

STATE OF NEW JERSEY
INTERNAL CONTROL AND COMPLIANCE REPORTS
RELATED TO OUR AUDIT OF THE STATE'S COMPREHENSIVE ANNUAL
FINANCIAL REPORT
FOR THE FISCAL YEAR
ENDED JUNE 30, 1996

State of New Jersey

Internal Control and Compliance Reports Related to Our Audit of the State's Comprehensive Annual Financial Report

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Honorable Christine Todd Whitman
Governor of New Jersey

The Honorable Donald T. DiFrancesco
President of the Senate

The Honorable Jack Collins
Speaker of the General Assembly

Mr. Albert Porroni
Executive Director
Office of Legislative Services

INTERNAL CONTROL AND COMPLIANCE REPORTS RELATED TO OUR AUDIT OF THE
STATE'S COMPREHENSIVE ANNUAL FINANCIAL REPORT

We have audited the general purpose financial statements of the State of New Jersey, as of and for the year ended June 30, 1996, and have issued our report thereon dated October 8, 1996. In connection with that audit, we tested the internal control structure and compliance to laws and regulations. The results of our tests are contained in the following reports:

1. Independent Auditor's Report on the Internal Control Structure at the Financial Statement Level.
2. Independent Auditor's Report on Compliance with Laws and Regulations at the Financial Statement Level.

Along with the reports listed above, there is included an internal control and compliance finding and recommendations section.

The audit was performed and these reports are submitted pursuant to the State Auditor's responsibilities as set forth in Article VII, Section 1, Paragraph 6 of the State Constitution, and Title 52 of the New Jersey Statutes.

Richard L. Fair
State Auditor
October 8, 1996

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INDEPENDENT AUDITOR'S REPORT ON THE INTERNAL CONTROL STRUCTURE
AT THE FINANCIAL STATEMENT LEVEL

We have audited the general purpose financial statements of the State of New Jersey, as of and for the year ended June 30, 1996, and have issued our report thereon dated October 8, 1996.

We conducted our audit in accordance with generally accepted auditing standards and Government Auditing Standards, issued by the Comptroller General of the United States. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the general purpose financial statements are free of material misstatement.

The management of the State of New Jersey, is responsible for establishing and maintaining an internal control structure. In fulfilling this responsibility, estimates and judgments by management are required to assess the expected benefits and related costs of internal control structure policies and procedures. The objectives of an internal control structure are to provide management with

reasonable, but not absolute, assurance that assets are safeguarded against loss from unauthorized use or disposition, and that transactions are executed in accordance with management's authorization and recorded properly to permit the preparation of general purpose financial statements in accordance with generally accepted accounting principles. Because of inherent limitations in any internal control structure, errors or irregularities may nevertheless occur and not be detected. Also, projection of any evaluation of the structure to future periods is subject to the risk that procedures may become inadequate because of changes in conditions or that the effectiveness of the design and operation of policies and procedures may deteriorate.

In planning and performing our audit of the general purpose financial statements of the State of New Jersey, for the year ended June 30, 1996, we obtained an understanding of the internal control structure. With respect to the internal control structure, we obtained an understanding of the design of relevant policies and procedures and whether they have been placed in operation, and we assessed control risk in order to determine our auditing procedures for the purpose of expressing our opinion on the general purpose financial statements and not to provide an opinion on the internal control structure. Accordingly, we do not express such an opinion. Our examination did not include a review of the internal control structure of the component unit authorities and the college and university funds. The financial statements of these funds are reviewed by other auditors and responsibility for the internal control structure is a function of the individual entities which manage these funds.

We noted certain matters involving the internal control structure and its operation that we consider to be reportable conditions under standards established by the American Institute of Certified Public Accountants. Reportable conditions involve matters coming to our attention relating to significant deficiencies in the design or operation of the internal control structure that, in our judgment, could adversely affect the State's ability to record, process, summarize, and report financial data consistent with the assertions of management in the general purpose financial statements.

A summary of the matters involving the internal control structure and its operation that we consider to be reportable conditions is as follows:

- C establishing proper authorization procedures for financial transactions; and
- C ensuring that service providers for the self-insured health plans have audits performed in accordance with American Institute of Certified Public Accountant's Statement on Auditing Standards (SAS) No. 70.

These matters are discussed in detail in the findings and recommendations section of this report.

A material weakness is a reportable condition in which the design or operation of one or more of the specific internal control structure elements does not reduce to a relatively low level the risk that errors or irregularities in amounts that would be material in relation to the general purpose 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 structure would not necessarily disclose all matters in the internal control structure that might be reportable conditions and, accordingly, would not necessarily disclose all reportable conditions that are also considered to be material weaknesses as defined above. However, we believe none of the reportable conditions described above is a material weakness.

We also noted other matters involving the internal control structure and its operation that we have reported to the management of the State of New Jersey, in a separate letter dated October 8, 1996.

This report is intended solely for the use of management of the state. However, this report is a matter of public record and its distribution is not limited.

Richard L. Fair
State Auditor
October 8, 1996

The Honorable Christine Todd Whitman
Governor of New Jersey

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President of the Senate

The Honorable Jack Collins
Speaker of the General Assembly

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INDEPENDENT AUDITOR'S REPORT COMPLIANCE WITH LAWS AND REGULATIONS
AT THE FINANCIAL STATEMENT LEVEL

We have audited the general purpose financial statements of the State of New Jersey, as of and for the year ended June 30, 1996, and have issued our report thereon dated October 8, 1996.

We conducted our audit in accordance with generally accepted auditing standards and Government Auditing Standards, issued by the Comptroller General of the United States. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement.

Compliance with laws, regulations, contracts, and grants applicable to the State of New Jersey, is the responsibility of the State's management. As part of obtaining reasonable assurance about whether the financial statements are free of material misstatement, we performed tests of State's compliance with certain provisions of laws, regulations, contracts, and grants. However, the

objective of our audit of the general purpose financial statements was not to provide an opinion on overall compliance with such provisions. Accordingly, we do not express such an opinion. Our examination did not include procedures to test compliance with certain laws, regulations, contracts, and grants at the financial statement level of the component unit authorities and the college and university funds. The financial statements of these funds are reviewed by other auditors and responsibility for complying with laws, regulations, contracts, and grants at the financial statement level is a function of the individual entities which manage these funds.

The results of our tests disclosed no instances of noncompliance that are required to be reported herein under Government Auditing Standards.

This report is intended solely for the use of management of the state. However, this report is a matter of public record and its distribution is not limited.

Richard L. Fair
State Auditor
October 8, 1996

STATE OF NEW JERSEY
INTERNAL CONTROL AND COMPLIANCE FINDINGS AND RECOMMENDATIONS
FINANCIAL STATEMENT LEVEL
RELATED TO OUR AUDIT OF THE
STATE'S COMPREHENSIVE ANNUAL FINANCIAL REPORT

SUMMARY

We have audited the general purpose financial statements of the State of New Jersey, as of and for the year ended June 30, 1996, and have issued our report thereon dated October 8, 1996. Our audit included a review of the internal control structure and compliance to laws, regulations, contracts and grants. During our tests of the internal control structure at the financial statement level, we noted two reportable conditions that should be addressed by management.

Internal Controls - Transaction Approval

Internal controls would be strengthened through the proper segregation of the approval function.

Office of Management and Budget Circular Letter 95-11 states that, "to achieve a better level of internal controls, it will no longer be acceptable for one person to be able to apply all three levels of approval." During our audit period certain administrative support personnel in the Department of the Treasury, Office of Management and Budget possessed all of the levels of approval necessary to enter or change and process a transaction in the state accounting system without additional supervisory approval. Without independent review, an inaccurate or inappropriate transaction could be processed without being detected. Subsequent to our audit the department has taken action to assure that all transactions are subject to supervisory review.

We recommend that the Department of the Treasury, Office of Management and Budget continue to monitor the state's accounting system to ensure compliance with Circular Letter 95-11 on internal accounting controls.

Service Provider Monitoring

Review procedures provide additional assurances of proper spending by the service providers.

The State of New Jersey, Department of the Treasury, Division of Pensions and Benefits does not monitor the activities of the service providers for the self-insured health plans. Management is responsible for developing review procedures to attest to the reasonableness of claims being processed and paid by these service providers and to safeguard funds against potential misuse. During fiscal year 1996 approximately \$600 million of service provider claims were not subject to an American Institute of Certified Public Accountant's Statement on Auditing Standards No. 70 (SAS

70) audit. In accordance with SAS 70 the service organization is responsible for establishing assurances of the internal control structure of the service provider.

We recommend service providers for the self-insured plans be required to have a SAS 70 audit performed which is to be reviewed for reasonableness by the Division of Pensions and Benefits. In addition, management should develop a review procedure that will routinely test claims to determine correctness.