KPMG

STATE OF NEW HAMPSHIRE

Management Letter

Year Ended June 30, 2008

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To the Fiscal Committee of the General Court
State of New Hampshire:

We have audited the financial statements of the State of New Hampshire (the State) as of and for the year ended June 30, 2008, and have issued our report thereon dated December 18, 2008. In planning and performing our audit of the financial statements of the State, in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States, we considered the State's internal control over financial reporting (internal control) as a basis for designing our auditing procedures for the purpose of expressing our opinions on the financial statements, but not for the purpose of expressing an opinion on the effectiveness of the State's internal control. Accordingly, we do not express an opinion on the effectiveness of the State's internal control.

The maintenance of adequate internal control designed to fulfill control objectives is the responsibility of management. Because of inherent limitations in internal control, errors or fraud may nevertheless occur and not be detected. Also, controls found to be functioning at a point in time may later be found deficient because of the performance of those responsible for applying them, and there can be no assurance that controls currently in existence will prove to be adequate in the future as changes take place in the State.

Our consideration of internal control was for the limited purpose described in the preceding paragraph and would not necessarily identify all deficiencies in internal control that might be significant deficiencies or material weaknesses. However, as discussed below, we identified certain deficiencies in internal control that we consider to be significant deficiencies.

A control deficiency exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent or detect misstatements on a timely basis. A significant deficiency is a control deficiency, or combination of control deficiencies, that adversely affects the State's ability to initiate, authorize, record, process, or report financial data reliably in accordance with generally accepted accounting principles such that there is more than a remote likelihood that a misstatement of the State's financial statements that is more than inconsequential will not be prevented or detected by the State's internal control. We consider items in Section I to be significant deficiencies in internal control.

A material weakness is a significant deficiency, or combination of significant deficiencies, that results in more than a remote likelihood that a material misstatement of the financial statements will not be prevented or detected by the State's internal control. We believe that Findings 2008-1 and 2008-2 in the accompanying schedule of findings and responses are material weaknesses.

Although not considered to be significant deficiencies or material weaknesses, we also noted other comments during our audit which we have presented in Section II that we would like to bring to your attention.

The State's written responses to the significant deficiencies in Section I and the other comments in Section II identified in our audit has not been subjected to the auditing procedures applied in the audit of the financial statements and, accordingly, we express no opinion on them.

This communication is intended solely for the information and use of the Fiscal Committee, management, elected officials, and federal awarding agencies and is not intended to be and should not be used by anyone other than these specified parties.

KPMG LLP

December 18, 2008

STATE OF NEW HAMPSHIRE

Management Letter

Year Ended June 30, 2008

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SECTION I

SIGNIFICANT DEFICIENCIES

AND

MATERIAL WEAKNESSES

2008-1 - MATERIAL WEAKNESS

Accounting and Financial Reporting for Capital Assets

The Department of Transportation (the Department) does not have sufficient systems, processes, and controls to ensure the accurate and complete reporting of the State's non-turnpike infrastructure assets. During the 2008 audit, the Department recognized it had previously understated by approximately $50 million the cost of its non-turnpike infrastructure assets. This understatement reflected errors in the valuation of its non-turnpike infrastructure assets that occurred in prior fiscal years. These assets consisted of a variety of projects including new construction, replacement construction, and capacity improvement construction on the State's non-turnpike highway system.

This understatement was originally detected during fiscal 2007 when the Department performed a more robust review of its capital assets. This review resulted in the discovery of approximately $10 million of non-turnpike capital assets that should have been recorded on the State's books in prior fiscal years. However, at the time these projects were identified and recorded on the State's books, the full costs associated with these projects were not identified due to an improper analysis of the Department's project expenditure database.

This error, stemming from inadequate systems, processes, and controls over the tracking and recording of non-turnpike infrastructure assets, has been recognized in past audits and resulted in the reporting of material weaknesses in prior audit reports. The Department's information systems were not designed to track this information. The Department has established manual processes to capture all projects and costs associated with these projects, but as noted in fiscal years 2007 and 2008, these manual processes are also prone to error.

The Department is responsible for managing over $2.8 billion in infrastructure assets. As of June 30, 2008, those assets have a net book value of over $1 billion.

Similar material weaknesses have been reported in prior management letters.

We recommend that the Department re-evaluate the way in which it tracks non-turnpike infrastructure assets. The Department should continue to plan for the replacement of its information systems.

Management's Response:

We concur. While we have improved over the last couple of years with recording fixed assets, the process is very manual and there are still many opportunities for error. The Department has instituted a quarterly review with a senior engineer from the Bureau of Design to verify fixed asset projects are properly identified. The Department will perform a review of capital spending through the end of February 2009 to make sure projects have been properly classified. Based on this review, quarterly reviews will be implemented and formal procedures will be documented to allow for a better reporting of assets.

Finding 2008-2 - MATERIAL WEAKNESS

Statewide Succession Planning Process

The State is currently experiencing an outflow of personnel who have decades of institutional experience and are skilled in the financial and non-financial processes around the State. The result of this "brain drain", if not mitigated, will be a lack of critical human resources needed for continued controlled State operations. The state will be required to immediately implement an appropriate personnel succession plan throughout the State to counter the effects of that loss of human resources. Such a plan will help ensure that adequate resources, in both financial and operational areas, are available in the future to adequately meet the ever increasing financial, operational and accountability demands being placed on the State. Such a plan needs to ensure that all key departmental roles are identified and reviewed to determine how best to plan for personnel replacements.

As an example, the Comptroller position has been vacant for nearly two years as of the date of this letter. The State Comptroller is an integral part of the State's overall control environment and is responsible for the preparation of the Comprehensive Annual Financial Report. The Comptroller is also a main player in the implementation of major new accounting systems, such as NH First, the State's Enterprise Resource Planning (ERP) system.

While this vacancy was not the cause of many of the States problems, the vacancy certainly has exacerbated certain situations, such as untimely financial reporting in prior years and the delayed implementation of NH First. The lack of a Comptroller has resulted in an understaffed Bureau of Financial Reporting, a lack of outreach for financial expertise to State agencies, a limited critical review process over financial information, and an increased risk for the occurrence of undetected errors.

An entity that is both large and complex can not afford to let this position go vacant for a long period of time, especially when the go-live date of NH First is around the corner. We understand the State is in the process of filling this vacancy, therefore, we recommend the State continue its efforts to find the right person to fill the job.

A comment similar to this comment was reported in connection with the 2006 and 2007 audits.

Management's Response:

On January 18, 2008, the Division of Personnel hired an employee into the newly created position of Workforce Development Coordinator. Since filling this position a number of workforce development initiatives have taken place. Beginning February 2008, a thirteen member workforce development committee representing seven of the larger state agencies was established. The workforce development committee developed two surveys for top executives throughout the state system as well as an employee survey. 373 administrators responded and 3093 employees responded to the survey. The responses to both surveys are being used as part of the SWOT (Strengths, Weaknesses, Opportunities, Threats) analysis for the workforce development strategic plan developed by the workforce development committee. The survey information is being used for the Gap Analysis portion of the plan. The committee has also reached out to stakeholders in other *ways including presenting information at meetings with the Governor and his Council, Governor's Advisory Group, 3 House Committees, Senate Finance Committee, Labor Relations Committee, Commissioners, and added the vice-president of the largest union to the committee membership. The workforce development committee has planned a Workforce Development Strategic Initiatives Summit or April 17, 2009 at which they will share with stakeholders 7 workforce planning models designed to help all state agencies develop and implement workforce development programs. These models include:*

1. *Workforce Development Planning Model*
2. *Individual Development Plans for Career Ladders, Career Paths, and Organizational Enhancement Model*
3. *Mentor Program Model*
4. *Executive & Critical/Difficult to fill Positions Candidate Development Model [Succession Planning Model]*
5. *Knowledge Management & Transfer Model*
6. *Strategic Planning Model*
7. *How to Measure Customer Satisfaction in New Hampshire State Government Model*

The workforce development committee strategic plan is a 10 year plan including 3 major goals with 23 objectives. Some objectives have been accomplished while others [part of the longer plan] are being reviewed and, where appropriate, modified to be consistent with the SWOT analysis. Part of the plan includes seeking an Executive Order from the Governor to implement workforce development on a statewide basis. The Governor has indicated his support for the order pending the results of legislative action for workforce development sought by the workforce development committee. At this time, there is discussion of possible legislation to address statewide workforce development needs and initiatives. Regardless of the outcome of the proposed workforce development budget the workforce development committee plans to push forward with the workforce agenda and plan.

Specific to the Comptroller position, on March 4, 2009, Governor and Council approved an executive search service contract with Snowden Associates. With this contract now in place, the State intends to move aggressively in filling this position.

<u>2008 – 3 – SIGNIFICANT DEFICIENCY</u>

<u>Unknown Cash Accounts</u>

During an audit of the Board of Tax and Land Appeals (the Board) by the Office of Legislative Budget Assistant – Audit Division (LBA), it was discovered the Board had over $7 million of cash accounts previously unrecorded on the State's Comprehensive Annual Financial Report. These accounts are assets held by the State in escrow for other entities and were ultimately recorded as an Agency Fund.

The accounts consist of a checking and savings account maintained by the Board to hold and pay out amounts held in escrow related to contested eminent domain property takings. During fiscal year 2008, approximately $8.5 million were deposited into the accounts and $4 million were paid from the accounts. As of June 30, 2008, the balance of the two accounts was approximately $7.2 million.

It appears the Department of Administrative Services and the Treasury Department were unaware of the magnitude of the financial activity the Board was responsible for in the multimillion-dollar cash account operating outside of the State's central control and accounting systems.

We recommend the State determine whether other departments, boards or offices maintain or use cash accounts outside the control of the Treasury Department. Further, if the funds remain in the control of the Board, we recommend the Board and the Treasury Department work together to ensure the proper control structure is in place

Management's Response:

We concur. The Treasury has taken a number of actions to correct this deficiency. Treasury met with the Board and its staff on February 2 to understand and evaluate the Board's business needs and the control structure in place. As a result of the meeting, the Board will be seeking Governor and Council approval to maintain its own bank account and the Treasury will participate in periodic monitoring of banking and accounting services the Board receives.

In addition to the actions taken specific to the Board of Tax and Land Appeals, Treasury is in the second phase of a project to identify the business needs and associated risks with all bank accounts held under the State's tax identification number that are not in the custody of the Treasurer. We have identified all such accounts held by our three largest banking partners and, as a result, some of those accounts are being closed. In the second phase, we are seeking similar information from every bank doing business in the State. If necessary, Treasury will share the results of its work with the Department of Administrative Services.

2008 – 4 – SIGNIFICANT DEFICIENCY

Preparation of Accounts Receivable Estimates

During preparation of the State's Comprehensive Annual Financial Report, the Department of Administrative Services (DAS), using various inputs from the Department of Revenue Administration (DRA), estimates the amount of revenue to record for business taxes and interest and dividend taxes from taxes receivable as of June 30.

During the audit of the Department of Revenue Administration, LBA auditors noted the methodology used by DAS would have resulted in the overstatement of receivables as of June 30, 2008 of approximately $31 million. The methodology was based on a forecasted increase in revenues even though, due to the economic slow down, the fiscal year 2008 budget projections were not met and the fiscal year 2009 budget projections are not expected to be met. The inputs used by DAS were inappropriate in the current environment and revised projections were used to calculate the receivable.

Additionally, the State's estimate of uncollectible accounts is based on historical data where, in the current environment, historical collection rates may not be indicative of future collection rates.

Given the current environment, it appears the methodologies used by the State to estimate its receivables and uncollectible accounts need to be re-visited. Further, we note that DRA is in the best position to estimate collections and uncollectible accounts given their knowledge and exposure, yet DAS developed the methodology and does not review the calculation with the DRA for concurrence on assumptions and trend information that may impact the accuracy of it. We recommend the State take a clean look at how it prepares these estimates and, given the DRA's knowledge of the State's taxes and tax trends, fully involve the DRA on a yearly basis to determine the annual estimates.

Management's Response:

We concur. DRA and DAS Bureau of Financial Reporting (BFR) have met to review BFR's closing process, receivable calculations and growth assumptions used in 2008 year end accounts receivables. Going forward, DRA and BFR will develop and implement reallocation of responsibilities for determining and reporting accounts receivables for revenues collected by DRA.

2008 – 5 – SIGNIFICANT DEFICIENCY

No Service Organization Audit – SAS No. 70 –performed for Medicaid Pharmaceutical Claims Processor

During fiscal 2008, the State paid over $75 million of Medicaid pharmaceutical claims. These claims are paid after they have been processed for accuracy and propriety by the State's vendor, First Health. Despite the use of a vendor to process the claims, the State Department of Health and Human Services chose not to require First Health to get an audit of the procedures and policies and controls over the processing of these claims – commonly referred to as a SAS No. 70 report.

The decision to not require a SAS No. 70 audit exposes the State to the risk that First Health's controls, policies and procedures were not working properly and may have resulted in the State paying claims for inaccurate amounts or for ineligible individuals.

We recommend the State require that First Health and all other service organizations used by the State provide Type II SAS No. 70 reports and that the appropriate State agency review the results of the report to determine whether adequate controls are in place to ensure that information processed by service organizations is reliable.

Management's Response:

Department of Health and Human Services

Concur. The State of NH Department of Health and Human Services, Office of Medicaid Business and Policy has contracts with First Health Services for Pharmacy Benefits management. The first SAS70 audit was done for SFY04 and there was one finding for visitors to sign a confidentiality statement for HIPAA. Management took corrective action and subsequent SAS70 audits indicated no weaknesses. Due to budget constraints and results of prior audits, the Commissioner's office decided to forgo an audit for 2008. The department did receive written assurance from the contractor that the internal controls had not changed since the last SAS70 audit. The current contract requires a SAS 70 audit, performed for SFY 2009 and in the future contracts, we will be requiring SAS 70 audits annually.

SECTION II

OTHER COMMENTS

2008 – 6 – MANAGEMENT LETTER COMMENT

New Hampshire Community Technical College System

Chapter 361, Laws of 2007, established the Community College System of New Hampshire (the System) as a body politic and corporate. The System was formerly a department of the State and its financial activity was reported in the State's general fund.

Due to the passage of this law, the State was required to re-evaluate the manner in which the System was reported in the State's financial statements. The System went from being included in the general fund of the State to being separately reported as a discretely presented component unit. While evaluating the impact of this law on the State's financial statements, we determined that additional consideration needs to be given to the fiscal, administrative, and legal impacts on the State and the System.

Below are some areas the State needs to address relative to the separation of the System from the State:

- The System continues to use the financial and administrative services of the State Treasurer and the State Department of Administrative Services, but the expenses related to providing those services have not been allocated or assigned to the System but remain an expense of the State. The State should evaluate whether it wants to continue to fund these costs for the System.

- It is unclear who has title to the assets constructed or purchased with State money. The law was unclear as to the transfer of title of assets to the System. Currently, the State continues to report most of these assets.

- The System is now a separate body politic and corporate but still uses the State's Federal Taxpayer Identification number. The System should consider obtaining its own Federal Taxpayer Identification Number.

- The System receives a significant amount of federal funds via the student financial aid program. Currently, these funds are issued to the State in the State's name. Should there be any non-compliance issues noted, the State may be responsible for any related penalties. The State should review with the System and the federal grantor agency as to whether it is appropriate for the State to continue to receive the federal funds or whether the System should receive federal funds in its own name.

- The System is overseen by a separate Board, but, despite its status as a separate entity, it is still subject to Governor and Council approve for many of its decisions. The governance issues that may arise by having multiple oversight bodies needs to be clarified.

- It is unclear whether the Board of the System wants to issue separate financial statements in the future. Given the System's ability to borrow, advice of bond counsel should be sought to assess the need for separately audited statements for future bond issues.

Management's Response:

We concur in part. We would not categorize decisions requiring G&C approval as "many" per Chapter 361, but limited to certain area's such as borrowing on credit. These are all certainly concerns shared by Administrative Services and in some cases these concerns were raised by Administrative Services. Some of the issues above require legislation for clarification such as the transfer of assets. In the absence of any specific language, Administrative Services interpretation regarding transfer of assets for purposes of the CAFR for the period ending June 2008, limited those transfers to only those buildings which were funded by student fees. A number of the assets still have debt service payments outstanding which are being made by the general fund, so if there is movement to transfer additional assets it should not be done without the corresponding debt service liabilities. The use of the Taxpayer Identification number and the receipt of federal funds in the state's name are particularly troubling as many of the checks and balances and systems put in place over the years to ensure the appropriate financial controls are in place for state government are not necessarily in place for the College since they are in this hybrid state. The state's checks and balances have further been shorn up over the years as a result of lessons learned from audits. If we are to minimize the state's exposure in this area, clarification and resolution to all of the above needs to be decided quickly.

2008 – 7 – MANAGEMENT LETTER COMMENT

Single Audit Major Programs Requiring Audit

Federal Circular A-133 requires auditors to use a risk-based approach to determine which federal programs are major programs which affect the scope of the audit. The determination of the programs to be audited is based on an overall evaluation of the risk of noncompliance occurring that could be material to the individual federal programs. Many factors are considered in determining risk, such as current and prior audit experience with the auditee, findings identified in previous audits, results of audit follow-up, oversight by the federal agencies, and inherent risk of the federal programs. A high risk determination based on these factors would mean the federal program would need to be re-audited resulting in added audit costs to the State.

During 2008, the State had 18 major programs audited, at least four of which were re-audits resulting from findings identified in the 2007 audit that were not properly corrected during 2008. The existence of significant findings and the lack of follow-up and resolution to the findings result in an increase in the scope of the State's single audit and the related audit costs.

We recommend that the State put a process in place to ensure that findings identified during the Single audit are addressed and resolved by the Departments in a timely manner. This will help to ensure that compliance with federal requirements is met, that costs are not disallowed and that the cost of the Single audit is being contained.

Management's Response

We concur. During the 2007 audit, the responsibility for and compilation of the Single Audit of Federal Financial Assistance Programs was transitioned from the Office of Legislative Budget Assistant to the Department of Administrative Services (DAS). DAS continues to identify and assimilate Single Audit responsibilities amongst existing staff. A procedures manual will be established and resources tasked to include follow-up with Departments to help ensure prior year findings are corrected on a timely basis.

<u>2008 – 8 – MANAGEMENT LETTER COMMENT</u>

<u>Information Technology General Control Weaknesses</u>

Today's businesses increasingly rely on information technology to help them reach their daily and long-term objectives. The challenges entities face in this environment is creating a strong and robust internal control structure over information technology general controls (ITGC) that does not compromise the adequacy of the overall internal control environment.

The underpinning of a strong internal control environment includes strong ITGC's. Given the integration of computer systems into today's businesses, a weak ITGC environment can compromise an otherwise strong manual control environment.

As part of performing an audit of the State's financial statements, we obtain an understanding and assess the State's ITGC environment in order to determine the adequacy of the State's overall internal control environment.

IT systems and applications included:

- New Hampshire Integrated Financial System (NHIFS),
- Government Human Resources System (GHRS),
- Medicaid Management Information System (MMIS),
- New HEIGHTS,
- Liquor Commission – BIS and ACR (Point Of Sale) and
- Supporting LAN/WAN network and data processing infrastructure.

During our review, we noted an overall strong ITGC environment, however, we did note certain areas for improvement, which are summarized below.

Data Center Access

Unregulated and unauthorized data center access may result in the compromise of sensitive information, the inappropriate use of technical resources, the unauthorized manipulation of information and an increased potential of legal action against the State in the event of unauthorized disclosure of sensitive personal information. We noted that no access form is prepared, signed off on, or retained for access to the Liquor Commission data center.

Passwords

Weak computer access authorization including inadequate password parameters offer opportunities for unauthorized persons to gain unauthorized and inappropriate access to business systems leading to the compromise of key systems, applications and data assets. We noted inadequate password parameters for the Liquor Commission's BIS and ACR systems, including no minimum length or complexity for BIS and only a minimum of 4 characters for ACR.

Superusers

While it is recognized that small IT departments may struggle to find a balance between administering systems and maintaining an appropriate separation of duties (SOD), unregulated powerful system access increases the risk of the compromise of important business systems, applications and data assets. For Liquor Commission programs, we noted that programmers and developers have superuser access to both development and production environments.

New Access

The granting of access to key business systems without appropriate documented authorization increases the likelihood that unauthorized individuals could receive inappropriate access rights that could lead to the compromise of key systems, applications and data assets. For liquor, we noted that access is assigned following receipt of a phone call to the help desk or an email. Validation is limited to ensuring that the named person has a valid NH Liquor license on file. Nor formal document is completed or maintained for access to BIS or ACR applications.

Review of Access

Unregulated access to data center facilities that house critical computer equipment and data media could result in access by unauthorized persons, and lead to the physical compromise of key systems, applications and data assets. No formal review of the State's and Liquor Commission's data center access lists have been conducted to ensure that only authorized IT personnel have access to the Concord data centers.

Review of Access Rights

A lack of periodic reviews of system or application functional access by appropriate Business and/or IT management increases the risk that individuals may retain unauthorized access to systems, applications and data assets and/or have inappropriate access to important application functions. We noted no formal review of the user access to the BIS or ACR application is conducted to ensure that only authorized personnel have access to the applications and that their functional access is consistent with their job responsibilities (SOD).

Access to Change Environment

While it is recognized that small IT departments may struggle to find a balance between administering systems and maintaining an appropriate separation of duties, providing developers with the ability to migrate modified code into the production environment without effective monitoring increases the risk that unauthorized, untested, and/or unapproved changes could be made. We noted that Liquor Commission BIS Developers have access to migrate modified code into the production environment.

Restoration of Back-up Media

A lack of a periodic process to test backup tape data restoration increases the risk that data is not able to be recovered resulting in a physical loss of data and inability to adequately restore operations in the event of a disaster. For the Liquor Commission, there is currently no process in place to periodically test the ability to restore backup data from tapes, and for New Heights, there is currently no process in place to periodically test the restoration of data sets.

We realize that the ERP System (NH First) will replace the NHIFS and GHRS systems. Therefore, the State should ensure that these weaknesses relative to the legacy systems are addressed in the implementation of the ERP. For those Systems that will not be affected by the ERP System, the State should address these weaknesses in a timely manner.

Management's Response

<u>Data Center Access</u> - *Access to the data center is maintained by one individual at the Liquor Commission. Authorized access is reviewed, monitored and obtained by the IT Manager at Liquor and Liquor Commission Bureau Chiefs. Access has been limited to necessary personnel. All other personnel must be granted access by an individual in the data center and must sign in and out utilizing the Data Center Access Log. These logs are maintained and stored at the Liquor Commission.*

<u>Passwords</u> *– BIS To address the restrictions on the BIS passwords requires a major systems change by Unisys (BIS vendor). Unisys is working on a new feature that they hope will be available in their next major release, BIS 11. It is a single sign on and external user authentication, which would then allow for the required complexity. This release is expected out in late 2009 or early 2010. The recommendation is to monitor access until such point that BIS 11 is available for a customer upgrade. At this time, we are awaiting information from our POS Software Vendor, ACR, to determine the level of effort required to further restrict the ACR passwords. Note: NHSLC has requested funding in FY 2010 & 2011 to review and potentially replace all systems, including BIS and ACR POS. Adequate Password Parameters will be a requirement of these systems.*

<u>Superusers</u> **-** *A BIS script named PRC is used to move programs (scripts) from the development environment to the production environment. In the past, this script was available to be run by anyone who had a log-in on the development system. Access to this script has been restricted to super users only. There are currently three super users within BIS. One super user ID is the default BIS super user and two IDs belong to development staff that are responsible for the environment. Note: NHSLC has requested funding in FY 2010 & 2011 to review and potentially replace all systems, including BIS. Separate of Dev and Prod environments and access rights by individual will be a requirement of these systems.*

<u>New Access</u> **-** *The process for obtaining and removing BIS access has been established. Access will be requested and revoked by the associate's management. BIS and ACR access is requested for new associates on the new employee form and removed utilizing the exit/leave checklist. The BIS Access list will be reviewed every six months by the IT Manager and Liquor Bureau Chief to ensure compliance.*

<u>*Review of Access*</u>

(State) - For the past year to year and a half we have been working to reduce the number of people who have access to the data center. Access has been removed for staff that did not have appropriate roles. We broke down remaining staff access into two groups - the operations and GSS teams in one group and agency support teams in the other. For operations and GSS we maintained 24x7 access. For agency staff we created another level of access from 5pm Sat to 8am Sunday and 5pm Sunday to 8am Monday (when operations is not manning the data center). During all other hours these agency staff must either schedule access or have their names on a list of approved staff when they show up with identification at the rear door (at night typically) to gain access. We think we have come a long way and going forward will be reviewing access lists on a quarterly basis.

(Liquor) - Access has been limited to necessary personnel. Necessary personnel include associates residing in the data center, emergency personnel and the IT Manager. Access to the data center will be reviewed every six months by the IT Manager and Liquor Bureau Chief to ensure compliance.

<u>*Review of Access Rights*</u> *- The BIS Access list will be reviewed every six months by the IT Manager and Liquor Bureau Chief to ensure compliance. ACR access will be reviewed periodically by each store manager.*

<u>*Access to Change Environment*</u> *- A BIS script named PRC is used to move programs (scripts) from the development environment to the production environment. In the past, this script was available to be run by anyone who had a log-in on the development system. Access to this script has been restricted to super users only. Within BIS an audit trail is used to document the reason for a change and the code change that was made. Note: NHSLC has requested funding in FY 2010 & 2011 to review and potentially replace all systems, including BIS. Minimizing access rights for Promoting code to Production will be a requirement of these systems.*

<u>*Restoration of Back-up Media*</u>

NHIFS & GHRS - Though there are no formal tests of data restores in IFS/GHRS Production, we do experience issues from time to time which require restores. This occurs at a minimum of once per month. In the past week we have had occasion to provide two separate restores. All of our restores to date have been successful.

Liquor - The IT group at Liquor does have a backup and restore procedure in place. We are using the Veritas Netbackup application. Operations checks backups every day and logs the success of those jobs that were run for that day. We send full backups off site for two weeks and then archive these tapes. Our incremental jobs are to a disk to disk tape system and are retained for two weeks. Our restore procedure requires that a request form be submitted detailing the file(s) needed, the location of the file(s) and where they need to be restored, the requestor's name and the urgency of the request with a comment section for specific information on the request. We process approximately three to four requests a month. A log of all requests is maintained. When the request is completed, the requestor is notified either by e-mail or verbally, and the completed time is noted in the log.

New Heights - On May 21, 2008 Governor and Executive Council (Item #2) approved a contract amendment with International Business Machine (IBM) to provide Business Recovery Services (BRS) for the New HEIGHTS system on behalf of the Department of Health and Human Services (DHHS), Division of Family Assistance (DFA). The availability of BRS ensures that the State has a back-up computer system to run the New HEIGHTS application in the event that the IBM computer located at the DoIT Data Center becomes dysfunctional or incapacitated for an extended period of time. DHHS has no guarantee that in the event of a disaster the IBM application could operate on non-IBM equipment. The BRS specified in this contract would be provided at an IBM facility located in Sterling Forest, New York. The contract provides provisions for one recovery exercise per year at the Sterling forest facility. Federal regulations are codified at 45 CFR Part 95. The Federal Office of Inspector General audit sited DFA (NH-SC-01) as at high risk for not having an alternate processing site for service continuity. Procurement of the defined services provides that the State is in concurrence with federal mandates.

2008 – 9 – MANAGEMENT LETTER COMMENT

Accounting and Financial Reporting for Pollution Remediation Obligations

In November 2006, the Governmental Accounting Standards Board (GASB) issued definitive guidance on how entities should account for any legal obligation to remediate pollution. The new standard, Statement No. 49, *Accounting and Financial Reporting for Pollution Remediation Obligations*, identifies the circumstances under which an entity would be required to report a liability related to pollution remediation.

An entity would have to estimate its expected outlays for pollution remediation if it knows a site is polluted and any of the following recognition triggers occurs:

- Pollution poses an imminent danger to the public or environment and an entity has little or no discretion to avoid fixing the problem
- An entity has violated a pollution prevention-related permit or license
- A regulator has identified (or evidence indicates it will identify) an entity as responsible (or potentially responsible) for cleaning up pollution, or for paying all or some of the cost of the clean up
- An entity is named (or evidence indicates that it will be named) in a lawsuit to compel it to address the pollution
- An entity begins or legally obligates itself to begin cleanup or post-cleanup activities (limited to amounts the entity is legally required to complete).

Liabilities and expenses would be estimated using an "expected cash flows" measurement technique, which is used by environmental professionals and may be used for the first time by many entities. Statement 49 also will require entities to disclose information about their pollution obligations associated with clean up efforts in the notes to the financial statements.

The challenge for large, decentralized organizations such as the State, is creating an inventory of sites that may be subject to a pollution remediation liability in the future. The State should utilize the expertise of facilities personnel to identify existing potential pollution sites. This primarily includes identifying buildings containing asbestos and lead pipes, underground fuel storage tanks, chemical spills or any other type of potential pollution.

Once the existing potential pollution has been inventoried, the State would then monitor the inventory to determine if any of the triggering events have occurred. If the State determined that a triggering event did occur, then they would be required to estimate the potential future liability using the expertise of a third party

Statement 49 will be effective for the State's year ending June 30, 2009. The State would be required to restate beginning net assets (July 1, 2008) if a liability is identified. Therefore, it is important that the State continue to inventory pollution sites and start to determine whether any triggering events have been met.

Management's Response:

The Department of Administrative Services (DAS) is familiar with Statement 49 and began the process of consulting with state departments to identify potential pollution sites during fiscal year 2008. DAS is continuing to inventory sites and assess whether triggering events have occurred and will work with appropriate department personnel to estimate related future liabilities.

2008 – 10 – MANAGEMENT LETTER COMMENT

Future Accounting Standards

Intangible Assets

In July 2007, the GASB issued Statement No. 51, *Accounting and Financial Reporting for Intangible Assets* (GASB Statement No. 51). Governments possess many different types of assets that may be considered intangible assets, including easements, water rights, timber rights, patents, trademarks, and computer software. Intangible assets, and more specifically easements, are referred to in the description of capital assets in Statement No. 34, *Basic Financial Statements–and Management's Discussion and Analysis–for State and Local Governments.* This reference has created questions as to whether and when intangible assets should be considered capital assets for financial reporting purposes. An absence of sufficiently specific authoritative guidance that addresses these questions has resulted in inconsistencies in the accounting and financial reporting of intangible assets among state and local governments, particularly in the areas of recognition, initial measurement, and amortization. The objective of this Statement is to establish accounting and financial reporting requirements for intangible assets to reduce these inconsistencies, thereby enhancing the comparability of the accounting and financial reporting of such assets among state and local governments.

The requirements of GASB Statement No. 51 are effective for financial statements for periods beginning after June 15, 2009. The provisions of this Statement generally are required to be applied retroactively. For governments that were classified as phase 1 (such as the State) for the purpose of implementing Statement 34, retroactive reporting is required for intangible assets acquired in fiscal years ending after June 30, 1980, except for those considered to have indefinite useful lives as of the effective date of this Statement and those that would be considered internally generated. Retroactive reporting is not required but is permitted for intangible assets considered to have indefinite useful lives as of the effective date of this Statement and those considered to be internally generated.

Fund Balance Reporting

In February 2008, the Governmental Accounting Standards Board issued an Exposure Draft (ED), *Fund Balance Reporting and Governmental Fund Type Definitions*. The ED proposes dramatic changes to the way governments report fund balances in their governmental funds.

The requirements of this proposal would improve financial reporting by establishing fund balance categories and classifications that are easier to understand. The proposed Statement establishes fund balance classifications comprising a hierarchy based primarily on the extent to which a government is bound to observe constraints imposed upon how it can use amounts reported in governmental fund balances.

Currently, the requirements of the proposed Statement would be effective for financial statements for fiscal years ending June 30, 2011, or later.

We recommend that the State obtain an understanding of these future standards and determine what steps will be necessary to ensure a smooth implementation.

Management's Response:

The Department of Administrative Services (DAS) is reviewing or monitoring these future standards and assessing implementation steps.

2008 – 11 – MANAGEMENT LETTER COMMENT

Summary Schedule of Prior Audit Findings and Corrective Action Plan

The Federal Single Audit Circular A-133 requires the auditee to be responsible for follow-up and corrective action on all audit findings identified through the Single Audit. As part of this responsibility, the auditee is required to prepare a summary schedule of prior audit findings. We noted that the Department of Administrative Services (DAS) does not have a process in place to update and obtain a corrective action plan from those various agencies that have outstanding findings in the single audit report.

We recommend that DAS develop a process to compile an updated corrective action plan in a timely manner. Further, DAS may want to certify with the various agencies as to the status of the finding, whether the agency received a formal management decision from the federal government or why no further action on each finding is required.

Management's Response

We concur. During the 2007 audit, the responsibility for and compilation of the Single Audit of Federal Financial Assistance Programs was transitioned from the Office of Legislative Budget Assistant to the Department of Administrative Services (DAS). DAS continues to identify and assimilate Single Audit responsibilities amongst existing staff. A process will be established and resources tasked to include the development of a corrective action plan to track and follow up with those agencies that have outstanding findings along with the documented status or resolution of the findings.