



NEW HAMPSHIRE RETIREMENT SYSTEM

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

And
Management Letter

Year Ended June 30, 2006



KPMG LLP
99 High Street
Boston, MA 02110-2371

Telephone 617 988 1000
Fax 617 507 8321
Internet www.us.kpmg.com

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

The Fiscal Committee of the General Court:

We have audited the financial statements of the New Hampshire Retirement System (the System), as of and for the year ended June 30, 2006, and have issued our report thereon dated November 6, 2006. 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 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. Our consideration of the internal control over financial reporting would not necessarily disclose all matters in the internal control that might be material weaknesses. 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. We noted no matters involving the internal control over financial reporting and its operation that we consider to be material weaknesses.

Compliance and Other Matters

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

We noted certain matters that we reported to management of the System in a separate letter dated November 6, 2006.

This report is intended solely for the information and use of the management of the New Hampshire Retirement System and the Fiscal Committee of the General Court and is not intended to be and should not be used by anyone other than these specified parties.

KPMG LLP

November 6, 2006



KPMG LLP
99 High Street
Boston, MA 02110-2371

Telephone 617 988 1000
Fax 617 507 8321
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MANAGEMENT LETTER

November 6, 2006

The Fiscal Committee of the General Court:

We have audited the financial statements of the New Hampshire Retirement System (the System), as of and for the year ended June 30, 2006, and have issued our report thereon dated November 6, 2006. In planning and performing our audit of the financial statements of System, we considered internal control in order to determine our auditing procedures for the purpose of expressing our opinion on the financial statements. An audit does not include examining the effectiveness of internal control and does not provide assurance on internal control. We have not considered internal control since the date of our report.

During our audit we noted certain operational matters that are presented for your consideration. These comments and recommendations, which have been discussed with the appropriate members of management, are intended to result in operating efficiencies and are summarized as follows:

Cash Reconciliations

Since the implementation of the Pension Gold system, the System has experienced a history of un-reconciled amounts. These discrepancies have varied but the cumulative amount was placed into a suspense account with a corresponding increase to the System's cash with a June 2006 journal entry for approximately \$279,000. Since June 2006, the System indicated that it has not experienced any un-reconcilable amounts.

We recommend that the System modify its internal control procedures which may include modifications to its Pension Gold software to identify and correct variances in a more timely manner. In addition, we recommend that the System either resolve the amounts placed into suspense or write-off the amounts to net assets.

Management Response:

The System agrees with the observation. The implementation of the Pension Gold system has resulted in cash accounting discrepancies amounting to approximately \$279,000. Throughout the system implementation process, significant resources have been devoted researching and resolving these discrepancies, including the involvement of the System's internal audit staff in the research process. As discrepancies have been found they have been corrected, and in many cases, the system developer has been informed of system bugs and requests have been made to have them fixed. The System has also requested that the system developer modify their system in instances where System staff has determined that the modifications could strengthen the internal controls inherent in the system.



Significant progress has been made in identifying the discrepancies and resolving the issues. Evidence of that is the fact that the cash accounts have been reconciled since June 2006. The System will continue the reconciliation efforts to identify and correct the \$279,000 variance and we will make every effort to strengthen the accounting internal controls related to the Pension Gold system.

New Financial Reporting for Postretirement Benefits

The Governmental Accounting Standards Board (GASB) issued Statement No. 43, *Financial Reporting for Postemployment Benefit Plans Other Than Pension Plans* and the related Statement No. 45, *Accounting and Financial Reporting by Employers for Postemployment Benefits Other Than Pensions*. Those Statement's establish the standards for the measurement, recognition, and display of OPEB expense/expenditures and related liabilities (assets), note disclosures, and, if applicable, required supplementary information in the financial reports of the System and state and local governmental contributing employers.

The measurement of OPEB under the new standards will significantly impact the System's financial statements and those of its contributing employers. This project, including dealing with the ramifications of potential funding decisions, will constitute a significant effort for the System. Accordingly, senior management should begin now to familiarize itself with the available literature and analyze the results to prepare for future implementation. The System will be required to comply with Statement No. 43 as of June 30, 2007. The System's contributing employers most likely will be required to comply with Statement No. 45 as of June 30, 2008.

Management Response:

The System agrees with the observation. The System is aware of the new Governmental Accounting Standards Board (GASB) Statements No. 43 and 45 that require new accounting measurements, reporting and disclosures for post employment benefits other than pensions. We plan to implement the new standards in our annual reporting for the fiscal year ended June 30, 2007. It is our intention to work closely with our actuary and our auditors to insure that the new GASB pronouncements are fully implemented.

Prior Year Reportable Conditions

In our "Auditors' Report on Compliance and On Internal Control Over Financial Reporting In Accordance With *Government Auditing Standards*" letter dated May 23, 2006 we noted several reportable conditions, based on the Bingham McCutchen LLP report issued on April 28, 2006, as described in that letter's accompanying Exhibit I. Below is a summary of those reportable conditions:

1. Consent Agenda Process – Board of Trustees use of consent agenda process for non perfunctory items.
2. Code of Ethics Controls – The System's process for monitoring, reporting and resolving such occurrences did not adequately address potential violations.
3. Clarify Escalation Requirement – Recommendation to the System to clarify their escalation requirements provided by the System's Code of Ethics to ensure that all established protocols are adhered to.
4. Board Governance – The Board should study the governance and committee structure of other large state retirement systems to increase the investment expertise of the Board.



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5. Code of Ethics Violations – The System should evaluate and prepare a corrective action plan to specifically address the Code violations identified in Bingham report.

Management has taken the following remedial action to address the issues raised in the Bingham report:

The System has systematically reviewed each of the reportable conditions identified in the Bingham McCutchen LLP report dated April 28, 2006. Appropriate actions are being taken to address each of the items identified in the Bingham McCutchen report.

The System has hired Ms. Nancy Williams of Ennis Knupp to assist in this endeavor. Ms. Williams is a nationally recognized expert on Board governance matters. Ms. Williams is working with the System's Board of Trustees and management to develop a comprehensive board governance policy to address many of the items contained in the Bingham McCutchen report. That policy is currently under development and will be shared with KPMG LLP upon adoption by the System's Board of Trustees.

In addition, a program of board education has been implemented and the System's Code of Ethics policy has been revised.

The adoption of a board education program, revisions to the System's Code of Ethics and the comprehensive board governance policy currently under development will serve to address the items delineated in the Bingham McCutchen report.

* * * * *

Our audit procedures are designed primarily to enable us to form an opinion on the financial statements, and therefore may not bring to light all weaknesses in policies or procedures that may exist. We aim, however, to use our knowledge of the System's organization gained during our work to make comments and suggestions that we hope will be useful to you.

We would be pleased to discuss these comments and recommendations with you at any time.

This report is intended solely for the information and use of the New Hampshire Retirement System and the Fiscal Committee of the General Court and is not intended to be and should not be used by anyone other than these specified parties.

Very truly yours,

KPMG LLP