by the LBA 2005 Management Letter)

Policies and Procedures

In fiscal year 2005, the Department of Environmental Services added resources (personnel) and rectified a number of control deficiencies, however, the Department has still not established and/or implemented written policies and procedures (controls) for the following areas:

1. Documentation of computerized business applications

2. Cash receipts (policies and procedures internal auditing)

3. Ensuring that lab fees at the Department's are in compliance with applicable RSAs

4. Fraud Prevention

5. Revenues collected for the Department of Safety

6. Reporting Real Property

7. Disaster Recovery

8. (Timely) closing of contract escrow accounts

9. Billing of Winnipesaukee River Basin assessments

The effect of not establishing written policies and procedures for the areas noted above, includes potentially subjecting the fund to (a) fraud, waste and abuse; (b) non-compliance with RSA's; (c) loss of revenue, and; (d) unnecessary losses due to disaster.

We recommend that management implement policies and procedures related to each of the areas above.

Department of Environmental Services Response

The Department of Environmental Services has implemented corrective action, to the extent possible, on all of the above listed items. Various items, such as the revenue collected from the Department of Safety, cash receipts, reporting real property, escrow accounts, billings and real property documentation have been completed. The others are in process and either require the department to coordinate efforts with other state agencies or require statutory change, which we continue to work with the legislature to enact.

Department of Education (2003 and 2004 Management Letters)

Financial Reporting Redundancy

The NH Department of Education (the "Department") 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 LEAs, Vocational Education, Class Size Reduction, Child Nutrition and Title II – Improving Teacher Quality.

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 employee's.

The lack of integration leads to 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 Department's internal and external users on a timely basis.

We recommend that the Department 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 Department and their external users.

Department of Education's Response

The New Hampshire Department of Education concurs that the lack of a modern integrated accounting/management system leads to inefficiency and potential for errors. We anticipate that an Enterprise Resource Planning (ERP) system that completely addresses this need will be implemented statewide in the coming 18 months. Vendor contracts for the ERP implementation were approved by the Executive Council on April 19, 2006. As specified by the State's Strategic Information Technology Plan (SITP), the ERP will consist of multi-module application software packages designed to serve and support several business functions across the organization. It will be a strategic tool that helps the State improve operations and management by integrating business processes and helping to optimize the allocation of available resources. Key functional areas of the State's ERP software will include budgeting, financial accounting, accounts payable, grants, projects, assets, inventory, purchasing, human resources, revenue and receipts, and cross function requirements. Implementation will allow the Department to migrate all current business office accounting functions to the ERP system and eliminate the four separate accounting systems including: the Form 2 system, the Federal Ledgers, the Grant Control Ledgers, and the state financial accounting system (NHIFS).