STATE OF NEW HAMPSHIRE

Management Letter

Year ended June 30, 2014

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

March 26, 2015

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, 2014, 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 basic 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.

Our consideration of internal control was for the limited purpose described in the preceding paragraph and was not designed to identify all deficiencies in internal control that might be significant deficiencies or material weaknesses and therefore, significant deficiencies or material weaknesses may exist that were not identified. However, as discussed below, we identified two deficiencies in internal control that we consider to be a significant deficiency.

Because of its inherent limitations, internal control over financial reporting may not prevent or detect misstatements. Also, projections of any evaluation of effectiveness to future periods are subject to the risk that controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.

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 a combination of deficiencies, in internal control, such that there is a reasonable possibility that a material misstatement of the entity's financial statements will not be prevented, or detected and corrected, on a timely basis. Neither of the identified significant deficiencies listed in Section I are considered to be material weaknesses.

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. We consider the deficiencies listed in Section I to be significant deficiencies.

Although not considered to be significant deficiencies or material weaknesses, we also noted the items in Section II during our audit which we would like to bring to your attention.

The State's responses to the findings identified in our audit are described in Section I and Section II of the management letter. We did not audit the State's responses and, accordingly, we express no opinion on them.

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

March 26, 2015

STATE OF NEW HAMPSHIRE

Management Letter

Year ended June 30, 2014

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SECTION I

Significant Deficiencies

2014-1

Payroll and Human Resources Control Deficiencies

Through our testing of the State's payroll and human resources process during our audit of the State's financial statements as of and for the year ended June 30, 2014, we noted the following items related to the State's payroll and human resources process:

Ineffective General Information Technology Controls related to the NHFIRST Human Resources/Payroll Lawson System

In February 2013, the NHFIRST Human Resources/Payroll Lawson System (Lawson or System) was implemented for certain state agencies. Based on our review of the implementation of Lawson, we determined that certain General Information Technology Controls (GITC) related to the System were ineffective. Our findings related to the System are as follows:

- In the System, application roles are used to control user access privileges. However, we noted that privileged access (access to all application functions and capabilities) had been granted to 45 application users and the job responsibilities of some of these individuals was not properly aligned with their assigned roles.
- The System utilizes an Oracle database. It was noted that system enforced password parameters, with the exception account lockout after 3 failed log-on attempts, were not in place. Subsequent to initial testing and after corrective action was taken by management, it was determined that system enforced password parameters did include minimum password length, password expiration, password complexity, and password history, however, the password parameters were not in accordance with the State's policy.
- For terminated users, access to system software should be removed in a timely manner after the date of termination of the employee. During our review, we noted that access to Lawson was not removed in a timely manner for the 5 sample selections made, with the duration of time between termination date and removal of access ranging from one month to six months. It was noted during our review that responsibility for the removal of access for a terminated employee is decentralized to the various State agencies,
- As with most IT operations, formal testing and authorization of hardware and software changes, including application operating system changes, is required prior to migration to production. During our review, we determined that evidence of testing and subsequent authorization of changes was not consistently or comprehensively documented on the change request forms stored in the System's change tracking application, and for certain selected changes, the change request form was not available. Further, it was noted that one individual has the ability to both develop and migrate changes without involvement from any other parties.
- Processing and monitoring of backup jobs should be monitored and backup tapes should be stored in a secure offsite storage area. During our review, we determined that documentation relative to monitoring of the daily backup process was not available for the entire fiscal year, and documentation related to the monitoring of backup tapes as they move from onsite storage to offsite storage was not available for review. Subsequent to initial testing and after corrective action was taken by management, it was determined that, beginning in September 2013, appropriate levels of documentation relative to the processing and monitoring of backup jobs was available.

Ineffective Controls over Compensated Leave Balances

One feature of Lawson is that it allows all employees to access their leave balances (e.g., sick, annual, compensatory time) electronically. Employees rely on those balances as they plan time off or require sick leave, among other uses. To some degree, employees have always been able to access such information. Before the use of technology, the payroll system was a paper-based system. The accuracy and timeliness of accrued and decremented time was dependent on employees, as they recorded their time; and on managers and payroll staff, as they administered and reviewed the written documentation. Now, under Lawson, the timekeeping process is totally paperless. Despite the change to a paperless process, the Department of Administrative Services (DAS) determined that certain Lawson leave balances were inaccurate due to the process and controls implemented.

Lawson is dependent on both the accuracy of data and timeliness of computer processing. In addition to having the employee enter accurate and timely information, managers are required to review the time to be taken and approve it. Likewise, payroll staff at the State agencies are required to review and approve the use of time off and ensure the accuracy of the leave balances available to be taken. Once completed, the agencies' payroll staff "passes" the approved time to the Lawson portal from the time management module of the system. Once passed, the time is decremented from the employee's balance. Also, based on an employee's anniversary date, each employee is credited time monthly based on their number of years of service.

When Lawson first became operational, DAS experienced software issues, application configuration problems, and human errors in the determination of compensated leave balances. As time progressed, however, those issues were mostly resolved. Remaining errors are believed to be predominantly attributable to human error. Initially, DAS believes that many agencies were omitting the final step of the approval process of "passing" the time from the timekeeping module to the NH FIRST portal. Thus, this "time not passed" eliminates or delays the decrement of time balances giving some employees the impression they have more time accrued than they actually have. The more "time not passed" to the NH FIRST portal there is, the less accurate the balances are. Therefore, the balances many employees were relying on when making time-off decisions may not have been accurate.

Controls over Compliance with Federal Wage and Hour Regulations

As a result of the conversion to Lawson, and the resultant ongoing analysis of, and changes to, payroll processing, the State became aware of certain potential compliance concerns with provisions of Federal wage and hour regulations associated with the processing of payroll. Upon identification of these potential concerns, the State began a self-assessment into the various areas of the Federal wage and hour regulations to identify potential noncompliance and determine any required changes to State payroll policies and procedures. As a result of this compliance self-assessment and to improve internal controls, the State has made certain changes to its payroll policies and processes effective in 2015.

Effect

Ineffective General Information Technology Controls related to the NHFIRST Human Resources/Payroll Lawson System

Excessive access to application functions and capability increases 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.

Lack of strong password parameters for the Oracle database increases the risk that unauthorized users gain access to the information stored in the database which could be used for inappropriate purposes, as well as increases the risk that the integrity of the data is not secure.

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.

The absence of appropriate documentation supporting the change management function including documentation of appropriate approvals and user acceptance testing increases the risk that unauthorized or untested changes could be migrated into production. Further, weak controls over the individuals who can migrate changes into production increases the risk that unauthorized changes could be put into production.

Lack of appropriate controls relative to the monitoring of the daily backup process, including monitoring the process of moving backup tapes from onsite storage to offsite storage increases the risk that important backup information is not available to be restored when necessary.

Ineffective Controls over Compensated Leave Balances

Lack of appropriate controls relative to compensated leave, including monitoring of the accuracy of accumulated compensated leave balances, increases the risk that leave balances are not accurately presented to employees resulting in the potential use or payment of unearned leave time, as well as, the inaccurate presentation of the State's obligation for compensated leave in the financial statements.

Controls over Compliance with Federal Wage and Labor Regulations

Lack of effective controls over monitoring compliance with applicable Federal and other payroll-related wage and labor regulations and requirements increases the risk of noncompliance with such regulations and requirements

Recommendations

Ineffective General Information Technology Controls related to the NHFIRST Human Resources/Payroll Lawson System

While it is recognized that some experienced business users may need to be granted privileged user access to support and/or train the general business user community, the number of such users granted super-user privileges should be significantly reduced. Further, management of the Lawson application should ensure that existing and new roles support appropriate segregation of duty controls and provide users with the minimum access privileges necessary to do their jobs.

Management of the Lawson application should establish password parameters for the Oracle database including minimum password length, password expiration, password complexity, and password history that are in compliance with State password policies.

Management of the Lawson application should establish policies and procedures to ensure that notification of termination for users of the Lawson application and the elimination of access for such terminated users occurs in a timely manner.

Management of the Lawson application should review change management procedures associated with the System.

Management of the Lawson application should establish policies and procedures to ensure that appropriate levels of documentation supporting the monitoring of the daily backup process, as well as monitoring of the movement of backup tapes from onsite storage to offsite storage exists and is available.

Management Response

We concur:

- Financial Data Management (FDM) NH FIRST Security has worked with the Division of Personnel (DOP) (18 people) and the FDM Reporting team (6 people) to restrict any enhanced access. FDM developed a new security role and DOP has tested this new role that restricts DOP personnel access from any configuration capabilities and allows only functional processing, e.g., position management, benefits, HR transactions, recruiting. Tests for most of the sections in DOP have been successfully completed and the remainder is planned to be completed this month. This new security role is planned to be implemented throughout DOP by April 30, 2015. NH FIRST Security is still working with the FDM Reporting team to define their more limited access requirements.
- During the last quarter of FY2014, DoIT has established password parameters for the Oracle database including minimum password length, password expiration, password complexity, and password history that are in compliance with State password policies.
- Early in 2014, FDM NH FIRST Security had termination reports developed to identify those employees in a final termination status for more than 60 days. As of 4/4/2014 these reports have been run biweekly and those users identified have all NH FIRST access roles removed and their Active Directory account disabled. If a NH FIRST security access form is received from an agency requesting back office access removal, those requests are processed immediately. As of 3/6/2015 the NH FIRST Security Terminated Employee User ID Maintenance Policy and Procedures document was amended to further tighten NH FIRST security access controls by implementing biweekly identification of all employees in any termination status and those employees with back office access have their back office access removed immediately.
- Financial Data Management (FDM) uses a process, in collaboration with the DAS business units that requires a written Business Requirements Document (BRD) for all major changes. For all changes, FDM has implemented a change management process that requires a comprehensive project directory be created that contains written documentation of the change, including a description of the change, the specific changes that were made including screen prints as applicable, detailed testing process and results including all files used during the testing, and sign-off by the DAS business unit on the change and testing. Production migration is planned with the business unit that requested the change and coordinated by FDM with DoIT, including the submission of a written request using the Footprints Helpdesk ticket system. Migration requests require the written approval of the Director of FDM or a member of the FDM management team. The details of the testing are not included as part of the migration change request. DoIT creates a Production Migration Log Signoff for all application changes that is reviewed and signed-off by the DoIT Director of Operations and the DAS Director of Financial Data Management. This process was implemented in July 2014 with a review of all production migrations for fiscal year 2014, and is being done quarterly going forward. Reviews were completed in October 2014 for the first quarter of fiscal year 2015 and in January 2015 for the second quarter of fiscal year 2015.
- Beginning in September 2013, appropriate levels of documentation relative to the processing, monitoring, and review of cartridge movement of backup jobs was available for review.

(Continued)

Ineffective Controls over Compensated Leave Balances

We recommend that State management continue to review compensation leave balances and perform manual adjustments as deemed necessary. Further, we recommend that training for payroll staff in State agencies responsible for the processing of compensated leave time in Lawson be provided additional training, and that system controls designed to prevent inaccuracies in compensated leave balances and delays in the processing of used time be pursued.

Management Response

We concur. Regarding leave usage, the State implemented new internal controls in this area in January 2015 which, in general and for the majority of agencies, will no longer allow employees to submit time cards with leave usage that is not available as of that date. The employee will receive an error message which will indicate to them that they have an inadequate balance and the issue will need to be resolved prior to submitting their time card to their supervisor. Additionally, DAS has developed additional/expanded reporting to detect issues in this area and we have hired a new Payroll Auditor who will centrally review areas such as this to detect errors that were not prevented prior to entry but before the amounts are paid to the employees. DAS has also updated the leave accrual system functionality such that employee leave accruals are recorded on a daily basis when earned. DAS has provided additional communication and training to agency HR/Payroll staff and additional training will be provided as needed.

Controls over Compliance with Federal Wage and Hour Regulations

We recommend that the State continue with its self-assessment and monitoring of its payroll policies and processes against the provisions of payroll-related regulations and requirements and make necessary revisions to such policies and processes to ensure compliance. We also recommend that members of State management and other employees responsible for payroll policies and processes receive regular periodic training on the provisions of payroll and related regulations and requirements, and that the State continue to perform compliance self-assessments on a periodic basis to mitigate the risk of potential noncompliance with these regulations and requirements.

Management Response

We concur. The State continues to review the general HR/Payroll internal controls and procedures to ensure compliance with all requirements including Collective Bargaining Agreements, Federal and State laws, etc. As the State has historically operated in a very decentralized manner, DAS believes that the centralization of HR and Payroll will provide additional and important internal controls in this area in the future. DAS now has a fully staffed Statewide Payroll Unit within the Division of Accounting Services which currently consists of 3 individuals as well as a new payroll auditor.

2014-2

Reporting of Jointly Owned Highway Capital Assets

Observation

The State reports the revenues and expenditures used in the construction and maintenance of the State's public highways and supervision of traffic thereon in the Highway Fund. This Highway Fund is reported as a major special revenue fund in the State's basic financial statements. This fund is prepared using the current financial resources measurement focus and the modified accrual basis of accounting. Under this measurement focus and basis of accounting, capital assets are not recorded on the fund's balance sheet. Amounts incurred related to capital assets are reported as capital outlay expenditures on the statement of revenues, expenditures and changes in fund balance.

The Highway Fund financial statements are ultimately aggregated with other governmental fund types into the governmental activities column of the State's government-wide financial statements. All information in the government-wide financial statements is presented using the economic resources measurement focus and the accrual basis of accounting. Therefore, capital assets are reported in these financial statements, as is depreciation, which is generally taken straight-line over the assets' useful lives.

The differences in the measurement focus and basis of accounting create several reconciling items between the governmental fund financial statements and the government-wide financial statements. One of the most common, and usually largest in size, is the reporting of capital assets. The State generally makes manual adjustments to the governmental fund financial statements (the basis of their general ledger) to arrive at the government-wide financial statements. Information to make the capital asset adjustment that relates to highway-related capital assets is based on information provided by the State Department of Transportation.

The Governor and Council approved the replacement of the Memorial Bridge (the Bridge) on December 14, 2011. The replacement of the bridge and other approach work and bridges, which are jointly owned by the State, the State of Maine and the City of Portsmouth, were to be funded in part by the State, the State of Maine, and the City of Portsmouth, with the State being responsible for the execution of construction. The State recorded all costs of construction as expenditures in the Highway Fund, reporting reimbursement of such expenditures from Maine and the City of Portsmouth as miscellaneous revenues. However, upon completion of the Bridge in fiscal year 2014, State management identified that in fiscal year 2012 and 2013, the State reported the full cost of the Bridge incurred to date as a construction in progress capital asset in the government-wide financial statements, instead of only reporting the State's portion of the cost of the Bridge as a capital asset. This resulted in an overstatement of governmental activities' capital assets in the June 30, 2013 financial statements of $41.2 million. This error was identified by management and corrected in the June 30, 2014 financial statements resulting in an overstatement of governmental activities' transportation expenses for the year then ended.

(Continued)

Effect

Ineffective controls over the capitalization of joint-owned capital outlay expenditures could result in a material misstatement of the State's financial statements.

Recommendation

KPMG recommends Department of Transportation management review all capital asset projects to ensure those with cost sharing or joint-ownership agreements with other entities are properly recorded as capital assets. KPMG recommends management at the State Department of Transportation implement controls to identify and track such projects within its capital asset system.

Management Response

We concur.

The State does not have a statewide integrated capital asset system (fixed assets) accounting module in its current automated general ledger system. To compensate for this, the Department has, and continues to implement and improve compensating controls and procedures to mitigate this significant shortfall in automated accounting processes.

In fiscal year 2014, the Department requested for and was approved a reclassification of position to Accountant III. This position was established for the sole purpose of recording and maintaining Department accounting records for fixed assets. In October of 2014, this position was successfully filled. It is anticipated that the identification and tracking of capital projects and the recording of such to the financial records will be further improved as a result.

SECTION II

Other Comments

2014-3

Controls over the Processing of Medicaid Claims at the Service Provider

Observation

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.

The State is responsible for overseeing and paying for the billions of Medicaid claims processed annually. Due to the sheer volume and complexity of Medicaid claims, the State outsources the processing of those Medicaid claims to a third-party service organization. However, although the State outsources the responsibility for processing claims, it is still responsible for ensuring that the service organization has the proper internal controls in place and they are operating effectively to ensure the claims processed that are ultimately accounted for in the State's financial statements are complete and accurate.

To ensure that the service organization has proper internal controls, organizations, including the State, often require service organizations to undergo an audit in accordance with Statement on Standards for Attestation Engagements No. 16 – *Reporting on Controls at a Service Organization*, commonly referred to as a SOC 1 audit. For fiscal year 2014, the State required its Medicaid service organization to undergo a SOC 1 audit, which the State would then review and rely on as evidence that controls at the service organization are operating effectively.

The SOC 1 report stated controls should be established such that the user entity is responsible for managing their employees' access to Xerox (NHMMIS) online. KPMG determined through testing, that five users with modified roles to the NHMMIS application did not have the appropriate 'Access Request Form' completed indicating the modification date. Documentation for the modified roles was not available, as such, KPMG was unable to determine if access was updated in a timely manner.

The SOC 1 report stated controls should be established to ensure that the user entity is reviewing and addressing data errors noted within the enterprise Operational Report for data error report (MEM-ELG-015) and duplicate report (MEM-ELG-018). KPMG determined through testing, that the control owner did not retain the audit evidence during the audit period. As such, KPMG was unable to test or conclude on the operating effectiveness of the control.

We did find that the State performed other procedures and analyses to help ensure that Medicaid-related amounts presented in the financial statements were complete and accurate, which mitigated the severity of this finding.

Recommendation

We understand that the change in service organization in 2013 precipitated, and the State obtained, the first SOC 1 report from the new service organization in 2014. Going forward, we recommend that the State work to ensure these two end user controls are executed timely and that evidence of their execution be retained to create an audit trail in the event of a discrepancy or other issue.

Management's Response

We concur.

- The final documentation for the access modification for the five employees at go-live should have been executed and retained; however, this was an unintentional oversight during a very busy time. Documentation of system access changes including additions, terminations and changes is required and maintained on a normal basis.
- Regarding the error reports, there are multiple manual processes used to review error reports and to address identified issues. The MMIS staff reviews eligibility error reports daily. When issues are identified, they are analyzed and determined either to be from the source system New HEIGHTS, in which case they are reported to the New HEIGHTS help desk, or they are determined to be an MMIS defect, in which case a defect is created. Defects are monitored and tracked, and are resolved in future code releases, as part of the maintenance requirements of the system. Error reports are all stored and accessible from the system's on-line document repository. The issues may persist across daily reports until the defect is fixed and deployed in a code release, and in subsequent reports no longer appears. The MMIS uses the appropriate system development methods to track identified defects. DHHS understands the importance of documenting internal controls and will consider additional documentation options going forward to provide the required audit evidence in the future for the controls performed. What is most critical is that the error reports are produced, are being reviewed, and defects are documented and addressed appropriately.

2014-4

New GASB Pension Standards and Exposure Draft on Other Postemployment Benefits

Observation

As discussed in prior year management letters, in June 2012, the Governmental Accounting Standards Board (GASB) issued Statement No. 68, *Accounting and Financial Reporting for Pensions* (GASB 68). This standard revises and establishes new financial reporting requirements for pension benefits provided by governments. In the context of the State's participation in the New Hampshire Retirement System (NHRS) and the New Hampshire Judicial Retirement Plan (NHJRP), key provisions of GASB 68 that will result in changes to the State's financial statements include the following:

- A requirement to report a net pension liability (asset) in the accrual-basis statement of net position that represents the difference between the total pension liability and plan net assets (essentially representing the unfunded actuarial accrued liability), measured as of a date no earlier than the employer's prior fiscal year-end. Because NHRS is a cost-sharing, multiple-employer plan, the State will report its proportionate share of the collective net pension liability of the plan in its government-wide statement of net position. The employers' proportionate share should be determined in a manner consistent with how contributions to the plan are determined, and is expected to be determined for the participating employers by or through NHRS. Because NHJRP is a single-employer plan, the State will report the entire net pension liability (asset) associated with the plan.
- Immediate recognition of most components of the periodic change in total pension liability as pension expense. Certain changes in total pension liability and plan net assets will be reported as deferred outflows of resources or deferred inflows of resources in the statement of net position and will be recognized as pension expense over the average remaining service life of all employees (actives, inactives and retirees). For NHRS, the State will report its proportionate share of collective pension expense and deferred inflows of resources and deferred outflows of resources in the government-wide statement of activities and statement of net position, respectively. The proportion applied will be the same as that applied to allocate the net pension liability described above. Deferred inflows of resources and deferred outflows of resources also will be reported to account for the impact of any changes in the proportion of NHRS attributed to the State from period to period. Because NHJRP is a single-employer plan, the State will report the entire amounts of pension expense, deferred inflows of resources and deferred outflows of resources associated with the plan.
- Changes to key actuarial methods and assumptions used to determine total pension liability for financial statement reporting, including:
  - Use of a single blended discount rate that applies (a) the expected long-term rate of return on pension plan investments to the extent that plan assets are expected to be available to make projected benefit payments and (b) the interest rate on a tax-exempt 20-year AA-or-higher rated municipal bond index to projected benefit payments for which plan assets are not expected to be available for long-term investment in a qualified trust. Currently, the discount rate is solely based on the expected long-term rate of return on plan investments. Therefore, if municipal bond interest rates continue at their current level, discount rates may decline upon implementation of Statement No. 68, particularly for underfunded pension plans.

- Required use of a single actuarial cost allocation method –"entry-age normal" – rather than the current choice among six actuarial cost methods. Both NHRS and NHJRP used an entry-age method in its most recent actuarial valuation, therefore, this change will likely have a limited impact on each plan's actuarial accrued liability.
- New note disclosures and required supplementary information, including additional disclosures related to the determination of the discount rate and the expected rate of return on plan investments, and the components of deferred inflows of resources and deferred outflows of resources related to pension benefits.

Statement No. 68 will be effective for the State's fiscal year ending June 30, 2015. To the extent practical, in the first period that Statement No. 68 is applied, changes made to comply with the Statement should be reported as an adjustment of prior periods, and financial statements presented for the periods affected should be restated. Therefore, a measurement of net pension liability under the new standards will require determination as of a date no later than June 30, 2014 for NHRS and December 31, 2013 for NHJRP to restate the beginning net position of the fiscal year ended June 30, 2015. Additionally, NHJRP will be required to implement GASB Statement No. 67, *Financial Reporting for Pension Plans*, for its fiscal year ended December 31, 2014, that will impact certain disclosures and required supplementary information provided in the NHJRP stand-alone financial statements.

To address certain audit issues related to the actuarial information that will be required by employers participating in cost-sharing multiple-employer pension plans, and likely provided by those plans, the AICPA has issued the following two whitepapers:

- Government Employer Participation in Cost-Sharing Multiple Employer Plans: Issues Related to Information for Employer Reporting
- Single-Employer and Cost-Sharing Multiple Employer Plans: Issues Associated with Testing Census Data

These whitepapers provide recommended alternatives for the provision of pension information by cost-sharing multiple-employer plans to participating employers to facilitate compliance with the requirements of Statement No. 68. The whitepapers also provide guidance related to the audit of such amounts by the plan auditor as well as responsibilities to be executed by participating employers and their auditors to be able to rely on the pension information provided by the plan. The whitepapers also introduce new audit guidance regarding the testing of census data by the auditors of the cost-sharing multiple employer plan and the participating employers. Multiple audit interpretations have been issued by the AICPA to codify the guidance provided in the whitepapers into existing professional audit standards.

In the wake of the issuance of the new pension standards, the GASB has issued an exposure draft of a proposed standard, *Accounting and Financial Reporting for Postemployment Benefits Other Than Pensions* (the Exposure Draft). If approved as proposed, the provisions of the Exposure Draft would provide accounting and financial reporting guidance for other postemployment benefits (OPEB) similar to that provided for pension benefits in GASB 68. This would result in a net OPEB liability being reported in employers' accrual-basis statements of net position that represents the difference between the total pension liability and any net position held in a trust to fund OPEB. GASB expects to issue a final standard on OPEB in June 2015. The Exposure Draft proposed an effective date of fiscal years beginning after December 15, 2016 (the State's fiscal year ended June 30, 2018).

Recommendation

The State should continue engaging in communications with NHRS and other participating entities and NHJRP regarding the impact of the new pension standards and the plans' timetable for developing the financial statement information required by participants upon implementation of the standards. The State also should monitor the progress of GASB's OPEB project and review the related exposure draft to preliminarily evaluate the impact of the proposed changes in current standards on the financial reporting of the State's OPEB obligation.

Management's Response

We concur and will continue to work with the NHRS and NHJRP regarding the implementation of the new standards effective for the fiscal year ended June 30, 2015.

(Continued)

2014-5

FHWA-Funded Projects Preliminary Engineering and Right-of-way Costs

Observation

As part of DAS' process to identify potential loss contingencies for the State in preparing the State's June 30, 2014 financial statements, the Department of Transportation (DOT) identified a potential contingency related to regulations in the US Code for FHWA-funded projects that would require potential reimbursement of federally funded preliminary engineering and right-of-way costs if construction had not begun or progressed within a specified time period. Specifically, these are US Code 23 Section 102(b) (preliminary engineering) and US Code 23 Section 108 (a)(2) (right-of-way). These sections are as follows:

> *US Code 23 Section 102 (b): Engineering Cost Reimbursement – If on-site construction of, or acquisition of right-of-way for, a highway project is not commenced within 10 years (or such period as the State requests and the Secretary (of FHWA) determines to be reasonable) after the date on which Federal funds are first made available, out of the Highway Trust Fund (other than Mass Transit Account), for preliminary engineering of such project, the State shall pay an amount equal to the amount of Federal funds made available for such engineering. The Secretary shall deposit in such Fund all amounts paid to the Secretary under this section.*

> *US Code 23 Section 108 (a)(2):Advance Acquisition of Real Property – Construction – The agreement between the Secretary and the State for the reimbursement of the cost of the real property shall provide for the actual construction of the transportation improvement within a period not to exceed 20 years following the fiscal year for which the request is made, unless the Secretary determines that a longer period is reasonable.*

State DOT has no history of being required to make reimbursement to the Federal government under either of these two sections of the US Code. However, in recent months, the State has become aware of more aggressive pursuits of reimbursements under these sections of the code by FHWA.

Recommendation

We recommend that the State DOT to continue analyzing the Federal Management Information System (FMIS) for any federally funded highway projects that did not have construction commencement in accordance with the aforementioned sections of the US Code and, therefore, may be exposed to required reimbursement of preliminary engineering or right-of-way costs. Additionally, State DOT should consider these construction requirements when determining the timing of future federally funded highway projects to reduce its exposure to potential reimbursement of such costs.

Management's Response

We concur.

As the auditors state, *DOT has no history of being required to make reimbursement to the Federal government under either of these two sections of the US Code. However, in recent months, the State has become aware of more aggressive pursuits of reimbursements under these sections of the code by FHWA.*

As recommended, we will continue to analyze the Federal Management Information System (FMIS) for any federally funded highway projects that did not have construction commencement in accordance with the aforementioned sections of the US Code and, therefore, may be exposed to required reimbursement of preliminary engineering or right-of-way costs. Additionally, DOT will consider these construction requirements when determining the timing of future federally funded highway projects to reduce its exposure to potential reimbursement of such costs.