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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*

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

We have audited the financial statements of New Hampshire Turnpike System as of and for the year ended June 30, 2006, and have issued our report thereon dated February 22, 2007. We conducted our audit 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.

Internal Control over Financial Reporting

In planning and performing our audit, we considered the Turnpike System's internal control over financial reporting in order to determine our auditing procedures for the purpose of expressing our opinion on the financial statements and not to provide an opinion on the internal control over financial reporting. However, we noted certain matters involving the internal control over financial reporting and its operation that we consider to be reportable conditions. Reportable conditions involve matters coming to our attention relating to significant deficiencies in the design or operation of the internal control over financial reporting that, in our judgment, could adversely affect the Turnpike System's ability to initiate, record, process, and report financial data consistent with the assertions of management in the financial statements. Reportable conditions are described in the accompanying schedule of findings and responses as items 2006-1, 2006-2, and 2006-3.

A material weakness is a reportable condition in which the design or operation of one or more of the internal control components does not reduce to a relatively low level the risk that misstatements caused by error or fraud in amounts that would be material in relation to the financial statements being audited may occur and not be detected within a timely period by employees in the normal course of performing their assigned functions. Our consideration of the internal control over financial reporting would not necessarily disclose all matters in the internal control that might be reportable conditions and, accordingly, would not necessarily disclose all reportable conditions that are also considered to be material weaknesses. However, of the reportable conditions described above, we consider items 2006-1 and 2006-2 to be material weaknesses.

Compliance and Other Matters

As part of obtaining reasonable assurance about whether the Turnpike System's financial statements are free of 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.



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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*.

However, we noted certain other matters that will be reported to management as part of the State-wide management letter.

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

KPMG LLP

February 22, 2007

**New Hampshire Turnpike System
Schedule of Findings and Responses
June 30, 2006**

MATERIAL WEAKNESSES

Finding 2006-1

Financial Reporting

The financial reporting process over the Turnpike System financial statements was not effective at generating GAAP financial information in a timely or efficient fashion. The process also did not include an adequate supervisory review of the financial information prior to submission to KPMG for audit. For example, many of the agency compiled "spreadsheets" contained inaccurate information and there was no evidence of a management level review. This compilation and review process is important to the financial reporting process as many GAAP adjusting entries recorded by the Department are based on the summarization of these worksheets. If a calculation error exists in a spreadsheet and it is not detected by management's control system, amounts recorded by management could be misstated and ultimately affect the values reported on the financial statements. Additionally, processes were not established to ensure the financial statements were reported in accordance with GAAP.

This ineffective process resulted in additional audit hours being incurred, numerous audit adjustments being identified and significant delays in finalizing the audited financial statements. Finally, the reporting process is not well documented. We noted that supporting documentation for journal entries, reconciliations and other key controls, when they are performed, is not always available.

We recommend a complete revamping of the Turnpike System's financial reporting process to ensure that proper controls are in place, that processes are established and documented, that adequate supervision of staff and management review of financial information exists and that all accounts are reconciled and adjusted on a monthly basis.

Turnpike System's Response

We concur.

Due to substantial turnover in the Bureau of Finance & Contracts, the prescribed preparation and review process for agency-generated financial information has deteriorated. With the addition of a number of recent hires, as with three more positions just added to the Bureau, staffing will be established at an appropriate level. The Bureau has adopted a formal Journal Voucher process with appropriate support and proper reviews. Further, the Bureau has reengineered the series of spreadsheets used to convert the cash basis records to the full accrual process to mirror the process used by Administrative Services.

The Bureau is also in the process of implementing policies and procedures to more formally establish employee roles and duties, clearly defining responsibilities, timelines, and workflow from source data through final approval. Having these documented policies and procedures in place, will ensure that all transactions are properly supported and will improve the efficiency, timeliness, and accuracy of the spreadsheets and other financial information prepared by the Bureau, both for use internally and for submission to the auditors. These procedures will include detailing the daily, weekly and monthly responsibilities.

In addition, we are compiling all of the year-end procedures in a closing document, which is a checklist to ensure the information is accurate, timely, and complete. The document will not only include steps used to create information but will include additional steps taken to test and verify the accuracy of the information. We have learned through the recent audits to challenge the information and to take the additional steps to reconcile this information against other sources and databases.

Since the Bureau has fallen behind in fiscal year 2007, our plan is to use the March 31, 2007 account balances to perform the necessary analysis so that June 30th balances will be correct. In addition, the Bureau of Finance and Contracts will need to engage the Turnpike's management further in the preparation of these statements so that all appropriate management personnel are fully involved in the finances of the system.

**New Hampshire Turnpike System
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June 30, 2006**

Finding 2006-2

Turnpike Toll Collections

The Department of Transportation–Division of Turnpikes implemented the E-Z Pass automated toll collection system in late fiscal 2005 and operated under this system for all of fiscal 2006. To implement the system, the State contracted with a private company, ACS, to provide the transaction processing services supporting this effort.

Under the transaction processing arrangement, ACS has been hired to perform numerous internal control processes that are critical to the integrity of the State's financial accounting and reporting functions and, while such arrangements are common in other states, it is imperative that the adequacy and effectiveness of controls at ACS be validated by State officials and that State officials design and implement controls within the State to effectively monitor and validate the activities of ACS.

Key financial accounting and reporting processes that ACS performs for the State for which the State officials have not assessed adequacy or effectiveness include:

- Valuing the individual toll transactions
- Applying toll discounts for New Hampshire tag holders
- Processing credit card and recording cash receipt transactions for New Hampshire tag holders
- Determining and reporting revenue and deferred revenue to be recognized by the State

While the State has indicated that they have implemented selected controls, it relies solely on ACS for the execution of the key controls above and the controls implemented by the State do not appear to be adequate or to reduce the risk of fraud and errors to a reasonable level. For example, the State has indicated that a review of revenue recognized versus treadle counts is performed periodically, but the analysis is not sufficient to provide any assurance regarding the appropriateness of revenue as the treadle count is not the only determinant of the correct toll amount and the counts are not a readily verifiable statistic. The State also maintains a database of transactions, but relies solely on ACS to process those transactions for recording in the State's financial reports. Additionally, although the transaction data collected by the State in the database is forwarded to ACS for processing, other than an e-mail acknowledgement of receipt of the file sent, there is no control over whether the data sent and received was complete and accurate.

For fiscal 2006, the Turnpike officials have neither assessed or had assessed the integrity of ACS internal controls as contemplated by a SAS No. 70 'audit' nor have those officials implemented effective controls to monitor the activities of ACS to a level sufficient to provide assurances that all toll activity is being accurately accumulated, valued and reported in the Turnpike's internal and external financial statements.

Without adequate support from State officials demonstrating that all toll activity has been accurately compiled, valued and reported, the State runs the risk of receiving a qualified opinion on its financial statements and being unable to demonstrate compliance with its bond covenants.

Adequate internal control systems dictate that controls be in place at both the transaction processor and at the State. For fiscal 2007, the Turnpike officials need to ensure that an adequate SAS No. 70 'audit' is performed over the controls at ACS and that appropriate controls are instituted at the State to ensure that all E-Z Pass activity is properly captured, valued, accounted for and reported. Relying on ACS for calculating significant financial activity for the Turnpike, including the reported amounts of revenue and deferred revenue, without adequate validation and oversight by State management does not constitute good internal control and increases the risk of error and fraud.

We recommend Turnpike System management establish controls to ensure that the activities of contractors involved in the processing of Turnpike System financial data are adequately monitored and reviewed. While a SAS 70 report was obtained for a portion of fiscal 2007, management must ensure that its reporting responsibilities throughout the year are met. This may require a second SAS 70 report to be obtained closer to June 30, 2007.

Turnpike System's Response

We concur in part.

Putting in a major new system such as electronic tolling is a major undertaking and not all events and requirements were fully anticipated. While we have had significant challenges reconciling traffic to revenue collected, we feel that we have made substantial progress.

In FY 2007, we received a four month SAS 70 audit ending October 31, 2006. We are in process of securing additional audit coverage so that most of the Fiscal Year will be covered.

We have contracted with Vollmer Associates to enhance our auditing process. This review is ongoing as we are still working with The Revenue Markets Inc (TRMI) to enhance the reporting requirements and to use the combination of technologies to maximize the accuracy of vehicle counts.

Every month, an internal reconciliation of Traffic to Revenue Report is prepared which reconciles traffic to revenue after considering E-ZPass discounts within an acceptable error margin. Finally, we are conducting additional analysis to demonstrate that we are actively managing ACS. For instance, we will now trace transactions through the ACS systems on a test basis to individual customer accounts to not only test revenue, but to also verify deferred revenue balances.

Through the audit process we have been educated to the importance of employing risk assessment and to take a variety of documented actions to employ an effective system of controls over this critical toll collection function.

**New Hampshire Turnpike System
Schedule of Findings and Responses
June 30, 2006**

REPORTABLE CONDITION

Finding 2006-3

Turnpike Cash

The cash recorded on the Turnpike's general ledger did not agree with the cash records in the Treasury Department and the difference of over \$1 million could not be sufficiently explained in a timely manner. Additionally, there is not an adequate system of controls over cash to ensure that (a) these records are compared and reconciled during the year; (b) Turnpike cash receipts are properly coded for the Treasurer to record the receipts to Turnpike bank accounts; and (c) transfers from Turnpike bank accounts to State disbursement accounts are properly made to cover Turnpike expenses.

We recommend that Turnpike System management ensure that reconciliations between its books and the Treasurer's records are done at least monthly.

Turnpike System's Response

We concur. While the cash balance per the general ledger for the state as a whole is in balance with all of the state bank accounts, the dedicated Turnpike bank balances were not reconciled to the Turnpike general ledger during the audit period.

In January 2007, the Department in conjunction with the State Treasurer's office conducted an in depth review of this issue. The reconciling items have been identified and a banking adjustment has been proposed. The Treasury and the Department are in the process of documenting the necessary actions that are required to keep this account in balance, which will be fully documented and in balance at June 30, 2007.

Treasury Department's Response

We concur. Treasury will work with the Department of Transportation (DOT) to ensure reconciliations are performed monthly. While working with the DOT, Treasury identified the types of transactions causing differences between cash reported in Turnpike's general ledger and cash held in Turnpike bank accounts. Treasury has modified its Turnpike reconciliation procedures to specifically seek out these transaction types and will continue to work with DOT with the goal of employing a process that will eliminate these differences.