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Independent Auditors' Report on Internal Control Over Financial Reporting and on Compliance and Other Matters Based on an Audit of Financial Statements Performed in Accordance With *Government Auditing Standards*

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

We have audited, in accordance with the 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, the financial statements of the governmental activities, the business-type activities, the aggregate discretely presented component units, each major fund, and the aggregate remaining fund information of the State of New Hampshire (the State) as of and for the year ended June 30, 2016, and the related notes to the financial statements, which collectively comprise the State's basic financial statements, and have issued our report thereon dated January 31, 2017. Our report includes a reference to other auditors who audited the financial statements of the Liquor Commission, Lottery Commission, Highway Fund, Business Finance Authority of the State of New Hampshire, Community Development Finance Authority, Pease Development Authority, Community College System of New Hampshire, New Hampshire Public Deposit Investment Pool, and the New Hampshire Judicial Retirement Plan, as described in our report on the State's basic financial statements. This report does not include the results of the other auditors' testing of internal control over financial reporting or compliance and other matters that are reported on separately by those auditors. The financial statements of the New York Public Deposit Investment Pool and the Business Finance Authority of the State of New Hampshire were not audited in accordance with *Government Auditing Standards*.

Internal Control Over Financial Reporting

In planning and performing our audit of the financial statements, we considered the State's internal control over financial reporting (internal control) to determine the audit procedures that are appropriate in the circumstances 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.

A deficiency in internal control exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent, or detect and correct, misstatements on a timely basis. A material weakness is a deficiency, or combination of deficiencies, in internal control, such that there is a reasonable possibility that a material misstatement of the State's financial statements will not be prevented, or detected and corrected, on a timely basis. A significant deficiency is a deficiency, or a combination of deficiencies, in internal control that is less severe than a material weakness, yet important enough to merit attention by those charged with governance.

Our consideration of internal control was for the limited purpose described in the first paragraph of this section and was not designed to identify all deficiencies in internal control that might be material weaknesses or significant deficiencies and therefore, material weaknesses or significant deficiencies may exist that were not identified. Given these limitations, during our audit we did not identify as deficiencies in internal control that we consider to be material weaknesses. However, material weaknesses may exist that have not been identified. We did identify certain deficiencies in internal control, described as 2016-001, 2016-002, 2016-003, and 2016-004 that we consider to be significant deficiencies.

Compliance and Other Matters

As part of obtaining reasonable assurance about whether the State's financial statements are free from material misstatement, we performed tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements, noncompliance with which could have a direct and material effect on the determination of financial statement amounts. However, providing an opinion on compliance with those provisions was not an objective of our audit, and accordingly, we do not express such an opinion. The results of our tests disclosed no instances of noncompliance or other matters that are required to be reported under *Government Auditing Standards*.

The State's Responses to Findings

The State's responses to the findings identified in our audit are described in the accompanying schedule of findings and responses. The State's responses were not subjected to the auditing procedures applied in the audit of the basic financial statements and, accordingly, we express no opinion on the responses.

Purpose of this Report

The purpose of this report is solely to describe the scope of our testing of internal control and compliance and the results of that testing, and not to provide an opinion on the effectiveness of the State's internal control or on compliance. This report is an integral part of an audit performed in accordance with *Government Auditing Standards* in considering the State's internal control and compliance. Accordingly, this communication is not suitable for any other purpose.

KPMG LLP

January 31, 2017

SCHEDULE OF CURRENT YEAR FINDINGS AND QUESTIONED COSTS
FOR THE YEAR ENDED JUNE 30, 2016

2016-001 –Department of Administrative Services

Ineffective general information technology controls related to the NHFIRST Human Resources/Payroll Lawson System.

Background

Per 2 CFR Part 200.303, non-Federal entities receiving Federal awards must establish and maintain effective internal controls over Federal awards that provide reasonable assurance that they are managing Federal awards in compliance with Federal statutes, regulations and the provisions of contracts or grant agreements that could have a material effect on each of its Federal programs. One of the many state responsibilities includes establishing a system of internal controls in determining activities that are allowed or un-allowed.

Observation

The State of New Hampshire uses the NHFIRST Lawson System (Lawson or System) for the Financial Reporting and Human Resource/Payroll functions. As a result of testing performed over Lawson, we determined that certain General Information Technology Controls (GITCs) related to the System were ineffective.

Specifically, for terminated users, access to Lawson should be removed in a timely manner after the date of termination of the employee. Upon date of termination, the Human Resource function at the agency level initiates a transaction that notifies DAS Division of Personnel, including the security management team for Lawson, that the employee has been terminated. Once notification is received, the security management team for Lawson modifies the individual's access rights such that they are limited to read-only access to the individual's payroll and benefit information. This read-only access remains in place for 60 days.

During our review, we noted that, for 21 out of 25 sample selections, evidence supporting the timely removal of elevated user access rights (more than read-only access rights) was not available. Further, through review of the 2015/2016 and 2014/2015 listing of terminated employees, 235 terminated individuals were identified as still having access to the System after their 60 day read-only period had expired. Due to system limitations, management of the Lawson system does not have the ability to provide audit evidence documenting when access rights for the 235 individuals identified was reduced to read only.

Risk

The policies and procedures in place, including the notifications that trigger removal of elevated user access for terminated employees, are decentralized across the various State agencies, for which management of the Lawson application has no control over. As such, in order to remove a terminated individual from the Lawson application in a timely manner, they must rely on timely notification from the various State agencies, and the completeness, accuracy, and timeliness of these notifications is not consistent across the State. When accounts for terminated employees are not disabled and/or removed in a timely manner, there is a risk that terminated users may obtain access to the Lawson application.

SCHEDULE OF CURRENT YEAR FINDINGS AND QUESTIONED COSTS
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Recommendation

Management responsible for the Lawson application should establish policies and procedures to ensure that notification of termination for users of the Lawson application occurs in a timely manner, resulting in timely removal of any non-read-only access rights as well as the removal of all access rights within 60 days of termination. Further, procedures should be established that allow management of the Lawson application the ability to enforce policies and procedures relative to timely notification of terminated employees. In addition, documentation evidencing this de-provisioning activity should be retained.

Management Response

We concur. From a preventative perspective, it is critical state agencies initiate the transactions necessary for the removal of the elevated access rights of terminated users timely, and in a manner consistent with a central policy and procedure. In order to foster a greater degree of compliance with the policies and procedures prescribed by the Department for initiating the removal of these elevated access rights, the Department has reviewed, improved, clarified and re-communicated these policies and procedures to the State's agencies and departments.

However, as the effectiveness of these policies and procedures are dependent upon compliance, the Department has also implemented additional controls to evaluate and monitor such compliance. As instances of non-compliance (untimely initiation of elevated access termination) are detected, investigations will be made and documented to confirm the terminated employee did or did not execute unauthorized transactions during the period of exposure.

Whereas the clarified procedures described above have been re-established mid-year during fiscal year 2017, the Department also intends to determine the control deficiency identified in this finding did not allow associated risks to culminate during the first half of fiscal year 2017. Initial compliance monitoring will look back at elevated access terminations initiated during the first half of the year, identify those transactions not initialized timely, and investigate to confirm unauthorized transactions were or were not executed by the terminated employee.

SCHEDULE OF CURRENT YEAR FINDINGS AND QUESTIONED COSTS
FOR THE YEAR ENDED JUNE 30, 2016

2016-002 –Department of Administrative Services

Insufficient / ineffective management review controls over financial reporting

Background

The Department of Administrative Services (DAS) is responsible for drafting the State of New Hampshire's Comprehensive Annual Financial Report (CAFR). The CAFR is comprised of management's discussion and analysis, the basic financial statements and supporting footnote disclosures, required supplementary information, other supplementary information, and statistical information, all of which are compiled from financial data prepared and maintained centrally by DAS (e.g., governmental funds), as well as by various State entities, some of which prepare stand-alone financial statements (e.g., Turnpike System, Liquor Commission). Based on DAS's internal control structure, preparation of the CAFR has historically been the responsibility of the Financial Reporting Administrator with additional review of the CAFR and oversight over the financial reporting process performed by both the Comptroller and the Commissioner at a sufficient level of precision that would identify a material misstatement in the CAFR.

By State law (RSA 21-I:8-II), the first draft of the CAFR is due to be released by September 30th of each year unless an extension is granted by governor and council. Precedence has been, that this first draft only included the basic financial statements and footnotes that will be subject to audit, understanding that there may be subsequent minor adjustments made to this draft by DAS but none that would result in material modification. Historically, a complete, revised CAFR draft is prepared and reviewed by DAS and released to the external auditors for further review by the end of November, and then a final draft is released in early December just before the final, audited CAFR is issued. Pursuant to RSA 21-I:8-II, the CAFR must be completed and available to the public on or before December 31st of each year unless an extension is granted by the Fiscal Committee of the General Court.

Observation

Resource constraints within the financial reporting divisions of the Department of Administrative Services and key State agencies presented challenges in the current financial reporting period for timely preparation and review of the CAFR, resulting in a one-month delay in providing the initial complete draft of the CAFR for audit, several revisions to the draft due to incomplete information requiring modification, and a one-month extension granted by the Fiscal Committee to issue the audited CAFR. Additionally, several key balances presented in the basic financial statements and related disclosures presented in the footnotes contained misstatements that were identified during the audit. As a result, KPMG proposed audit adjustments in the following areas: capital assets, federal grant revenues and receivables, Medicaid liability, cash and investments, accrued unemployment benefits, and debt service. The majority of these misstatements were corrected by DAS prior to issuance of the CAFR. The uncorrected misstatements were not considered material to the financial statements.

This is a repeat finding from fiscal year 2015.

SCHEDULE OF CURRENT YEAR FINDINGS AND QUESTIONED COSTS
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Risk

Inadequate controls in financial reporting, including those related to DAS management's review of the CAFR at an appropriate level of precision, increase the risk that a material misstatement could occur in the CAFR. There is a reasonable possibility that the insufficient / ineffective level of review performed by DAS management could result in unsupported account balances and the omission of required disclosures. Furthermore, delays in drafting financial statement footnotes and finalizing account balances further limits DAS's ability to perform a timely and meaningful review of subsequent draft versions of the financial statements to ensure adjustments are properly made throughout the CAFR.

Recommendation

DAS should continue to refine the financial reporting process to ensure all balances are finalized and significant disclosures are reviewed in a timely manner that is consistent with the State's statutory and historical financial reporting timeline. This will allow issues and questions to be addressed earlier in the process, leading to a better quality CAFR and timelier financial reporting. We also recommend that the key DAS individuals responsible for drafting the CAFR stay abreast of new and relevant Government Accounting Standards Board (GASB) pronouncements so that they can be properly accounted for and disclosed in the CAFR.

Management Response

We concur. During the fiscal year ended June 30, 2016, the Division of Accounting Services, Bureau of Financial Reporting (BFR) made steady progress in its financial reporting responsibilities, as all previously vacant financial reporting staff positions were filled throughout the year. However, the Division continues to be hampered by an overall increase in statutorily required duties without any associated increase in staffing resources to accomplish the workload increase. For the FY18-19 budget currently being developed, the Division has requested three additional financial staff positions to allow the Division to be better equipped to handle required duties and adhere to timelines.

Despite these difficulties, BFR did meet the statutory requirement to produce an initial draft of the State's FY 2016 CAFR by September 30, 2016, however, this draft was incomplete in certain aspects. In addition, BFR was unable to meet the requirement for a final CAFR by December 31, 2016, thus an extension of that deadline by one month was granted by the Fiscal Committee and the final CAFR was issued within that extended deadline.

Compounding matters during FY 2016 was the continued effects of turnover of financial staff in several state agencies, causing delays in the receipt of critical financial information on which BFR relies. We believe that, while the prescribed timeframes will still be tight, with additional communication and guidance provided to the agencies, BFR will be better able to reestablish the analysis and review necessary to produce accurate financial statements in a timely manner. While the recent resignation of the State Comptroller may delay implementation of initiatives pertaining to oversight and analysis, we have established monitoring tools required for compliance with deadlines, such as an auditee "dashboard" to be shared with agency Commissioners and the Governor's Office, in

SCHEDULE OF CURRENT YEAR FINDINGS AND QUESTIONED COSTS
FOR THE YEAR ENDED JUNE 30, 2016

order to provide regular audit status updates on pending items. Within DAS as well as with financial staff in other state agencies, we have already begun planning for the preparation of the fiscal year 2017 financial statements and we will, to the best of our ability, work to meet all requirements in fiscal year 2017.

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2016-003 – The Department of Administrative Services and Adjutant General's Department

Capital assets accounting and financial reporting is not complete and accurate.

Background

The Department of Administrative Services (DAS) Long-Term Assets Policy and Procedures Manual outlines policies, definitions, and dollar thresholds for the accounting and financial reporting of the State's capital assets in accordance with GASB Statement No. 34, *Basic Financial Statements – and Management's Discussion and Analysis – for State and Local Governments*. Within the DAS Manual is guidance for agencies' consideration in determining what a long-term asset is, as well as when and how to record it.

At each fiscal year closing, agencies are required to review their internal records of open and final vouchered projects to determine whether any should be added to construction in progress or capitalized as fixed assets. Agencies must then complete an "Exhibit E" spreadsheet, representing a roll-forward of capital assets and related depreciation/amortization by asset category for the fiscal year, and submit it to DAS for financial reporting. DAS management, in turn, reviews each Exhibit E for completeness, accuracy, and overall reasonableness at a sufficient level of precision to detect material misstatements in the financial statements and compiles the information for recording government-wide closing entries and preparing the Comprehensive Annual Financial Report (CAFR).

Observation

As a result of substantive audit procedures performed over capital assets as of and for the year ended June 30, 2016, KPMG identified exceptions relating to the accounting period in which capital assets are recognized by one specific State agency, The Adjutant General's Department (TAG). Upon further investigation, which involved extended testing over fiscal year 2016 capital asset additions and capital outlays as well as inquiry of TAG accounting personnel, we learned that the agency has been consistently applying a non-GAAP practice whereby all costs incurred for long-term construction projects (e.g., construction of new National Guard facilities within the State, as well improvements to existing facilities) are expensed as incurred and then capitalized only upon project completion, regardless of when these costs exceed the State's capitalization threshold. TAG defines project completion as the point at which final payment has been made on the construction contract, approval has been granted by the Division of Public Works - Design & Construction, and the asset is ready to be placed into service. Due to this breakdown in internal control, KPMG proposed an audit adjustment to recognize accumulated costs for incomplete projects as a construction in progress capital asset and to recognize in beginning net position the impact of the capital assets and related depreciation that should have been recorded in prior periods.

Additionally, a discrepancy was identified between the fiscal year 2016 depreciation expense calculated in the government-wide Exhibit E and the amount recorded at year-end. The error was attributed to DAS management oversight in preparing the closing entry and resulted in an overstatement of capital assets. KPMG proposed an audit adjustment to correct the misstatement in the accumulated depreciation balance and related expense reported in the government-wide financial statements.

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Risk

By delaying the recognition of capital assets and related depreciation (where applicable) until project completion, these account balances will be understated in the financial statements. Additionally, failing to review the fiscal year closing entries and underlying support for capital assets at a sufficient, appropriate level of precision increases the risk that a material misstatement could occur in the CAFR.

Recommendation

TAG should modify its internal accounting procedures to ensure that project costs are capitalized and related depreciation is recognized in the proper accounting period in accordance with State policy and U.S. GAAP. Further, DAS should refine the design of its internal management review controls to operate at a level of precision that would prevent and detect material misstatements in the CAFR.

Management Response

We concur. While the Exhibit E initially prepared by the Adjutant General's Department was not in accordance with U.S. GAAP, the department utilized the State's Long-Term Assets Policy and Procedures Manual, specifically, page 3, that reads: "For Construction in Progress assets, no depreciation is recorded until the asset is placed in service" but did not recognize that the remainder of the State's Policy applied to these transactions, which require capitalization of the assets. The department took corrective action by preparing a revised Exhibit E, as requested by DAS, for the fiscal year ended June 30, 2016, and will work with DAS to continue to ensure internal procedures result in reporting that is consistent with U.S. GAAP and State policies.

During the fiscal year ended June 30, 2016, the Division of Accounting Services, Bureau of Financial Reporting (BFR) made significant improvements in the oversight of Exhibit E reporting and the related CAFR journal entries. FY16 was the first full year for both the Financial Reporting Administrator and the Accountant responsible for overseeing the Exhibit E preparation by agencies, and we continue to enhance our review procedures as we evaluate areas of risk in financial reporting. Due to the manual nature of the capital asset journal entry preparation, an input error was made and was not detected through BFR's internal review and approval process. Going forward as part of our government-wide entry preparation, BFR will incorporate additional analysis over the summarized Exhibit E reporting, in order to enhance our detection of any manual input errors by either BFR or the agencies preparing the underlying data. BFR will continue to provide outreach to agencies as part of our annual fiscal year-end closing process, with additional focus on the proper use of Construction in Progress. In addition, BFR will perform analysis over capital project expenditures throughout the year as an additional monitoring control over agency Exhibit E reporting.

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2016-004 – Department of Health and Human Services

Ineffective general information technology controls related to the New Heights application.

Background

Per 2 CFR Part 200.303, non-Federal entities receiving Federal awards must establish and maintain effective internal controls over Federal awards that provides reasonable assurance that they are managing Federal awards in compliance with Federal statutes, regulations and the provisions of contracts or grant agreements that could have a material effect on each of its Federal programs. One of the many state responsibilities includes establishing a system of internal controls in determining activities that are allowed or un-allowed.

Observation

The State of New Hampshire uses the New Heights application for eligibility determination for certain programs. We tested the General Information Technology Controls (GITCs) related to the New Heights application for the following domains: Access to Programs and Data; Change Management; Computer Operations; Program Development. During this testing it was determined that certain controls were deemed to be ineffective for the period of July 1, 2015 - June 30,2016, as noted below.

When de-provisioning access for terminated users, access to the application should be removed in a timely manner after the date of termination of the employee. During our review, we noted that access to New Heights was not removed in a timely manner for 9 out of 25 users sampled, as the duration of time between the date of termination and the removal of access was between 17 and 117 days. For 1 of the terminations, we were unable to determine the date of access removal.

For access provisioning (new hire access and modified user access), the request and related approval of such requests should be formally documented. During our review, it was noted that for 1 out of 15 access modifications sampled, appropriate documentation evidencing approval was not available for review.

A periodic user access recertification should cover all users with access to the application during the fiscal year. During our review, it was determined that the population of users reviewed was not complete or accurate, with 588 users, out of the total population of 1762 users, not included as part of the access recertification during the period under audit.

A full restoration of the New Heights production environment should be performed on at least an annual basis to confirm the ability to restore technical and financial data. During our review, it was determined that a disaster recovery test was not completed during the audit period.

SCHEDULE OF CURRENT YEAR FINDINGS AND QUESTIONED COSTS
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Risk

With regards to removal of access for terminated users, the policies and procedures related to removal of access for a terminated employee is decentralized to various agencies, for which management of the New Heights application must rely on and has no control over. When accounts for terminated employees are not disabled and/or removed in a timely manner, there is a risk that unauthorized users may obtain access to the network or applications.

With regards to modification of access for current employees, the policies and procedures related to the modification of access for employees were not followed when requesting a modification in access. When accounts are modified for active employees without using the approved forms, there is a risk that inappropriate access is granted, providing users inappropriate access to roles within the application.

With regards to periodic review of user access rights, management identified that if a user(s) were missed during the monthly review, the system used to generate the monthly review report would not select the user again for future reviews' thus making the access recertification incomplete. Excess access to application functions and capabilities increase the risk that segregation of duties controls will be ineffective and that secure access to sensitive data and/or transactions will be compromised leading to increased opportunity for error.

With regards to a disaster recovery test, management indicated New Heights did not perform a disaster recovery test during the period. When data restores are not completed on a yearly basis, there is a risk that if a failure occurs the system may be unable to restore transactional data.

Recommendation

Management should reinforce policies and procedures relative to logical access de-provisioning for terminated users to ensure that access related to terminated individuals is removed in a timely manner.

Management should reinforce policies and procedures such that documentation supporting the appropriateness of logical access provisioning and de-provisioning is sufficiently maintained.

Management should perform procedures necessary to ensure that the population used to review logical access rights to the New Heights application on an annual basis is complete and accurate.

Management should perform a disaster recovery test annually to ensure the agency has the capability to restore data successfully.

Management Response

We concur with the finding.

In response to KPMG Recommendation #1 –

Overview - New HEIGHTS has an Identity Management (IdM) project. IdM will be integrated with the State of New Hampshire's Human Resources system (LAWSON) which will trigger notification to

SCHEDULE OF CURRENT YEAR FINDINGS AND QUESTIONED COSTS
FOR THE YEAR ENDED JUNE 30, 2016

the Security Administrator for employees being terminated. Security enhancements to HEIGHTS application will be made to interact with Identity Management (IdM) solution which enables operational efficiency, security compliance, and risk management to the Department of Health and Human Services (DHHS).

For non-employees it's the role of the Departmental authority who requested access to ensure timely notification to the New HEIGHTS Security Administrator. Additionally, as part of the JIRA tracking enhancement (see recommendation #2) the process will be streamlined to have periodic reviews for non-employee users. As a secondary measure the system does auto-revoke user ID's after 90 days of inactivity.

Details – The Change Control Document for the 'Security Enhancements for IdM" project is attached for complete details.

- 11/6/2015 – Requirements for Bundle 41473 'Security Enhancements for New HEIGHTS (IdM) were completed
- 11/13/2015 – Design completed
- 12/11/2015- 9/30/2016 – Construction and unit testing completed
- 9/30/2016 – 12/30/2016 – Integration testing began and is currently still in progress
- 1/3/2017 – 2/24/2017 – Scheduled for System and Regression Testing
- 2/24/2017 Anticipated implementation/production release

In response to KPMG Recommendation #2 –

Overview - New HEIGHTS is in the process of developing a new tool through JIRA to track requests to gain access to the system; level of access; changes to access privileges and terminating access levels/users.

Details – The Change Control Document for 'JIRA – Security Request Management' described in the timeline below is attached to provide the full details of the new tracking.

- November 15, 2016 a meeting was held to capture the business requirements.
- December 19, 2016 a draft Change Control Document (CCD) was released for preview and comments pending the upcoming Review Meeting.
- December 20, 2016 the CCD Review meeting is scheduled.
- Design, development and integration tested will be completed by January 20, 2017
- User Acceptance Testing is planned from January 20 – February 3, 2017 with production implementation date of February 6, 2017.

In response to KPMG Recommendation #3 –

Overview - Due to a minor system issue when attempting to retrieve users due for a review in a given month the result set was incomplete and not capturing any that were overdue. A JIRA ticket was filed (#63386) with the correction moved to production on 8/31/2016.

Details - The New HEIGHTS Security Administrator was notified by KPMG that some sample users had not had a review. On 6/28/2016 she completed a JIRA ticket stating the following to have the issue researched with a potential resolution.

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When selecting individuals that are due a review it only retrieves reviews that are due in the Month/YR. So as a result, if I did not complete a review on someone for a prior month, that individual will never show up again. Need to modify this field to not only select for example reviews that are due in July 2016, but all records that have not had a review done within the pass year. Change the name of the field from Review Due to "Review Current/Pass Due"

7/5/2016 – 8/3/2016: During this time period the issue was prioritized, researched, a code fix was developed and tested in both unit and integration.

8/3/2016 – 8/15/2016: During this time period the fix was tested by the Security Administrator in both the System and Regression region.

8/27/2016 – 8/31/2016: The fix was deployed to production with a post implementation review ensuring that when pulling reviews under the newly titled field 'Review Pass/Current' due for the month of September 2016 that it also retrieved active users who had not had a review since August 2015.

In response to KPMG Recommendation #4 –

Overview - New HEIGHTS recognizes that a test should be performed on an annual basis; however, due to a timing issue no disaster recovery was performed during the audit period (July 1, 2015 to June 30, 2016).

Details - The below shows when the last test was performed and when the next scheduled test is due to be performed.

- Disaster Recovery testing was performed July 19-21, 2016 at Sterling Forest, NY
- Upcoming Disaster Recovery test is scheduled for January 2017.

STATE OF NEW HAMPSHIRE

Management Letter

For The Fiscal Year Ended June 30, 2016

KPMG LLP
Two Financial Center
60 South Street
Boston, MA 02111

March 29, 2017

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

In planning and performing our audit of the financial statements of the State of New Hampshire (the State) as of and for the year ended June 30, 2016, 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 audit procedures that are appropriate in the circumstances 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.

A deficiency in internal control exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent, or detect and correct misstatements on a timely basis. During our audit we noted certain matters involving internal controls and other operational matters that are presented for your consideration. These comments and recommendations, all of which have been discussed with the appropriate members of management, are intended to improve internal control or result in other operating efficiencies and are summarized on the accompanying schedule of management letter comments. Each item indicates whether it is considered a deficiency in internal control (Control Deficiency) or other comment (Observation).

The State's responses to the comments and recommendations are described in the accompanying schedule of management letter comments. The State's responses were not subjected to the auditing procedures applied in the audit of the basic financial statements and, accordingly, we express no opinion on the responses.

In addition, we identified certain deficiencies in internal control that we consider to be significant deficiencies, and in accordance with *Government Auditing Standards* communicated them in writing to the State in a separate report dated January 31, 2017.

Our audit procedures are designed primarily to enable us to form opinions on the basic 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's organization gained during our work to make comments and suggestions that we hope will be useful to you.

We would be pleased to discuss these comments and recommendations with you at your convenience.

This communication is intended solely for the information and use of the Fiscal Committee, management of the State, and elected officials, 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

Schedule of Management Letter Comments

Year ended June 30, 2016

Department of Health and Human Services

(1) Inputs and Assumptions Used in the Medicaid IBNR Liability Estimate (Control Deficiency)

Background

The State is responsible for administering the multi-billion dollar Medicaid program. Among its responsibilities related to Medicaid, the State is ultimately responsible for ensuring that Medicaid providers receive compensation for services provided to eligible Medicaid recipients. Annually, the Department of Health and Human Services (DHHS) is responsible for estimating a statewide accrual for program costs incurred but not reported (IBNR) as of the fiscal year-end. To determine the accrual, DHHS management considers both the actual claims processed and the estimated remaining claims to be processed in the months following the State's fiscal year-end. Actual claims data is obtained from a query of the State's Medicaid Management Information System (MMIS) that captures payment activity in the two months subsequent to year-end for dates of service on or before June 30th. DHHS then estimates the amount of remaining claims to be processed by running a similar MMIS query for prior fiscal year claims that were paid subsequent to year-end and determining a historical lag factor to be applied. Both queries are totaled by category of service, as well as month of payment, to take into account different payment patterns for each. The sum of actual claims processed subsequent to year-end and estimated remaining claims to be paid based on historical payment trends represents the State's Medicaid IBNR liability.

This analysis is used by the Department of Administrative Services (DAS) to record the Medicaid liabilities within the basic financial statements, consolidated into the accounts payable line in both the general fund balance sheet and the governmental activities statement of net position. A portion of the accrued claims is reimbursed by the Federal government through the Medicaid grant and is therefore recorded as a receivable due from the Federal government within both the fund-level and government-wide financial statements. The remaining portion of this liability is recognized as expenditures and expenses through the general fund and governmental activities, respectively.

The general fund financial statements are prepared using the current financial resource measurement focus and the modified accrual basis of accounting whereby expenditures and related liability are recorded in the accounting period the liability is incurred to the extent it is expected to be paid within the next twelve months. The government-wide financial statements are prepared using the economic resources measurement focus and the accrual basis of accounting whereby expenses and related liability are recorded when incurred, regardless of the timing of related cash flows.

Observation

In its original estimate of the fiscal year 2016 IBNR liability, DHHS management did not include maternity kickback payments related to managed care organizations, understating the liability by $1.7 million. Further, management's assumptions surrounding the determination of cost of claims related to category 065, which is subject to different payment patterns than other categories of service each year, were not specifically described in DHHS's formal methodology nor considered in its original calculation, leading to an additional $5.3 million understatement of the liability. In accordance with DHHS and DAS policy over the annual financial reporting process, DHHS management performs continuous look-back analyses of subsequent claims payments until the issuance of the State's CAFR in order to take into account the best information available in developing its estimate. Revisions relating to the State's share of Health Protection Program and managed care payments were taken into consideration by management as a result of these look-back analyses, which represented an overstatement of the original estimated liability of $3.8 million.

Taking into account the above offsetting impacts to its original estimate, DAS management deemed the impact on this estimate to be immaterial and did not adjust their financial statements. KPMG proposed an audit adjustment to correct the $3.2 million understatement of the liability and expenditures/expenses and corresponding Federal grant revenue and receivable in fiscal year 2016.

Risk

Failure to consider changes in the current year operating and regulatory environment impacting inputs and assumptions utilized in the IBNR estimate liability analysis increases the risk that the liability and expenditures/expenses and corresponding Federal grant revenue and receivable reported in the basic financial statements are not complete and accurate.

Recommendation

DHHS management should continue to evaluate and refine its methodology each year, including the inputs and assumptions utilized, for estimating the Medicaid liability reported as of year-end to ensure that it is properly supported. In addition, management at DHHS and DAS should continue to have open dialogue on the results of the Medicaid IBNR liability analysis until issuance of the audited financial statements.

Management Response

We concur.

DHHS has made significant improvements in developing, refining and calculating the IBNR. The implementation of managed care coupled with staff turnover in FY15 at key financial positions led the Department to make significant updates to the IBNR. As a result, the SFY16 IBNR of $207Mil we believe accurately reflects the liability.

DHHS will work closer with DAS, in both the development and precision of the IBNR estimate going forward.

Department of Employment Security

(1) Ineffective/Insufficient Management Review of the Accrued Unemployment Benefits Calculation (Control Deficiency)

Background

New Hampshire Employment Security (NHES) is a federally funded state agency that is responsible for administering the Unemployment Compensation program, which includes paying benefits to eligible claimants temporarily unemployed or underemployed through no fault of their own, as well as collecting taxes from employers to fund these benefit payments. Annually, NHES is responsible for estimating a statewide accrual for unemployment insurance benefits payable to eligible claimants as of the fiscal year-end, which includes amounts assessed for both initial claims and continued claims. NHES's accrual analysis is used by the Department of Administrative Services (DAS) to record a liability and corresponding expense within the Unemployment Compensation Fund columns of the basic financial statements.

Both the Unemployment Compensation Fund financial statements and government-wide financial statements are prepared using the economic resources measurement focus and the accrual basis of accounting whereby liabilities and related expenses are recorded when incurred, regardless of the timing of related cash flows.

Observation

Historically, NHES had developed its estimate of accrued unemployment insurance benefits based on the average time taken for initial claims to be received, processed, and paid, which involved detailed analysis of historical trends in these transactions and assumptions surrounding the current rate of unemployment in the State. During fiscal year 2016, NHES reevaluated and ultimately revised its methodology to consider

the actual benefit payments made subsequent to year-end using detailed claimant data derived from the New Hampshire Unemployment Insurance System (NHUIS). This approach provides a more accurate representation of amounts due to eligible claimants as of year-end.

As part of our audit of the liability, KPMG reviewed the system query designed to provide detailed claimant data for benefit payments made subsequent to year-end and tested the completeness and accuracy of this underlying data. As a result of our procedures, we identified duplicate claim information and other errors in the data set used by management to develop its estimate of the accrual, which led to an inaccurate liability being reported to DAS for fiscal year 2016. We determined that, while the adoption of this new methodology evidences NHES management's timely review of the estimate, the review was not performed at a sufficient level of precision to identify errors and inconsistencies in the data underlying the calculations. Due to this breakdown in internal control, KPMG proposed an audit adjustment to correct an overstatement of the liability and expenses in fiscal year 2016 which management recorded to properly state their basic financial statements.

Risk

Lack of timely management review of the accrual for unemployment compensation benefits at a sufficient level of precision could result in material misstatement of the account balance at year-end.

Recommendation

NHES management should continue to evaluate and refine its methodology, including the inputs and assumptions utilized, for estimating the unemployment compensation benefits liability reported as of year-end to ensure that it is consistently applied and properly supported.

Management Response

Due to the timing of implementing the new improved methodology for estimating the unemployment compensation benefits liability and the deadline for its submission, NHES released the data after management and IT staff performed numerous validations. The improved methodology was further reviewed, refined and any issues corrected the same day of its release. NHES management and IT staff will continue to evaluate and, if needed, refine its methodology for estimating the unemployment compensation benefits liability at year-end.

(2) Failure to Remove Access Rights to NHUIS Application For Terminated Employees (Control Deficiency)

Background

The New Hampshire Unemployment Insurance System (NHUIS) is the application used to process and manage unemployment benefits. Access to develop and migrate changes into a production environment should be appropriately restricted to users based on job function and responsibility.

Observation

KPMG tested the General Information Technology Controls (GITCs) related to the NHUIS application for the following domains: Access to Programs and Date; Change Management; Computer Operations; Program Development. During this testing, it was determined that 8 users listed with access to develop changes were terminated during fiscal year 2016 and their access was not properly removed during the revocation process.

Risk

A user may have inappropriate privileged access to make changes to the NHUIS Application, impacting the validity of the data within the production environment.

Recommendation

Management should periodically review the listing of privileged accounts to determine appropriateness of users based on job function and responsibility.

Management Response

NHES took immediate steps in July 2016 to further ensure all access privileges, including those required to make changes to the NHUIS application, are authorized and tracked within the NHES Access Control and Account Management System required for all user accounts.

In accordance with NHES Directive 2100-16 MR: Computer Use Policy and Agreement, supervisors must submit all requests for new users and requests for changes in access permissions to the Assistant to the Commissioner for review and approval. The Supervisor must also immediately notify the Assistant to the Commissioner when any user becomes temporarily or permanently separated from NHES.

The Assistant to the Commissioner's office has added the DoIT staff responsible for administering privileged accounts the distribution list used to notify system administrators when an account needs to be inactivated. DoIT will also conduct a periodic review of the list of privileged accounts in addition to NH Employment Security's ongoing role review process.

Additionally, DoIT is working to enact single sign-on (SSO) for Linux servers using Microsoft Active Directory (AD) Directory Services (DS) to authenticate and confirm user access to all Linux servers. Access to servers will be designated by security groups, and user account resets/deactivations can be done with existing processes within DOIT.

State of New Hampshire

(1) Succession Planning (Observation)

Observation

Public sector organizations, such as the State, find themselves in a time in which the demand for services has increased, the expectation for quality service is high, and the accountability for results is exceptional. These forces will continue to apply pressure to governments while they face perhaps their biggest challenge, the impending departure of some of the best, brightest and most tenured employees.

We have presented this observation and recommendation to the State previously, however, the issue of succession planning continues to present challenges now and into the foreseeable future for both the State and the government industry at large. According to the Center for State & Local Government Excellence (SLGE) 2016 workforce survey, at least 80% of state and local government human resource managers responding to the survey indicated that (a) recruiting and retaining qualified personnel with needed skills to public service, (b) workforce succession planning, and (c) staff development are important workforce issues to their organizations. In a separate survey of members of the International Public Management Association for Human Resources, it was noted that:

- 11% of survey respondents have a formal success planning process
- 27% of survey respondents are currently developing a formal succession planning process
- 33% of survey respondents will have a formal succession planning process in the next five years
- 13% of survey respondents did not know the prospects of developing a formal succession planning process.

Recommendation

KPMG recommends that the State continue to develop its process for managing succession planning. The Government Finance Officers' Association (GFOA) has published its Generational Change Task Force Report in an effort to assist governments to mitigate the risks of turnover of experienced employees. In this

report, the GFOA encourages governments to address the following key issues and develop strategies concerning succession planning:

- Develop an integrated approach to succession management. Organizations with an integrated, rather than "just-in-time," approach to succession management experience higher retention rates, increased employee morale, and an environment that stimulates innovation and organizational change. There are some positions in an organization that are more critical than others. A successful succession plan should place a high priority on planning for a smooth change in such positions. Key components of an integrated succession management approach include: workforce planning, succession planning, knowledge management practices, and recruitment and retention practices.
- Continually assess potential employee turnover. Making career planning discussions a part of a regular and ongoing performance review process assists in assessing potential turnover. Department heads are a good resource in helping to identify employees that may be planning to leave.
- Provide a formal, written succession plan as a framework for succession initiatives. Without a formal plan, workforce/succession planning tends to take place in a haphazard fashion. A formal plan identifies risks and strategies, thereby providing a guiding framework for specific succession initiatives, including how employees are eligible to participate and what being part of the succession plan means. Plans that have been thoughtfully articulated and communicated to the organization are more likely to be successful. Additionally, having a formal plan indicates organization and leadership commitment to succession management, which is critical for success and for sustaining successful planning across political and leadership transitions. The Budget Department and the Human Resources Department should work together to develop this plan, along with other departments as needed.
- Develop written policies and procedures to facilitate knowledge transfer. Knowledge transfer is a critical component of succession management. There should be written procedures in place to formalize the knowledge transfer. A meeting should be held with departing staff to document job responsibilities.
- Development of leadership skills should be a key component of any succession planning initiative. When leadership development occurs, the organization benefits from developing a leadership pool for other positions. Encouragement of personal professional development activities should be a key part of the succession planning effort. Personal professional development benefits the organization over the long term by helping employees gain the skills they need to assume increased responsibilities.
- Design of better recruitment and retention practices may aid in the succession process. Many organizations will focus more on recruiting the new employee and less on orienting the person to the position and the ongoing development of the employee. Making sure pay levels are competitive with the market place is one means of retaining employees. Providing career advancement opportunities for employees is another means of retention.
- Consideration must be given to collective bargaining agreements and how those agreements fit in with the overall succession plan. The engagement of bargaining units for cross training opportunities is encouraged.
- If early retirement programs are offered, it should be done in conjunction with a succession plan. GFOA strongly recommends that governments use considerable caution when considering the implementation of early retirement plans. If an early retirement program is offered, that might provide a window of opportunity to look at technology, potential to streamline, or rethinking the way services are provided, managed, and/or administered.
- Consider nontraditional hiring strategies. Options such as part-time work, job-sharing, volunteers, and flexible schedules and flexible-place arrangements are providing mechanisms to both meet the needs of the organization and employees.

Additionally, related to the topic of succession planning, in its 2015 research report, *Workforce of Tomorrow*, the SLGE and the Local Government Research Collaborative identifies the following six strategies for governments to build the workforce of tomorrow:

1. Reinvent human resources to become flexible, nimble, creative, can-do, strategic, and staffed by skilled employees who champion people management issues and set the workforce agenda. The local government manager should be a key advocate for this transformation.

2. Revamp antiquated policies and practices to meet the needs and expectations of a changing workforce and to compete successfully in the talent race.

3. Make government an employer of choice by building a brand that tells a great story of public service.

4. Focus on talent management, leadership development, and succession planning to prepare for workforce transitions, build needed bench strength, and grow future leaders.

5. Create a culture that values and engages employees in meaningful ways.

6. Leverage technology, data, and automation to improve government operations and provide employees with the tools they need to be highly productive and successful.

Management Response

We concur. Several workforce development and statewide training initiatives are underway in the Department of Administrative Services. From July 2007 to October 2011, a multi-agency team prepared and launched a workforce development strategy and toolkit for all state agencies. The goals of this Committee were the following:

- Every agency will implement a viable workforce development plan.
- The state of NH will successfully recruit and retain skilled workers.
- Career development programs will be in place for personnel at all agencies.

This toolkit created by this committee to support Workforce Development is recognized in New Hampshire and other states as an example of best practices on the subject matter. This toolkit includes:

- Self-Assessment Tools
- Employee Recognition Tool Kit
- Candidate Development Program Model
- How to Measure Customer Satisfaction
- Individual Employee Development Plans
- Knowledge Management Transfer Model
- Mentoring Model
- Organizational Readiness Assessment
- Strategic Planning Model
- Workforce Planning Model

These materials are available to all state agencies from the Division of Personnel's Human Resources website. The Division of Personnel will continue to incorporate this information into the Bureau of Education and Training's professional development and certification program.

In October 2015, the Department of Administrative Services and the Division of Personnel reestablished the statewide Workforce Development Committee, now called the Talent Acquisition and Management Committee (TAM), with committed representatives from more than a dozen state agencies participating. The TAM Committee is working to define focused priorities based on the analysis of statewide data and assessment of agency needs. One objective is to provide regular reports and measures on staffing, including retirement rates, turnover rates, vacancy rates, and staff productivity. In addition, this group is analyzing the current recruitment process and exploring an integrated approach to knowledge transfer and succession planning. To respond to these priorities, the Division of Personnel hired a part-time Talent Acquisition Manager in the fall of 2016. Key TAM focus areas for 2017 are: coordinating the work of the TAM Committee, identifying and tracking data related to turnover, internship program expansion statewide, recruitment strategies and shared resources across agencies, branding the State as an employer of choice to support recruitment and retention, knowledge transfer, onboarding and exit programming, and data collection and reporting.

Additionally, the Division of Personnel's Bureau of Education and Training (BET) continues to develop and deliver programs to build capacity in supervisors and managers related to succession planning. These include:

- Delivering Foundations of Supervision training for all supervisors in state service; a two-day program designed to develop skills needed for successful day-to-day supervision and management including performance management. In 2017, this program will be adapted as a hybrid delivery model combining online learning with a day of skill development;
- Launching *New Hampshire Online* in 2017 and providing online learning opportunities. The focus the first year will be on programs to support effective new employee onboarding and basic skill development available to all State of NH Employees. The learning management system provides new opportunities for standardized training in an on-line learning environment;
- Providing Lean process improvement training, including workflow process mapping and process improvements by state agencies and Lean summits to highlight process improvement gains.
- Expanding of BET's professional development programming to include courses in recruitment and retention strategies, succession planning, individual development plans (for supervisors to support their employees growth and development); performance evaluations (for supervisors), and knowledge management planning and strategies;
- Maintaining the quality programming offered in the BET Certified Public Supervisor and Certified Public Manager's programs. These two competency-based programs include a variety of courses focused on effective supervision and best practices in public management. The programs include courses in interviewing and evaluation, supervising employee performance, and knowledge transfer;
- Launching the Early Career Leadership Program in 2017. The program is designed to develop the skills and talents of the next generation of public service managers and leaders. Topics include career road maps; personnel development plans and a mentorship program.

The Division of Personnel will continue to pursue support for a new, full-time Talent Management Coordinator. In addition, a task force within the Department of Administrative Services completed a project to update the state's intranet, Sunspot, to document businesses process and facilitate knowledge management and knowledge transfer for statewide procedures. The group is now working on an Employee portal to provide easy access links and information on Career and Development as well as topics such as employee benefits, compensation, and health and wellness.

Department of Administrative Services

(1) New GASB Standard on Tax Abatement (Observation)

Observation

In August 2015, GASB issued Statement No. 77, *Tax Abatement Disclosures*. The objective of this Statement is to make the nature and magnitude of a government's tax abatement transactions more transparent to a user of the financial statements. This Statement is effective for fiscal years beginning after December 15, 2015.

For financial reporting purposes, this Statement defines a tax abatement as resulting from an agreement between a government and an individual or entity in which the government promises to forgo tax revenues and the individual or entity promises to subsequently take a specific action that contributes to economic development or otherwise benefits the government or its citizens. For purposes of this Statement, tax abatements include (1) a reporting government's own tax abatement agreements and (2) those that are entered into by other governments and that reduce the reporting government's tax revenues.

For a reporting government's own tax abatement programs, the Statement will require disclosures about the programs, including:

- Brief descriptive information, such as the tax being abated, the authority under which tax abatements are provided, eligibility criteria, the mechanism by which taxes are abated, provisions for recapturing abated taxes, and the types of commitments made by tax abatement recipients;
- The gross dollar amount of taxes abated during the period; and
- Commitments made by a government, other than to abate taxes, as part of a tax abatement agreement.

Governments should organize those disclosures by major tax abatement program and may disclose information for individual tax abatement agreements within those programs.

Tax abatement agreements of other governments should be organized by the government that entered into the tax abatement agreement and the specific tax being abated. Governments may disclose information for individual tax abatement agreements of other governments within the specific tax being abated. For those tax abatement agreements, the Statement will require disclosures, including:

- The names of the governments that entered into the agreements;
- The specific taxes being abated; and
- The gross dollar amount of taxes abated during the period.

Recommendation

The State should continue to review and analyze its various revenue programs that could fall within the scope of this Statement and develop policies and procedures related to the accumulation of required disclosure information for those programs in scope.

Management Response

We concur. We will continue to review the standard and will work with the relevant State agencies and component units in an effort to ensure proper implementation of the standard for the State's financial statements in the fiscal year ending June 30, 2017.

(2) New GASB Standard on Other Postemployment Benefit (OPEB) Obligations (Observation)

Observation

In June 2015, the GASB issued Statement No. 75, Accounting and Financial Reporting for Postemployment Benefits Other than Pensions. The objective of this Statement is to improve accounting and financial reporting by state and local governments for postemployment benefits other than pensions (OPEB). It also improves information provided by state and local governmental employers about financial support for OPEB that is provided by other entities to the extent applicable. This Statement is effective for fiscal years beginning after June 15, 2017.

This Statement establishes standards for recognizing and measuring liabilities, deferred outflows of resources, deferred inflows of resources, and expense/expenditures related to OPEB. In financial statements prepared using the economic resources measurement focus and accrual basis of accounting, an employer participating in single-employer plan that does not have a special funding situation, similar to the State's circumstance, is required to recognize a net OPEB liability, representing the difference between the total OPEB liability (the present value of future benefits attributed to past periods of service) and the fiduciary net position of the OPEB plan established for funding such benefits, if any. Changes in the net pension liability will be reported as deferred outflows of resources or deferred inflows of resources, or pension expense, depending on the nature of the change.

In governmental fund financial statements, a single employer is required to recognize a net OPEB liability to the extent the liability is normally expected to be liquidated with expendable available financial resources. OPEB expenditures are required to be recognized equal to the total of (1) amounts paid by the employer to the OPEB plan, including amounts paid for OPEB as the benefits come due, and (2) the change between the beginning and ending balances of amounts normally expected to be liquidated with expendable available financial resources.

This Statement also requires that notes to financial statements of single employers include descriptive information about the OPEB plans through which the OPEB is provided, along with the discount rate and assumptions made in the measurement of the net OPEB liability. Sources of changes in the current year net OPEB liability also will be required to be disclosed in the notes to the financial statements. Sources of changes in the net OPEB liability and components of the net pension liability and related ratios over the most recent ten years will be provided as required supplementary information.

Recommendation

The State should continue to review the issued OPEB Statement to evaluate the impact of the standard on the financial reporting of the State's OPEB obligation.

Management Response

We concur. We will continue to review the standard and will work with the relevant State agencies and component units in an effort to ensure proper implementation of the standard for the State's financial statements in the fiscal year ending June 30, 2018.