Management Letter
for the State of New Hampshire

For the year ended June 30, 2001

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November 30, 2001

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

We present, for your consideration, our comments and recommendations regarding internal controls and other matters. These comments and recommendations are intended to improve the internal control structure or to result in other operating efficiencies for the State. The factual accuracy of our comments has been reviewed with management so as to obtain their concurrence prior to the development of our recommendations for improvement. Matters commented upon represent findings during the audit and have not been reviewed subsequent to November 30, 2001.

Although the State's financial management system has many positive attributes, a management letter is critical by nature because its purpose is to identify areas where improvements can be made. It is also important to understand that it is generally not practical to achieve ideal internal control in the complex governmental accounting environment.

We would like to acknowledge the courtesy and assistance extended to us by State personnel during the course of our audit.

Very truly yours,

KPMG LLP

STATE OF NEW HAMPSHIRE
2001 MANAGEMENT LETTER

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Statewide

Governmental Reporting Model

As discussed in the prior year management letter, the Governmental Accounting Standards Board (GASB) issued its revolutionary new reporting model in June 1999, GASB Statement No. 34, *Basic Financial Statements and Management's and Management's Discussion and Analysis for State and Local Governments*. In short, GASB 34 will require state and local governments to completely revamp the way they report their financial results to the public. In GASB's view, the new standards will enhance the usefulness and comparability of governmental financial statements for the citizenry, oversight bodies, investors and creditors. Full accrual accounting, in-depth information about finances and operating results, and changes in the way certain programs and activities are reported are just some of the ways GASB hopes to improve financial and operational accountability.

Without question, the new reporting model will dramatically alter the presentation of the State's financial statements, and its implementation could consume significant levels of human, technological and financial resources. The effective date of the new pronouncement will require implementation by the State for its year ending June 30, 2002. The State's component units will also be required to adopt the new standards.

Following are some of the major aspects of the new model:

- *Management's Discussion and Analysis ("MD&A")* – A comprehensive MD&A will be presented as required supplementary information. MD&A will introduce the financial statements by presenting an analysis of the government's financial performance for the year and its financial position at year-end. MD&A will be similar to but separate from the transmittal letter currently required for Government Finance Officers Association ("GFOA") award candidates, such as the State. However, GFOA may modify its existing requirements to reduce duplication between the two documents.

- *Government-Wide Reporting* – The State will be required to report financial operations and net assets at the fund level for governmental activities from business-type activities. *All* information at the government-wide level will be reported using the economic resources measurement focus and accrual basis of accounting, as enterprise funds do under the current model. Fiduciary activities will be *excluded* from the government-wide level of reporting. General government fixed assets, *including* infrastructure, and long-term liabilities of the government will need to be reported with all other governmental assets and liabilities.

- *Statement of Activities* – Governments will be required to use a "net program cost" format for the government-wide statements instead of a traditional operating statement. This new format groups revenues and expenses by functional categories (such as public safety, etc.). The purpose of this new statement is to inform readers about the costs of specific functions and the extent to which they are financed with program revenues or general revenues of the government. Governments will have the option of reporting both direct and indirect program costs. Depreciation expense will be reflected as a cost in the statement of activities.

- *Infrastructure Reporting* – Historically, the State has not been required to record infrastructure assets in its financial statements. Under the new standard, the State must report infrastructure assets acquired since 1980. The standard provides several alternatives for determining historical cost of infrastructure assets. Once recorded, the standard requires these assets to be depreciated.

- *Fund-Level Reporting* – Fund-level financial statements will still be required and will provide information about the State's fund types, including fiduciary funds and blended component units. General capital assets and general long-term liabilities will only be reported at the government-wide level. Fund-Level reporting will continue to focus on fiscal accountability and reflect the flows and balances of current financial resources. The modified accrual basis of accounting will continue to be used at the fund level, except for proprietary and fiduciary funds, which will continue reporting based on economic resources and the accrual method of accounting. A reconciliation between the fund-level and the government-wide statements will be required on the face of the fund-level financial statements. Finally, proprietary fund statements of cash flows will be presented using the direct method.

- *Presentation of Budgetary Information* – Budgetary statements for the general fund and certain other governmental funds can be presented as required supplementary information. The original adopted budget of the State, as well as the final revised budget, must be presented and actual results on a budgetary basis will need to be reconciled to the GAAP-basis results.

The practical challenges involved in implementing GASB 34 are numerous and, in certain cases, significant. While GASB has issued further implementation guidance to interpret and apply the new standards, there are several new accounting aspects that will add layers of complexity to the State's external financial reporting process which may be difficult to implement. Among these are:

- Full-accrual accounting for all receivables, which will require appropriate measurement of gross amounts and the establishment of allowances for estimated uncollectible balances.

- Full-accrual accounting for all liabilities, including long-term liabilities (e.g., compensated absences) whose valuations will directly affect net assets.

- Statement of cash flows, which must be prepared using the direct method (this method is largely avoided by commercial entities due to its complexity).
- Infrastructure valuation and measurement of depreciation thereon.

To implement these changes, the State needs to develop a formalized implementation plan. The plan should identify each issue applicable to the State, and develop an implementation plan that addresses each issue. Each issue should include implementation milestones, dates of completion, and a designated individual responsible for each issues achievement.

Additionally, we recommend the State formalize its revenue recognition policies and specifically define when the "availability" criteria of the modified accrual basis of accounting is met. The policy should be consistent among similar revenue types. In light of these GASB standards, the State's policy will need to be included in the footnotes to the Comprehensive Annual Financial Report for fiscal 2002.

Finally, we recommend that the State continue to look at its systems and processes to ensure that the current systems can produce the required information for timely implementation. Further, the State should consider the cost of required changes to its systems and processes to ensure availability of necessary funds in future budgets.

Department of Administrative Services Response

We concur. The Department has formed a GASB 34 implementation team, which includes representation from the Department of Transportation and the Department of Health and Human Services. Issues have been identified and are being addressed. The Department of Transportation has been working diligently to capitalize infrastructure and the associated depreciation of these assets. GASB 34 allows for a series of choices that can be made on each issue. Until enhancements to the central state accounting systems are made, Administrative Services' overall approach is to keep the conversion as simple as possible and to capture data off-line. Spreadsheets will be used to convert the statements to a government wide format on a full accrual basis. Evaluation of the current system will include automated closing and statement generation in accordance with GASB 34.

Enterprise Resource Planning System Evaluation

In light of the new governmental reporting model's requirements and the increased demands of users and stakeholders for system integration, accessibility to data, and reporting, the State needs to continue to analyze its need for a new Enterprise Resource Planning system by matching current and future system requirements with current capabilities.

Some major shortfalls with the application of the functions of the State's current financial systems include:

- Significant dependence on paper, not servicing electronic workflow;
- Not all core business systems are integrated, causing duplicative processing;
- Not supporting E-Government solutions;
- Not adequately supporting agency project accounting and grant reporting needs;
- Lack of accessibility to data in a useable format; and
- Not generating financial statements in accordance with generally accepted accounting principles and with the new reporting model, GASB No. 34.

Currently, various agencies are requesting appropriations for new systems or modifications to their existing systems. The State needs to evaluate whether it is cost effective to continue to fund various agency requests or should a new enterprise-wide system be implemented. It is our understanding that the State's 2002 Statewide Information Technology Plan will include a recommendation for an Enterprise Resource Planning system.

Because of the significance of this undertaking, it appears the State continues to struggle with the decision to proceed. We recommend that the system user group established to study this issue, complete a plan which can be reviewed and approved by the Legislature. The plan should document how workflows will be made more efficient and services improved and also include an estimated cost analysis for a system replacement, including inventorying the current systems used by the various state agencies including costs associated with maintaining them.

Department of Administrative Services Response

We concur. The Statewide Information Technology Plan has identified the ERP initiative as the number one technology priority for the State. Administrative Services recognizes this project as a huge statewide undertaking and will complete a feasibility study for a new system this spring.

Reserved Fund Balances

Reserve for Unexpended Appropriations

The reserve for unexpended appropriations on the State's Comprehensive Annual Financial Report represents non-lapsing funds appropriated for a specific purpose. During our review of this reserve we noted, as we have in the past, that certain of these balances carried forward from year to year are for projects completed or have been inactive for years.

We recommend, as we did in the prior year, that the State perform an in-depth review of these accounts and make a determination as to whether the current practice to carry forward these funds makes business sense. The Department of Administrative Services and the Office of the Legislative Budget Assistant should work cooperatively to resolve this issue.

Reserve for Unexpended Appropriations – Negative Balances

Additionally, included as an offset to the reserve are negative balances. Negative balances could represent one of the following: encumbrances established for which federal revenues have not yet been drawn, expenditures incurred but not yet billed or drawn down from the Federal government or anticipated revenue not yet received. We noted approximately $4.1 million of negative balances for which either an expenditure was incurred but not yet billed or drawn down; or anticipated revenue was not received. Of this amount, the Department of Transportation Aircraft Rescue and Fire Fighting training facility had a negative available balance of approximately $2.5 million due to a delay in billing the federal government. A significant amount of these dollars were not collected until October 2001. There is potential that the remaining $1.6 million of these negative balances will need to be funded by the general fund.

In order to maximize the State's cash flow position, we recommend management take whatever steps it deems necessary to minimize the time period between the date they are eligible to request funds from the federal government and the date the funds are actually requested. Additionally, the Department of Administrative Services' should develop formal monitoring procedures to assist the Business Supervisors in performing an in depth review of each divisions accounts. This review can help monitor the timing of the federal draws or requests for reimbursement.

Encumbrances

The State also establishes a reserve for encumbrances, which represents the set-aside of appropriation balances to pay for committed purchases of goods and services. As of June 30, 2001, the State had encumbrances of approximately $10.7 million, which were established more than a year ago, some dating as far back as 1992. However, the amount is significantly down from the prior year and a good portion of these funds relate to long-term construction contracts.

We recommend that a review of all reserve accounts continue to be performed on a periodic basis through the year and at year-end by the Department of Administrative Services. The review will help to identify any potential overspending situations that are not being properly supported by revenue generation, that cash is drawn timely, therefore maximizing the State's cash flow position and that unexpended appropriations and encumbrances are closed to the appropriate fund balance.

Department of Administrative Services Response

The New Hampshire Legislature has continued to pass laws that earmark general revenues for specific purposes. This process allows the spending of these funds without going through the normal scrutiny as provided in the budget process. Further, these accounts are frequently non-lapsing, which allows the unexpended balances to be carried forward year after year. We recommend that a study be performed of all of these dedicated accounts and where possible, legislation be introduced to incorporate these accounts into the budget, thereby providing decision makers with as complete a view as possible of spending requests.

Administrative Services will use information from the data warehouse to identify accounts that are experiencing unfavorable revenue results and to identify encumbrances that have not had recent payment activity. Administrative Services will continue to work with the agencies to monitor performance and to take appropriate budgetary actions.

Department of Transportation's Response

The Aircraft Rescue and Fire Fighting (ARFF) training facility was designed and constructed through one contract for a general contractor, a purchase order to acquire an ARFF vehicle, a purchase order to acquire and install ARFF simulator equipment and a consultant contract.

During the initial phase of manufacturing of the simulator equipment, the product was developed off site in Texas and New Jersey. Payments were made by the state to the contractor through off site visits to Texas and New Jersey for proof of phase completion.

The Federal Aviation Administration (FAA) would not reimburse for the equipment until it physically arrived on site for installation. In addition, there is a delay of 60 to 90 days from when the contractor is paid until the reimbursement is received from the FAA. This is a normal delay in the process for all Airport Improvement Projects (AIP). As a result of the reasons stated above, there was a considerable delay in reimbursement for these funds for this project.

Department of Administrative Services

Reports on the Processing of Transactions by Service Organizations

The Department's Bureau of Risk Management contracts with a third party to provide claims administration, and accumulate financial and statistical data for the State's worker's compensation program. The State has responsibility for timely reporting of claims to the third party and cooperation with them to help contain costs.

Under this arrangement, the State places a great deal of reliance on the controls in place at the third party service bureau to input, process, track and expedite claims accurately and properly. To gain comfort over the controls in place at the service bureau, the State should request, on an annual basis, a service bureau audit report in accordance with Statement on Auditing Standards(SAS) No. 70, *Reports on the Processing of Transactions by Service Organizations* and consider including SAS No. 70 provisions/ requirements in future third-party service bureau contracts.

Department of Administrative Services Response

We concur. Administrative Services will discuss obtaining a service bureau audit with our third party administrator.

Department of Health and Human Services

Health Insurance Portability and Accountability Act of 1996

In August 1996, the United States Congress passed the Health Insurance Portability and Accountability Act of 1996 (HIPAA) to improve the portability and continuity of health insurance coverage and simplify the administration of health insurance. HIPAA also requires the implementation of security standards for the protection and privacy of individually identifiable health information.

The final rule for electronic transactions and code sets was signed on August 17, 2000. By finalizing these standards, the date for required compliance with transactions and code sets standards is October 16, 2002. A draft of the other rules was published in November 1999 and has not been finalized. However, it is unlikely that the final rules will differ significantly from the draft or that the deadline for privacy rules compliance will be extended beyond October 16, 2002. Other published but not yet finalized standards include:

- Privacy of Individually Identifiable Health Information
- Security and Electronic Signature Standards
- Health Claim Attachments
- National Standard Identifiers for Employers, Health Care Providers, and Health Plans

HIPAA requires that any patient identifiable information that is transmitted electronically be specifically protected. These HIPAA-mandated benefits must be addressed:

- Confidentiality: Ensuring that information is not made available or disclosed to unauthorized individuals.
- Integrity: Ensuring that data has not been changed or altered en route or in storage.
- Authentication: Making sure the person requesting information is who he or she claims to be.

- Non-repudiation: Once a transaction occurs neither the originator nor the recipient can deny that it took place.
- Authorization: Allowing users access to network information and resources based on defined privileges.

Although these mandated benefits appear at first glance to have a technology focus, the reality is that, in order to appropriately address HIPAA, an organization must consider its people and business processes as well as its technology infrastructure.

We recommend the State continue to plan for the adoption of the HIPAA security and privacy standards to ensure proper and timely compliance. We recommend the State:

- Understand the impact of the standards on its operations;
- Make an initial assessment of its compliance with the standards; and
- Develop a formal business strategy to become compliant with the standards.

Department of Health and Human Services Response

DHHS is committed to being HIPAA compliant by the dates imposed by finalized HIPAA regulations (Transactions and Code Sets and Privacy) and has been diligent in including the proposed rules for security, provider identifiers, etc in its assessment and compliance strategies.

The Department has completed a HIPAA compliance and gap analysis of its MMIS and is engaged in an enterprise-wide assessment of other system processes and business practices to identify compliance or non-compliance across the Department with regard to HIPAA regulations and proposed rules. Federal approval has been obtained for the implementation of an Electronic Data Interchange translator that, along with modifications to the MMIS, will ensure HIPAA compliance for claims processing and HIPAA covered transactions and code sets.

Consistent with the requirements for the Transaction and Code Sets compliance extension that recently was enacted, the Department will be submitting a plan by October 2002 that will delineate its HIPAA compliance strategy for covered transactions and code sets that will ensure compliance by the October, 2003 extended deadline. The implementation will be a phased approach, whereby the Department will be HIPAA compliant with inquiry and claims/payment transactions by June 2003 and will have implemented any remaining covered transactions by October 2003.

Following the completion of the enterprise-wide assessment to be concluded by August 2002, implications for HIPAA security and privacy compliance will have been reviewed and specific strategies will be defined for both systems and business practice implementation. Compliance gaps and corrective strategies will have been reviewed with applicable business entities across the department, with planned implementation of corrective measures completed by the October 2003 deadline imposed by the HIPAA privacy regulation.

Automation of the MMIS and Bridges Liability Calculation

The State's Medicaid Management Information System (MMIS) is a complex claims processing system that contains various database subsystems including recipient, provider, third party liability and reference databases. The State contracts with an independent computer service bureau (EDS) to process claims and accumulate financial and statistical data using MMIS. EDS generates an "incurred expense report for estimated expenditures" from the MMIS system which includes paid amounts and a total estimated incurred amount by month of service. The total estimated incurred amount could be used for the State's Medicaid liability at any one point in time. However, the State relies on the EDS generated reports only for the claims payment information.

For financial reporting purposes, the State manually estimates the necessary liability for both Medicaid and Child Care (Bridges) related expenditures. The liabilities are calculated by the State based on total processed claims paid subsequent to year end (July and August) for dates of service prior to year end. The total of such payments are then increased by a lag factor to estimate the liability. The lag factor is the ratio of the prior year actual payments made in July and August versus the total payments made over that subsequent year.

The EDS reports calculate the estimated liability, i.e. claims incurred but not reported; however the State does not use this system generated calculation. Additionally, the State's manual calculation may not take into account problems that may have occurred with processing the data, i.e. claims in suspense, or problems that may have occurred outside the system, such as, a significant backlog of claims; or properly analyzing significant credits in the data at the original claim date.

Through a review of the Bridges payable calculation, we noted that significant credits, for county rebills, were used to decrease the September payments for calculating what the liability should have been at the end of September. The credits were not analyzed based on the incurred date of original cost, thereby understating the estimated liability. We also noted certain instances where errors were made in the Bridges calculation. For instance, the September lag percentages were included in the calculation for July and August and the August lag percentages were used in the September calculation.

We recommend that the Department investigate whether using the EDS actuarially calculated reserves to report the liability at year end would result in a more reliable amount being reported. If the Department decides to continue to calculate the liability for Medicaid and Child Care manually, the calculations should be reviewed by someone other than the preparer, significant credits need to be accounted for properly and adjustments need to be made for any changes in payment trends such as changes of claim levels in backlog or suspense.

Department of Health and Human Services Response

Several years ago auditors advised the Department that the actuarial calculated reserves provided by EDS did not accurately report "incurred" claims. At that time the Department began using the manual process. The Department does consider transactions outside the system that may impact the recorded liability, however not all liabilities may be known when the calculation is done. We will revisit the possibility of using the system data next year, and will make a concerted effort to uncover any changes in payment trends that would effect the calculations.

County Accounts Receivable

All governmental funds are reported using the modified accrual basis of accounting. Under the modified accrual basis of accounting, revenues and assets are recognized when measurable and available, which means collectible within the current period or soon enough thereafter to be used to pay liabilities of a current period.

Accounts receivables due from the Counties at June 30, 2001 approximated $25 million; $4.6 million for the Department of Youth Development Services (DYDS), of which $2.2 million in Youth Detention Center (YDC) receivables date back to fiscal 2000, with the remaining $20.4 million relating to nursing services. Of the $25 million, $6.8 million remained uncollected as of the date of this report. Additionally, it is anticipated that not all of the total $4.6 million of fiscal 2000 and fiscal 2001 YDC receivables will be collected as the Counties contested the per diem rates used for billing. The rates were reduced, new bills were calculated and sent to the Counties in November 2001, which resulted in an approximate $500,000 reduction in the receivables.

As discussed in the prior year management letter, the reporting of revenues in the financial statements which have not yet been collected is not in accordance with the modified accrual basis of accounting and appears to have overstated the assets and revenues recorded in the financial statements.

We recommend that the State work with the Counties to resolve any outstanding issues and collect the funds owed as soon as possible. Additionally, we again recommend that revenues and assets for these programs be recorded in the financial statements if the cash has been received within 90 days after year-end, the time frame established by the State for recognizing other State revenues. This will help ensure that revenues reported are not overstated.

Department of Health and Human Services Response

The State continues to work with the counties to improve the timing of collections. During the State fiscal year 2002 closing process, any disputes that will result in the State being unable to collect amounts presumed due will not be included in the State fiscal year 2002 accounts receivable.

Department of Administrative Services Response

We concur. We will monitor the Department of Health and Human Services efforts regarding timely collection of County receivables and we will provide guidance to the Department on the appropriate recording of revenue at year-end.

Medicaid- Management Information System

In accordance with Title 45 Code of Federal Regulations Part 95.621, the Department of Health and Human Services (DHHS) shall maintain reports on its biennial Automated Data Processing (ADP) system security reviews, together with pertinent supporting documentation, which includes any reviews following Statement on Auditing Standards No. 70, *Reports on the Processing of Transactions by Service Organizations* (SAS 70 report), which may have been performed by outside processors, for DHHS onsite reviews.

DHHS contracts with an independent computer service bureau to process claims and accumulate financial and statistical data for the State's federally assisted Medical Assistance Program (Medicaid) using the State's Medicaid Management Information System (MMIS). For the year ended June 30, 2001, the State recorded approximately $467 million in Federal Medicaid expenditures.

DHHS did not obtain a SAS 70 report for the MMIS service provider in fiscal year 2001. Due to the significant volume of transactions processed by the service bureau, the significance of the dollars processed by the MMIS system, and the fact that the State's internal control policies and procedures are physically and operationally separate from the service bureau's policies and procedures, the State should consider requiring a service bureau audit report.

This matter has been raised in the State of New Hampshire's management letter dating as far back as fiscal year 1997 and still has not been addressed. We recommend that the DHHS request, on an annual basis, a service bureau audit report in accordance with SAS No. 70.

Department of Health and Human Services Response

The DHHS shares this interest in recommending the implementation of a service bureau audit report of the EDS Medicaid Management Information System (MMIS). While valuable to the Department in improving confidence in the reporting, the function would be costly to the state at this point in time.

The Departments current MMIS contract is scheduled to be renewed by July 2002. The Department will include a service bureau audit as part of the budgetary process in the next biennium's request to cover the costs of such an audit. The contract procurement process for the MMIS renewal will include this requirement.

Treasury Department

Cash Management Improvement Act

The Cash Management Improvement Act of 1990 (CMIA) is intended to improve the transfer of federal funds between the federal government and states by minimizing the time between the transfer of funds to the states and the payout for the program purposes and ensuring the federal funds are available when requested.

The State of New Hampshire uses the dollar weighted average clearance method to determine the date federal funds are requested from its awarding agencies. The requirement under Treasury Regulation 31 CFR part 205.7(c)(3) states that a state shall request funds one business day prior to the dollar-weighted average number of days required for funds to be paid out after a disbursement, and a federal agency shall deposit funds in a state account the next business day after receiving a request for funds.

Certain New Hampshire state agencies have been requesting funds from the federal agencies later than required, sometimes up to ten days late. KPMG noted that 6 of 30 (20%) cash draws tested were initiated two to ten days later than required. Deviation from the agreed upon average clearance patterns results in the disruption of the efficient transfer of funds between the federal government and the State. Late draw downs are also an inefficient way to manage cash.

A similar finding was noted in the fiscal year 2000 and 2001 single audit reports.

We recommend that the state agencies adhere to the timetable under the average clearance method when requesting reimbursement from its federal awarding agencies.

Treasury Department's Response

Treasury concurs and understands the importance of efficient transfer of funds from federal agencies to state agencies. The NH Integrated Financial System CMIA module provides the basis for agency drawdown guidance in terms of date on which to request funds based on expenditures. Treasury will continue to monitor agency draw downs and work with those agencies that consistently draw funds later than required. The anticipated completion date is December 31, 2002.

Department of Corrections

Restitution Payments

The Corrections Department collects restitution payments from offenders following a court order and distributes amounts to victims. The Department appears to lack controls over the payment of restitution to crime victims. Because of delays in a computer system update, the department has been calculating restitution checks manually. The manual process is behind, is quite involved and appears to lack formalized internal controls.

Each time a new case is opened at the district level, a payment card is completed for offenders ordered to pay money to a victim(s). Collection occurs at the District office and certain documentation such as pink copies of receipts, and/or the department's Collection Profile Form, is forwarded to those responsible for preparing paperwork for the check and making payments (CORE 4). There is no reconciliation performed of cash received to amounts included on the documentation forwarded to CORE 4 for payment or to the amounts paid by fiscal management. Additionally, the CORE 4 has no way of knowing if all victims are getting paid by using this information. Additionally, because the current process is manual, there are no controls in place to ensure that victims are not being paid twice, that the restitution payments are calculated correctly and that payments are made on a timely basis.

We recommend that controls be established over the collection and payment of restitution as soon as possible. The process should include a reconciliation of amounts from collection through to payment to ensure that the proper individuals are being paid the correct amounts, and are only paid once. Additionally, the Department should work towards updating and testing their computer system to help minimize as much manual intervention in the process as possible.

Department of Correction's Response

We have been working with a company to develop an automated payment/disbursement system for over two years. The current system of manual payments was designed as an interim process to allow victims to be paid until the new system comes on line.

In response to above comment, we identified six specific findings to address. They are as follows:

1. *"There is no reconciliation performed of cash received to amounts included on the documentation forwarded to CORE 4 for payment or to the amounts paid by fiscal management."*

   The CORE 4 personnel assigned to this task are provided copies of the payment receipts, collection profile (victim information) and a copy of the offender's payment card each time a disbursement run is done. One of the team checks each receipt against the Payment Receipt History Screen to ensure that the receipts have been posted to the correct offender payment account. Once determined to be correct, each receipt is placed in "hold status" to ensure that the receipt number is not used twice. This prevents over/under payment to the victim. Our computer system allows us to print grids to further verify payment/collection/receipt information should it be necessary. Another Central Office employee will review these to ensure that the totals agree.

We have implemented the additional procedures of printing the detail of the daily payment batches to reconcile them against the CORE 4 Spreadsheet which identifies that the victim has received restitution.

2. *"Additionally, the CORE 4 has no way of knowing if all victims are getting paid by using this information."*

   Currently, the District Office transfers the identify of a victim from the court order to an Offender's Collection Profile. The District Office sends all Collection Profile forms for an offender each time a payment-processing run is made. A Central Office employee who has not helped update the spreadsheet will compare information on the payment profile to the spreadsheet, then sign-off on the spreadsheet. The Audit Manager will design an audit program to test the validity and accuracy on the CORE 4 spreadsheet from a sample of offender files.

3. *"Also, because the current process is manual, there are no controls in place to ensure that victims are not being paid twice."*

   This observation will be solved through the printing of "Payment Grids" from the current system. The system is designed in such a way that once the status of an offender payment is changed from "Pending" to "Hold" the funds will not be remitted a second time. Payment Grids for the payments in the payment-processing run will be printed showing the change of status.

4. *"That the restitution payments are calculated correctly."*

   This statement would appear to be resolved through an audit. The auditor will trace the restitution payment amounts agreed upon by the offender (payment contract) to payment receipts for the full amount or to appropriately authorized receipts for reduced amounts. That audit has been requested.

5. *"That the restitution payments are made on a timely basis."*

   This present schedule of CORE 4 Remittances is only temporary until our new system is operational.

6. *"Additionally, the Department should work towards updating and testing their computer system to help minimize as much manual intervention in the process as possible."*

   As stated previously, we have been working with the company on our new computer system for approximately two years and we are hoping to have the system functional in six to seven months. However, it will take some time to have all the CORE 4 check runs entered into the system to ensure that all demand checks posted to the appropriate offender.

Payroll Authorization

In connection with our internal control testwork over payroll, we could not successfully test authorization of certain payroll transactions because certain documents that are used to show approval of a transaction or support the amount of money paid were missing. These documents include time certification logs (signature of supervisor at facility), leave slips and time sheets.

It appears that the Department does not necessarily verify all payroll documentation for proper authorization before submission for payment. This may result in over reporting of payroll expense and/or the improper recording of leave.

We recommend that all payroll time reporting be signed by the employee and authorized by the employee's supervisor. This will help ensure that time, including leave time, is recorded properly and is processed in accordance with the department's own policies.

Department of Correction's Response

Payroll processing within the Department of Corrections begins at each facility. At each facility or work section there is an assigned timekeeper. The assigned timekeeper is responsible for receiving the employees reported time, which is reported on a daily log sheet, weekly log or bi-weekly sheet, the employee signs off on their respective log sheet. The facility timekeeper then records this time on an individual green payroll card. Also, any authorized leave slips that are signed by both the employee and supervisor are also recorded on the green payroll card. The green payroll card is maintained as a continuous record at the local facility and will reflect all actual hours worked and leave taken each bi-weekly pay period for the full calendar year. This card is utilized as the official document for payroll transactions. Prior to the card being directed to the central payroll office, it is reviewed by the respective supervisor, who signs off on the time certification sheet, which accompanies the time cards each bi-weekly payroll reporting period, attesting that all recorded time is correct and authorized.

Due to the fact that the individual time and leave slips are maintained at the local site, some of the documents requested at the time of the audit were unable to be retrieved. However, since the auditing period, the central payroll office is now maintaining the authorized time certification sheets that are submitted from the various locations at the time of a payroll period. Also, the Department's payroll section will be contacting the respective timekeepers and reviewing consistency of practices between each facility. Timekeepers will also be provided guidance on maintaining supporting documents related to time and attendance of their employees.

This process is in compliance with our departmental policies and we are confident the system we have in place does not result in overpayments or underpayments to employees.

Department of Regional Community Technical Colleges

Segregation of Duties

The Accounts Receivable department at the Central Office of the NH Community Technical College System transfers student loan payments deposited in FIRSTAR Bank to the Treasury Department. AFSA (the collection service) deposits the payments in the FIRSTAR Bank and sends a monthly payment summary to the Accounts Receivable department. The same person that receives the summary, completes a cash receipt report, prepares a bank check for the same amount, and also reconciles the FIRSTSTAR bank statement. The cash receipt report and bank check are signed/authorized by the Chief Financial Officer. However, in order to establish proper segregation of duties it would be preferable to have another employee either prepare the bank check or reconcile the bank statement.

Department of Regional Community Technical Colleges' Response

The person in charge of the two duties has been changed to reflect proper segregation of duties. The FIRSTAR bank account reconciler has been changed to an accounting technician who does not have access to make deposits or cut checks from this account.

Perkins Program Cohort Default Rate

In accordance with the U.S. Department of Education's Student Financial Aid Handbook, Section 674.5 states that when an institution's cohort default rate calculation for outstanding Perkins loans, equals or exceeds 25 percent then the institution's Federal Capital Contribution is reduced to zero. Currently the Colleges have not been requesting additional federal funding for the Perkins loan program but, in fact have been able to allow the fund to continue on a self funded or pooled basis. Should the Colleges require an additional capital contribution, this issue would then become more critical.

The institutions should make every attempt to monitor outstanding Perkins loans and follow up on all aged accounts receivable to reduce the number of uncollectible outstanding loans. During our audit we noted that two of the Colleges had cohort loan default rates close to the 25% cap. Those Colleges included Concord and Berlin/Laconia whose rates were 21.7% and 22.8% respectively. We recommend that the Colleges review their current policies to follow-up on old outstanding accounts receivable and revise them accordingly to ensure more timely follow up on these accounts.

Department of Regional Community Technical Colleges' Response

The collection process will be reviewed by the internal auditor to determine if procedures can be added and/or strengthened to help reduce the Perkins cohort default rate.

EXHIBIT A

Outstanding Prior Years' Comments

The following represents comments identified in our past management letters that were reexamined during this year's audit and may require further attention by State management. The full text of each finding is included in the applicable prior year management letter.

Department of Administrative Services

Health Care Transition Fund (1998 management letter)

Chapter 351:74, Laws of 1997, states that "net Medicaid revenues for the fiscal year in excess of amounts budgeted, shall be transferred into the Health Care Transition Fund." The State only included Net Medicaid Enhancement Revenues, which appears to be in accordance with the intent of the law. Administrative Services should continue to work with the Legislature to clarify the language regarding Medicaid Enhancement Revenues in the law.

Department of Administrative Services Response

Administrative Services has reviewed the law and agrees that the intent needs to be clarified. Administrative Services believes legislation should be introduced to make this change.

Department of Health and Human Services (DHHS)

Disproportionate Share (1998 management letter)

Federal financial participation is available for aggregate payments to hospitals that serve a disproportionate number of low-income patients with special needs. The State Plan must specifically define a disproportionate share hospital (DSH) and the method of calculating the rate for these hospitals. DHHS delegates the task of performing the specific details, methodology and final DSH calculations to the New Hampshire Hospital Association (NHHA). Neither NHHA or DHHS verified the financial information submitted by the hospitals.

DHHS should implement policies and procedures to verify the financial data submitted by the participating hospitals. Verification could be assigned to the NHHA or another third party should DHHS not have the appropriate staff. The verifications should be documented and available for review at the DHHS.

Department of Health and Human Services Response

NHHA has performed the detailed tasks of calculating the DSH formula on behalf of the State. While the DHHS has not verified the financial information presented in recent years, past auditing disclosed no material differences and had no effect on the program. Since all hospitals submit cost reports and independently audited financial statements to various departments of the State including DHHS and the State Department of Revenue Administration, it is likely to be a duplication of effort.

DHHS will perform a sample number of reviews annually and follow up with additional reviews if initial findings warrant it. The DHHS had intended to begin this process in State fiscal year 2000; however, limited staffing resources delayed the start- up of these reviews. The Medicaid administration unit is still understaffed and a number of competing priorities have made it impossible to institute a review process this past fiscal year. The Medicaid administration unit has recently been reorganized and the plan is to begin a review process in the upcoming year.