STATE OF NEW HAMPSHIRE
DEPARTMENT OF REVENUE ADMINISTRATION

FINANCIAL AND COMPLIANCE
AUDIT REPORT
FOR THE YEAR ENDED
JUNE 30, 2001

STATE OF NEW HAMPSHIRE
DEPARTMENT OF REVENUE ADMINISTRATION

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STATE OF NEW HAMPSHIRE
DEPARTMENT OF REVENUE ADMINISTRATION

Reporting Entity And Scope

The reporting entity and scope of this audit and audit report is the revenues, expenditures, and fixed assets reported by the New Hampshire Department of Revenue Administration (Department) for the year ended June 30, 2001.

Organization

The Department was reorganized under the terms of RSA 21-J, effective July 1, 1985. The Department is under the executive direction of a commissioner who is appointed by the Governor, with the consent of the Council, to a four-year term. In addition, the commissioner is authorized to nominate an assistant commissioner, and division directors of audits and documents processing, subject to confirmation by the Governor and Council. The directors of automated information services, collections, property appraisal, and municipal services are appointed by the commissioner.

At June 30, 2001, the Department employed 167 classified and 22 unclassified employees, and was organized into the following seven functional areas: the Administration Unit and the Divisions of Automated Information Systems, Audits, Collections, Property Appraisal, Document Processing, and Municipal Services.

Responsibilities

The Department of Revenue Administration is responsible for overseeing the collection of state taxes, providing the Governor and General Court with information for public policy decisions, and for establishing a uniform system of financial reports and accounting for the state's political subdivisions.

The responsibilities of the Department's seven functional areas are summarized below:

Administration – This unit is supervised by the assistant commissioner and is responsible for all budget, personnel, payroll, and purchasing matters. The unit records taxes and other accounts receivables and assists the commissioner with short and long range planning.

Automated Information Systems – This division is headed by a director and is responsible for planning, developing, and implementing an automated information management system (AIS) for the Department. The AIS is designed to support the Department's tax administration activities and provide data useful to the Governor and General Court to aid in public policy decisions.

Audits – This division is under the supervision of a director and is responsible for classifying for possible audit all returns, reports, or other documents submitted by taxpayers. The division performs office and field examinations of taxpayer-submitted documents.

Collections – This division is headed by a director and is responsible for collecting all outstanding state taxes within the Department's jurisdiction, and securing all delinquent tax returns that have not been filed. The division oversees the telefile computer system used to record the meals, rooms, and rental car tax and oversees the real estate transfer tax and tobacco tax stamp inventory.

Property Appraisal – This division is under the supervision of a director and is responsible for assisting and supervising municipalities and appraisers in appraisals and valuations of property for tax assessment purposes, and appraising state-owned forest and recreation land. The division annually determines the total equalized valuation of properties in the cities, towns, and unincorporated places and prepares standard appraisal manuals.

Document Processing – This division is headed by a director and is responsible for sending, receiving, processing, storing, and retrieving all tax documents and electronic transactions filed with the Department.

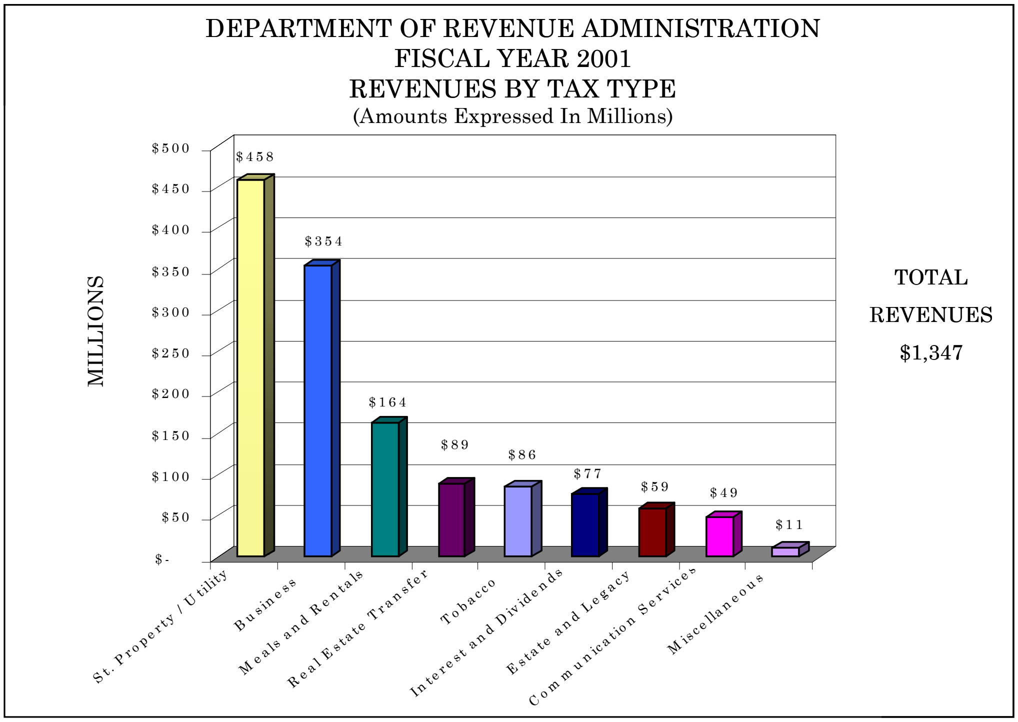
Municipal Services – This division is under the supervision of a director and is responsible for providing technical assistance to political subdivisions, assisting the commissioner in setting municipal tax rates, and establishing a standard technical manual to guide municipalities in finance and budget matters.

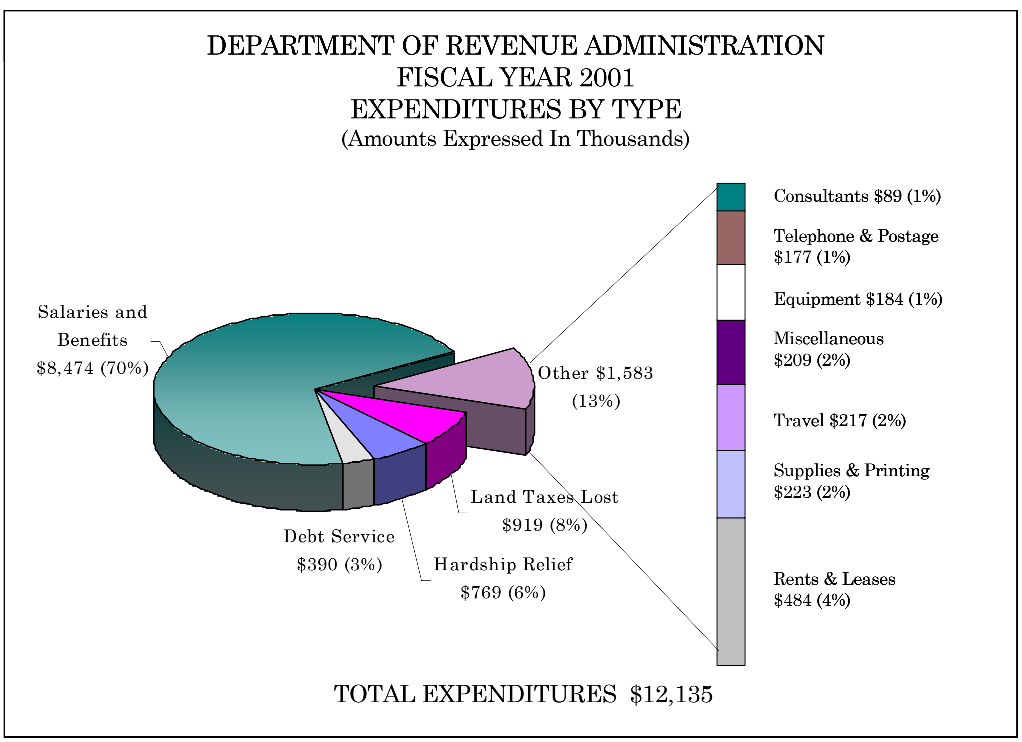
Funding

The financial activity of the Department of Revenue Administration is accounted for in the General and Education Trust Funds of the State of New Hampshire. A summary of the Department's revenues and expenditures during the fiscal year ended June 30, 2001 is shown graphically on page 3.

The fiscal year 2001 appropriations combined with supplemental warrants, balances forward, and transfers resulted in a spending authority for the year ended June 30, 2001 of $13,431,547 and $840,758 in the General and Education Trust Funds, respectively. Estimated restricted revenue combined with supplemental warrants, balances forward, and transfers resulted in anticipated fiscal year 2001 restricted revenue of $1,416,402 in the General Fund. There was no anticipated restricted revenue in the Education Trust Fund. Fiscal year 2001 estimated unrestricted revenue totaled $745,094,500 and $583,364,000 in the General and Education Trust Funds, respectively. The actual financial activity of the Department is summarized below:

Summary Of Revenues And Expenditures For The Year Ended June 30, 2001	**General Fund**	**Education Trust Fund**	**Total**
Unrestricted Revenues	$ 775,561,228	$ 571,337,361	$ 1,346,898,589
Restricted Revenues	334,814	-0-	334,814
Total Revenues	**$ 775,896,042**	**$ 571,337,361**	**$ 1,347,233,403**
Expenditures	**$ 11,295,318**	**$ 840,285**	**$ 12,135,603**
Excess of Revenues Over Expenditures	**$ 764,600,724**	**$ 570,497,076**	**$ 1,335,097,800**


DEPARTMENT OF REVENUE ADMINISTRATION
FISCAL YEAR 2001
REVENUES BY TAX TYPE
(Amounts Expressed In Millions)
MILLIONS
$500
$450
$400
$350
$300
$250
$200
$150
$100
$50
$-
$458
$354
$164
$89
$86
$77
$59
$49
$11
St. Property / Utility
Business
Meals and Rentals
Real Estate Transfer
Tobacco
Interest and Dividends
Estate and Legacy
Communication Services
Miscellaneous
TOTAL
REVENUES
$1,347


DEPARTMENT OF REVENUE ADMINISTRATION
FISCAL YEAR 2001
EXPENDITURES BY TYPE
(Amounts Expressed In Thousands)
Salaries and Benefits $8,474 (70%)
Other $1,583 (13%)
Land Taxes Lost $919 (8%)
Hardship Relief $769 (6%)
Debt Service $390 (3%)
Consultants $89 (1%)
Telephone & Postage $177 (1%)
Equipment $184 (1%)
Miscellaneous $209 (2%)
Travel $217 (2%)
Supplies & Printing $223 (2%)
Rents & Leases $484 (4%)
TOTAL EXPENDITURES $12,135

Prior Audit

The most recent prior financial and compliance audit of the Department was for the fiscal year ended June 30, 1995. The appendix to this report on page 47, contains a summary of the current status of the observation contained in that prior report. Copies of the prior audit report can be obtained from the Office of Legislative Budget Assistant, Audit Division, 107 North Main Street, State House Room 102, Concord, NH 03301-4906.

Audit Objectives And Scope

The primary objective of our audit is to express an opinion on the fairness of the presentation of the financial statement of the Department of Revenue Administration for the year ended June 30, 2001. As part of obtaining reasonable assurance about whether the financial statement is free of material misstatement, we considered the effectiveness of the internal controls in place at the Department of Revenue Administration and tested the Department’s compliance with certain provisions of applicable State laws, rules, regulations and contracts. Major accounts or areas subject to our examination included, but were not limited to, the following:

- Revenues and appropriations,
- Expenditures, and
- Real property and equipment.

Our reports on compliance and on internal control over financial reporting, and on management issues, the related observations and recommendations, our independent auditor's report, and the financial statement of the Department of Revenue Administration are contained in the report that follows.

Auditor's Report On Compliance And On Internal Control Over Financial Reporting

To The Fiscal Committee Of The General Court:

We have audited the accompanying Combined Statement of Revenues and Expenditures – Budget and Actual – General and Education Trust Funds of the New Hampshire Department of Revenue Administration, for the year ended June 30, 2001, and have issued our report thereon dated January 23, 2002, which was qualified with respect to the lack of presentation of the financial position of the Department in the General and Education Trust Funds and the omission of the Medicaid Enhancement Tax collected by the Department. We conducted our audit in accordance with auditing standards generally accepted in the United States and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States.

Compliance

As part of obtaining reasonable assurance about whether the Department of Revenue Administration's financial statement is free of material misstatement, we performed tests of its compliance with certain provisions of laws, rules, 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 that are required to be reported under *Government Auditing Standards*. However, we noted certain immaterial instances of noncompliance which are described in Observations No. 14 through No. 16 of this report.

Internal Control Over Financial Reporting

In planning and performing our audit, we considered the Department of Revenue Administration's internal control over financial reporting in order to determine our auditing procedures for the purpose of expressing our opinion on the financial statement and not to provide assurance 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 Department of Revenue Administration's ability to record, process, summarize, and report financial data consistent with the assertions of management in the financial statement. Reportable conditions are described in Observations No. 1 through No. 13 of this report.

A material weakness is a 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 in amounts that would be material in relation to the financial statement 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, we believe that none of the reportable conditions noted above is a material weakness.

This auditor's report on compliance and on internal control over financial reporting is intended solely for the information and use of the management of the Department of Revenue Administration 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.

Office Of Legislative Budget Assistant

Office Of Legislative Budget Assistant

January 23, 2002

Internal Control Comments
Reportable Conditions

Observation No. 1 - All Divisions Should Have Policies And Procedures Manuals

Observation:

Department of Revenue Administration (DRA) management has not established policies and procedures manuals for all of its divisions. Well designed policies and procedures manuals are an effective form of communication necessary in a comprehensive internal control framework and are particularly important to the proper functioning of controls over financial reporting.

In addition to properly communicating the functioning of internal controls over financial reporting, policies and procedures manuals help to clearly outline the specific authority and responsibility of individual employees, thus providing the essential foundation needed for establishing employee accountability. Manuals also serve as a reference tool for employees seeking guidance on the proper handling of less frequently encountered transactions and situations. Furthermore, policies and procedures manuals lessen the threat to continuity posed by employee turnover.

Three of DRA's seven functional areas: Automated Information Systems, Document Processing, and Municipal Services, have written, comprehensive, and current policies and procedures manuals. DRA has not established policies and procedures manuals for its functional areas of:

- Administration,
- Audits,
- Collections, and
- Property Appraisal.

Well designed policies and procedures manuals promote effective communication, lessen inefficiencies in Department operations, and assist employees in making appropriate and consistent decisions in accordance with management's goals and objectives. As discussed in Observations No. 3, 4, 5, 7, and 14, it appears that the Department would have benefited had employees involved in the tax notice, real estate transfer tax audit, tobacco and real estate transfer tax stamp inventory, and tobacco seizure processes had manuals that provided clear direction of management's goals and objectives and related policies and procedures to reach those goals and objectives. Well-designed policies and procedures include provisions to enable management to establish initial, and monitor ongoing, compliance with management's controls.

Recommendation:

The DRA should establish well-designed policies and procedures manuals for the Administration Unit, and the Audits, Collections, and Property Appraisal Divisions. These manuals should be comprehensive and kept current so that they will remain useful to employees in the normal course of performing their assigned duties. While it is recognized that establishing and maintaining current and comprehensive policies and procedures manuals is a time-consuming task, the manuals should be regarded as a critical component in the DRA's control structure as well as a potential source of increased efficiency in the long-term, as employees become accustomed to performing their duties according to management's plans and objectives.

Auditee Response:

The Department concurs with the observation that policies and procedures manuals should be established for the Administration, Audit, Collections and Community Services Division (formerly the Property Appraisal Division). The following summarizes the status of the development of these manuals:

Audit - The Audit Division has had a committee established to work on a procedures manual since last October. Currently, one third of the items to be included in the manual are completed and the remaining two thirds of the items are close to being submitted for supervisor review.

Collection - Although the Collection Division does not have a policies and procedures manual for every task, there are several manuals currently in use including a reference manual for the Real Estate Transfer Tax, a Field Compliance Officers manual and a Smokeless Tobacco Tax manual. The Collection Division has established a procedures manual committee that is currently meeting on a weekly basis to establish additional manuals and update the existing manuals.

Community Services - The former Property Appraisal Division does in fact have three separate and detailed policy and procedure manuals that are currently in use:

- An Equalization Procedures manual detailing all in-house procedures for the ratio study and equalization process;

- An Equalization Process and Procedures manual providing a detailed overview of the ratio study and equalization process that is appropriate for municipalities and the general public; and

- A Property Appraisal Procedures manual providing a detailed overview of all aspects of the property tax process, as well as applicable legislation, statutes, rules and forms utilized in that process.

A policy and procedures manual does not exist at this time that details internal policy and procedures for overseeing local application of the property tax, nor is there a procedures manual related to the internal application of the timber tax, excavation tax and state-valued railroads and utilities. It is the Department's intent to develop these manuals by the end of the 2002 calendar year.

Administration - The Administration Unit is in the process of developing a manual that will supplement the Department of Administrative Services' Manual of Procedures.

Observation No. 2 - Monitoring Of Control Activities Should Be Improved

Observation:

Department of Revenue Administration (DRA) management has not monitored to ensure that certain DRA control processes were operating as designed.

Statement on Auditing Standards No. 78 – *Consideration of Internal Control in a Financial Statement Audit* – defines five interrelated components of internal control (i.e., control environment, risk assessment, control activities, information and communication, and monitoring), all of which should be present and functioning to conclude that internal control is effective in meeting the organization’s objectives. It is essential that management monitor control related policies and procedures on an ongoing basis to ensure that deficiencies are identified and corrected by the organization in a timely manner.

During fiscal year 2001, certain DRA control monitoring activities were not in place and were not operating as management intended. As noted in Observations No. 3 (follow-up on late tax notices), No. 4 (audits of real estate transfer taxes at county registrars), and No. 5 (tobacco tax retailer inspections), management was unaware that these controls were inoperative in the Audit and Collections Divisions.

The effect of management not monitoring significant control activities of the Collections and Audit Divisions is that management did not become aware when its control processes failed and the Department faced an increased risk that any errors or frauds that might have occurred within those functional areas may not have been detected and corrected in a timely manner. In addition, when employees understand that control processes can be avoided or not complied with, without ramification, the control environment that management intends for the organization may not be achieved.

Recommendation:

DRA management should improve its monitoring of control related policies and procedures to ensure that controls are functioning as intended and designed. To be most effective, monitoring efforts should be ongoing and designed so that failures of the controls become readily apparent.

Auditee Response:

The Department concurs with the observation that management has not monitored to ensure that certain DRA control processes were operating as designed.

Although not intended as a justification, the Department attributes this deficiency to the significant amount of time management has devoted to addressing school funding issues. Since December 17, 1997 when the Supreme Court ruled in the Claremont case, key Department managers have been inundated with requests from the Governor, Legislature, and Courts to develop and analyze revenue options. They have also had to implement the changes adopted and, in the case of the property tax, defend the tax system in court. Responding to these demands has increased the risk that some internal control responsibilities were overlooked, or not monitored as closely as needed.

The Department concurs with the recommendation that its internal control monitoring efforts need to be designed so that absence of these controls become readily apparent. Acknowledging the State's current financial situation and the Court's continuing jurisdiction in the Claremont lawsuit, it does not appear that the demands placed on Department management will subside in the near future. Therefore, the Department proposes to address this concern by requesting that an internal auditor position be established to monitor control procedures and to report directly to the Commissioner. As an agency responsible for in excess of $1 billion in annual tax revenue, we feel an internal auditor is both warranted and justified.

Observation No. 3 - Status Of Outstanding Tax Notices Should Be Tracked More Closely

Observation:

During fiscal year 2001, the Department of Revenue Administration's (DRA) Collections Division did not effectively review reports of tax notices outstanding beyond 70 and 180 days. Reportedly, Division management relied upon Compliance Officers to notify them when collections cases were outstanding for an extended period of time.

A tax notice is issued when it is determined that a taxpayer owes a tax liability. A liability may be due to a taxpayer failing to file a return or making incomplete payment on a filed return or may result from an audit adjustment made to a filed return, etc. The Collections Division is responsible for following-up and collecting on tax-notice accounts receivable. Compliance Officers within the Division are assigned collection responsibilities on tax notices generally based on geographic location of the taxpayer in the State. Compliance Officers use mail and phone communications, as well as personal visits, to pursue collections of the amounts owed.

The process of collecting on accounts receivable is subject to risks for errors and frauds, especially in situations where collection efforts may be occurring offsite and away from the normal accounting controls available in a central business office. While the DRA appeared to have appropriate controls over the generation and relief of tax notices, during fiscal year 2001, there did not appear to be adequate controls to ensure the timely follow-up on outstanding tax notices.

- For the period July through December 2000, the Division had the capability to print outstanding tax notice reports for business taxes and interest and dividend taxes but the reports, which included the status of the collections efforts on the cases, were not reviewed by Division management reportedly due to increased Division workload. Division management reviewed a meals and rentals tax notice status report for the period July through December 2000, but the format of this report was not designed to identify an aging of the outstanding tax notices to allow for efficient management review of whether collection efforts provided timely follow-up on notices.

- No review of outstanding tax notices occurred during the period January through June 2001 due to complications experienced in the January 2001 restructuring of the meals and rentals computer system. The [then] Director stated that, subsequent to the conversion, the Division did not have the capability to print out queries for the aging of tax notices. Division management reportedly is currently in the process of developing queries to assist in its review of outstanding tax notices.

Department management expressed concerns when it informed the auditors that it had learned in August 2001 that these tax notice follow-up reports were not being produced and acted upon by the Collections Division. (Reference Observation No. 2.)

Internal control-related policies and procedures are essential to lessen the various risks identified by management that could impede or prevent management from accomplishing its goals and objectives. These control-related procedures were not in place for the tax notice process as no independent review of outstanding tax notices by management occurred during the audit period. Relying upon the Compliance Officers to notify management when the tax notices have become old does not provide for a proper segregation of duties between the performers and the authorizers of the collections functions. This lack of segregation could lead to errors or frauds occurring that would not be detected in a timely manner.

Recommendation:

Collections Division management should take measures to ensure that outstanding tax notices are reviewed on an ongoing basis in accordance with the Department's internal control-related policies and procedures. Division management should review the status of outstanding tax notices with Compliance Officers on a periodic basis in order to make informed decisions that can be appropriately communicated to Department management.

Auditee Response:

The Department concurs with the observation. The following measures have been taken to ensure that outstanding tax notices are reviewed on an ongoing basis:

- New queries have been developed for all tax notices generated off the Department's computer system. These queries will allow field staff and management to regularly monitor the status of system generated tax notices;

- Policies and procedures have been developed identifying the specific status that each case must be in within 90 days of assignment to the Division. Cases not meeting the status requirement will be reviewed by division management;

- Documentation of Field Compliance Officer's activity has been reviewed and standardized to insure accurate records concerning collection efforts;

- Management is planning to perform field reviews with compliance staff.

Observation No. 4 - Controls Over Collections Of Real Estate Transfer Taxes Should Be Consistently Applied

Observation:

The Department of Revenue Administration (DRA) has not adhered to its schedule for auditing the real estate transfer taxes collected by the ten county registrars of deeds.

The ten county registrars of deeds collected $89.2 million of real estate transfer tax during fiscal year 2001 on behalf of the DRA. Monthly, the registrars retain three percent of the taxes collected as a commission and forward the remainder of the taxes collected to the DRA along with summary reports of taxes collected and tax stamps applied during the monthly reporting period.

DRA's control policy for oversight of the registrars' collections of real estate transfer taxes provides for DRA auditors to audit the taxes collected by three different county registrars of deeds each year. These audits are intended to ensure triennially that each county registrar of deeds has properly collected and remitted the real estate transfer tax to DRA. Audits of the real estate transfer taxes collected by county registrars were performed according to the policy schedule during fiscal years 1994 through 1996; however, no audits were performed during fiscal years 1997 through 2000, and the taxes collected by two county registrars were audited in fiscal year 2001.

DRA management was not aware that the audits were not being performed as intended by the control policy. (Reference Observation No. 2.)

Recommendation:

DRA should implement procedures to ensure that regular real estate transfer tax audits are performed as intended by its control policies and procedures. This policy could be incorporated into a standard operating procedures manual for the Audit Division as noted in Observation No. 1 and should be monitored by management as discussed in Observation No. 2.

Auditee Response:

The Department concurs with the observation. During the years 1994 through 1996 all of the counties were audited in regards to the Real Estate Transfer Tax. The results of the audits were that each county had good controls in place. No material discrepancies were noted during these audits. The Department's decision was to use our limited resources by following up with intermittent audits rather than auditing all of the counties every 3 to 4 years.

As indicated in the observation, the Department audited two County Registrar's in FY 2001. The Department will continue with intermittent audits of the counties as it deems necessary. The annual independent audits submitted by each county will be reviewed to assist the Department in determining the need for further audit.

Observation No. 5 - Controls Over Reviews Of Tobacco Tax Stamps Should Be Consistently Applied

Observation:

The Department of Revenue Administration (DRA) has not adhered to its schedule for visiting retailers of tobacco products to ensure that tobacco products available for purchase in New Hampshire have New Hampshire tax stamps applied.

During fiscal year 2001, DRA collected $86.4 million of tobacco tax. Tobacco product wholesalers are responsible for paying the State's tobacco tax and affixing the tobacco tax stamps on the individual packets of product. New Hampshire retailers are allowed to sell only products on which the State tax has been paid. The tax stamp provides the retailer and the customer with evidence that the product is legal for retail sale in New Hampshire.

DRA's control policy for oversight of the collection of the tobacco tax and the application of the tax stamps is to have each DRA Compliance Officer perform three to five tobacco tax inspections each week. These inspections at retail sales locations of tobacco products are intended to ensure that tobacco wholesalers are properly affixing tax stamps to products and that only products that have been taxed are available for sale.

During fiscal year 2001, Compliance Officers were not performing tobacco tax inspections according to the frequency required in DRA's control policy. Per a review of the work schedule of one of the twelve field Compliance Officers, Compliance Officers may have performed on average only one inspection per month instead of the twelve to twenty inspections required by the control policy. According to the current Director of the Collections Division, the work schedule of this sample Compliance Officer is representative of the others. It was also noted that the documentation of the daily activities of the Compliance Officers is not consistent among the Officers and generally is not sufficient to allow the Director of Collections to track and evaluate the Officers' daily activities.

DRA management was not aware that the Collections Officers were not performing the number of inspections intended by the control policy. (Reference Observation No 2.)

Recommendation:

DRA should implement procedures to ensure that regular tobacco tax inspections are performed as intended by its control policies and procedures. This policy could be incorporated into a standard operating procedures manual for the Collections Division as noted in Observation No. 1 and should be monitored by management as discussed in Observation No. 2.

DRA should improve its system for tracking and reporting the daily activities of its Collections Officers.

Auditee Response

The Department concurs with the observations and recommendations regarding the overall administration of the Tobacco Tax. To address these concerns, the Department is:

- Revising and documenting all policies and procedures for the administration of the Tobacco Tax;
- Acquiring an automated inventory system for use with the Tobacco Tax and Real Estate Transfer Tax stamps;
- Reassigning specific tasks to insure segregation of duties;
- Monitoring that each Compliance Officer is performing a minimum of five tobacco compliance checks per week;
- Revising procedures and reporting documentation to insure that accurate records are maintained regarding Tobacco Tax seizures.

Observation No. 6 - Controls Over Tobacco Product Seizures Should Be Improved

Observation:

The Department of Revenue Administration (DRA) does not maintain complete and accurate records to account for tobacco product seizures performed by its Compliance Officers. This lack of record keeping, compounded with a lack of segregation of responsibilities over record keeping and the custody of seized tobacco products, creates a significant risk that errors or fraud could occur in the handling of seized tobacco products and not be detected in a timely manner.

RSA 78:16 provides that tobacco products, not subject to the exemption under RSA 78:12, II, that are found without the necessary stamps affixed to them be declared contraband goods subject to forfeiture to the state. RSA 78:34 requires any tobacco products sold that do not comply with all applicable federal laws be subject to forfeiture under RSA 78:16. Complete and accurate accounting records must be maintained over all seized tobacco products to ensure that the seizures of illegal products are properly controlled and reported.

During fiscal year 2001, DRA did not maintain complete and accurate records to account for tobacco product seizures performed by its Compliance Officers.

- The Tobacco Seizure Log is not comprehensive. Two out of a sample of five seizure incidents (as reported by Settlement Agreement and Release Form (Forms CD-73) or Receipt of Seized Tobacco Products (Form CD-73-A)) were not recorded in the log.

- Of 34,638 packs of cigarettes destroyed on November 28, 2001, DRA only had seizure records to support 34,238 packs. The origin of the additional 400 packs that were destroyed is not clear.

- There are no seizure records at DRA to support 391 packs of cigarettes stored in the vault subsequent to the destruction of cigarettes noted above. The origin of these cigarettes is not clear.

During fiscal year 2001, one DRA employee was responsible for essentially all recording and custody duties related to seized tobacco products. The lack of segregation of responsibilities related to seized tobacco products is a significant control weakness.

Recommendation:

DRA must implement procedures to ensure that complete and accurate records are maintained for all tobacco product seizures.

Responsibilities relating to seized tobacco products must be effectively segregated.

Auditee Response:

See Auditee Response to Observation No. 5 on page 14.

Observation No. 7 - Controls Should Be Established Over The Storage And Issuance Of Tax Stamps

Observation:

Effective controls have not been established over the Department of Revenue Administration's (DRA) inventories of tobacco tax stamps and real estate transfer tax stamps.

The Collections Division has not established effective controls over the tobacco and real estate transfer tax stamp inventory processes to ensure that stamps are properly accounted for and adequately controlled.

In accordance with RSA 78:7, a $.52 tax is imposed on each package of 20 cigarettes sold. RSA 78-B:1, imposes a tax of $.75 per $100 of the price or consideration for the transfer, sale, or granting of real property and the tax is assessed to both the buyer and seller. Tobacco and real estate transfer tax stamps are used to control the payment and collection of these taxes. The DRA collected $86.4 million in tobacco taxes and $89.2 million in real estate transfer taxes during fiscal year 2001.

As noted below, management has not established even rudimentary controls over the inventories of these tax stamp documents.

- There is no effective segregation of duties over the control responsibilities for tax stamps. The Director or Assistant Director of Collections is responsible for ordering stamps from vendors, receiving the delivery of stamps, recording the receipt into the inventory records, issuing tobacco stamps to the Clerk IV and issuing real estate transfer tax stamps to the Compliance Officers, and maintaining overall physical custody of both stamp inventories. There is no independent periodic review of the tax stamp inventories such as would be available from an annual inventory and reconciliation of the inventory records and activity. The lack of segregation of duties over the mutually incompatible functions of authorization, record keeping, and custody significantly raises the risk that errors or frauds could occur and not be detected.

- Tobacco stamps are not consistently issued in numeric order making control of the inventory problematic.

- A perpetual inventory system is not maintained for the real estate transfer tax stamps. A manual log is maintained that records purchases and issuances but does not record balances of stamps on hand. The lack of record keeping for inventory balances is a significant weakness minimizing the control value of the log.

The lack of effective management controls over the tax stamp inventories increases the risk that errors or fraud will occur and not be detected.

Recommendation:

DRA needs to immediately establish controls over the tobacco and real estate transfer tax stamp inventories. DRA should establish written polices and procedures that ensure, at a minimum, an adequate segregation of duties, issuing tobacco stamps in numeric order, tracking the numeric sequence of tobacco and real estate transfer tax stamps, performing annual physical inventories, and maintaining a perpetual inventory system for all tax stamp documents. Once controls are established, management needs to regularly monitor and review the stamp inventory controls to ensure that the established policies are adhered to.

Auditee Response:

See Auditee Response to Observation No. 5 on page 14.

Observation No. 8 - Security Over Access To The Telefile System Should Be Enhanced

Observation:

The security preventing unauthorized access and monitoring authorized access to the Department of Revenue Administration's (DRA) Meals and Rentals (M&R) telefile tax collection system is not as robust as it should be.

Telefile allows meals and rooms and vehicle rental operators to file their tax returns and pay their tax liability using either a touch-tone telephone or their personal computer. During fiscal year 2001, approximately 90% of meals and rental operators utilized the telefile system to report taxes collected and make payments to the DRA. DRA collected $164.1 million of meals and rental taxes during fiscal year 2001.

Recommendation:

The remote maintenance of information technology systems involves particularly high security risks. For security reasons, it is advisable to operate without external remote maintenance. If this is not possible, additional safeguards must be implemented.

- The access point to the system should be shut off when not in use. Contractor access to the system should be planned and coordinated with the DRA. DRA should consider requiring the establishment of the connection for remote maintenance be initiated from the DRA or by automatic callback to the contractor.

- The contractor's activities on the telefile system should be monitored and all changes to the telefile program should be controlled. Changes to the telefile programs should only be made after the DRA has first reviewed and approved the changes. All remote control access to the telefile system should be recorded in a log, including files and programs accessed during the session. The logs should be periodically reviewed for unmonitored and other unauthorized access of the system. Attempted access should also be recorded in a log and monitored.

- DRA should review the status of the settings for the remote access security (RAS) system to ensure that the Department is benefiting from the software's available security functionality. This will require coordination between the DRA and its contractor to establish and monitor compliance with available and appropriate software control configurations and features. This effort will need to be ongoing to ensure that only secure versions of the system configuration are defined and that, when the system configurations are changed, the new configuration is also secure.

Auditee Response:

The Department concurs with the observation. Security enhancements have been made to isolate the Telefile/PCfile system from the Department's Local Area Network. This was facilitated by disconnecting the Telefile/PCfile systems from the Department network rack, connecting the Telefile/PCfile system to a dedicated hub, and installing a line switch between the hub and the Department network.

The IS computer operators will operate the A-B switch to connect the Telefile/PCfile system to the network as needed. Currently there are two transactions per day requiring connectivity with the Telefile/PCfile systems.

Modem access for the Telefile/PCfile contracted vendor has been modified. The modem will be accessible from 8:30 am to 4:30 pm, Monday through Friday. The modem will be physically shut down during all other periods. Dial in verification will be controlled by the computer operators. An Audit Log has been enacted to log activity by the vendor and is reviewed by operations.

Observation No. 9 - Controls Should Be Instituted To Monitor Information System Program Changes

Observation:

The Department of Revenue Administration (DRA) does not actively monitor its computer operations to detect unauthorized changes made to its Tax Information Management System (TIMS) programs.

DRA has an eight-step Turnover Change Management System (TCMS) for requesting computer program changes and approving the requests before changes are made to TIMS programs. The TCMS includes provisions intended to ensure that all changes to TIMS programs are authorized, tested, and approved prior to the changes going into production. TCMS, which provides the control structure for this multistep process, also has the capacity to generate a Turnover Object History Report that details all computer software changes that have gone into production.

DRA does not systematically produce or review the Turnover Object History Report to verify that only changes that have successfully gone through the TCMS are migrated into production on TIMS.

Recommendation:

DRA should expand its TCMS procedures to include monitoring for unauthorized changes to TIMS programs. DRA should produce and systematically review the Turnover Object History Report to verify that all changes made to this system have gone through TCMS controls, prior to being allowed into production.

Auditee Response:

The Department concurs with the observation. The Turnover Change Management System protects the Department from unauthorized changes to the production environment at a high level. Along with this system, IS Division sign-ons and passwords limit the ability for staff members to promote unauthorized changes into the production environment. Computer operators and security officers only, can promote changes to the production environment and are authorized to do so only with signatures from the IT Director, Assistant Director or designee. A Turnover Object History Report is available as a monitoring device to check for unapproved promotions to production. This log has not been regularly reviewed.

The IS Division is developing an Audit Review Policy to detect unauthorized changes to production. The policy will include reviewing the Turnover Object History Report on a periodic basis.

Observation No. 10 - Telefile Data Capture And Analysis Should Be Expanded

Observation:

Because the telefile system requires the meals and rentals operators to report only the amount of tax collected and does not provide the Department of Revenue Administration (DRA) with any additional information to support the reported amount, DRA is reliant upon the accuracy and honesty of meals and rentals operators.

Telefile, including PCfiling, became available to meals and rentals operators in February 1998. Telefile allows meals and rooms and vehicle rental operators to file their tax returns and pay their tax liability using either a touch-tone telephone or their personal computer. During fiscal year 2001, approximately 90% of meals and rental operators utilized the telefile system to report taxes collected and make payments to the DRA. DRA collected $164.1 million of meals and rentals taxes during fiscal year 2001.

While the telefile worksheet captures 21 fields of information, an operator filing a return by telefile enters, at most, four fields of information into the telefile system. The four fields, total meals tax, total room rental tax, total motor vehicle rental tax, and total payment due are figures calculated by the meals and rentals operators. Neither telefile nor the Tax Information Management System (TIMS) captures enough data to perform edit checks on these calculations. While the operators using telefile to file tax returns are responsible for retaining the worksheet for possible review by the DRA, there is no information available to the DRA in a telefiled return to provide assurance that the operator is reporting the correct amount of tax collected.

According to the DRA, the telefile system has the capacity to generate reports that compare operators' current period gross tax to the tax reported in the same period in the prior year. These reports "have been developed to identify amounts beyond acceptable variances, with follow-up audits conducted as needed." The variance reports were run daily for calendar years 1999 and 2000. Since the telefile system was integrated with TIMS in the spring of 2001, the variance reports have not been run. While the reports were being produced, DRA used the reports as a source to assist in the selection of operators to audit. As such, the reports were generally first subject to review and use two years after the reports were produced. The reports were not used to provide a timely review or analysis of current tax filings. In fact, the calendar year 2000 reports apparently contained an error that caused the reports to fail to identify any variances making the reports for 2000 useless. The error in the calendar year 2000 reports was not detected until DRA reviewed the status of the reports subsequent to an auditor inquiry in March of 2002.

Recommendation:

DRA should consider requiring operators to report additional data to support the amount of tax forwarded to the DRA. Additional data collected to support tax amounts would make tax collection analysis data queries a more powerful and useful tool for reviewing tax returns for operators who may not be making accurate tax filings.

In order to get the most value out of data collection and analysis efforts, the results of the analyses must be used in a manner to ensure that indicators of errors and indicators of inaccurate tax filings are identified and addressed in a timely manner. While these analyses can be important tools to assist in selecting operators to audit, the analyses should also be used to identify operators that may require more timely attention from the Audit or Collections Divisions to increase the potential for DRA to recognize and address in an appropriate time and manner operators experiencing problems.

Auditee Response:

The Department concurs with the observation that it is "reliant upon the accuracy and honesty of Meals and Rentals Operators". In fact, all taxes administered by the Department (except the Utility Property Tax) rely upon the accuracy and honesty of the person preparing the tax return. This is known as a system of "voluntary compliance" and is used throughout the United States.

However, the Department does not concur with the recommendation that Meals and Rentals Operators should be required to file additional information. The premise of the recommendation appears to be that if more information was filed, additional edit checks and analysis could be made to ensure the accuracy of the reported tax. It is the Department's opinion that this premise is incorrect.

In the past when operators filed monthly paper returns that contained more information than the current telefiled returns, no additional assurances were provided by that information. To provide assurance that the reported information is correct, the Department must audit source documents such as the register receipts. Additional telefiled information does not substitute for source documents.

The objective of the telefile system was to streamline the filing and processing functions, both for the operators and the Department. The telefile system was never intended to supplement or detract from the audit function. Requiring additional telefile information will not substitute for the audit process.

In addition, "voluntary compliance" is enforced through the Field Compliance Officers who provide a continuous "presence", routinely working with operators to ensure proper reporting.

In regard to the comment concerning the variance reports for 2000, the Department concurs that the reports for that year contained an error (due to a Y2K bug that had not been detected). These errors have been corrected and the variance reports for 2001 are being utilized as intended.

Observation No. 11 - Formal Written Information Technology Security Plan Should Be Created

Observation:

The Department of Revenue Administration (DRA) has not documented its information technology (IT) security policy in a written manual or plan. While DRA recognizes the need and has initiated procedures to secure its IT system, DRA has not established a documented entity-wide security program and has not assigned a single responsible employee to coordinate and be accountable for DRA's IT security efforts.

DRA's Tax Information Management System (TIMS) is used for recording tax returns, including tax payments, refunds, and audit data. While paper tax returns and other paper files and documents currently back up much of the information in TIMS, some taxpayer information is only available to the DRA in the electronic form as it is stored on TIMS. Because of DRA's dependence on the use of IT and the operational capability provided through IT, and the confidential nature of the information stored in TIMS, the security of the IT system is critical to the continued efficient operations of the Department.

To ensure the continuity and consistency of the entire IT security process, it is essential that the IT security process is documented. Only in this way can basic weaknesses in the process be reliably detected and any departures from the established process be detected and corrected in a timely manner. The individual phases of the IT security process and the results of the process should also be documented. Such documentation is important to maintaining IT security and hence to ensuring that the process continues to develop in an efficient manner.

Recommendation:

DRA management has the ultimate responsibility for establishing and monitoring an IT security policy sufficient to protect the Department's IT resources. The information security policy should be based on management's IT security objectives and it should define the internal organizational structures, guidelines, rules, and procedures which are necessary to achieve the IT security goals. The policy should be set down in writing and formally approved by management.

The IT security policy should be written in a concise style. It should be examined at regular intervals to ensure that it remains current and is amended as necessary. Compliance with the policies should be monitored and also periodically tested. It may be appropriate to establish these cycles in the policy document.

A single IT security officer, who builds up an expertise in IT security, should be charged with the responsibility for all IT security issues. This individual should have direct access to management to ensure independence and objectivity of the IT security function.

Auditee Response:

The Department concurs with the observation. As stated, the Department recognizes the need for formal procedures to secure its IT systems and has many security policies and procedures currently in place. Security is guided by procedures which are not centrally located but rather distributed to designated staff for implementation. For example, security matrix procedures are filed within the computer room procedures since it is the computer operators who must follow the security procedure. The IS Division has two staff members who share the role of security officer. This responsibility is shared due to the data base security needs and technical security needs.

The IS Division has begun work on a single security document and has designated one staff member as the primary security officer, overseeing the other two staff members. The primary security officer will be responsible for monitoring and testing defined policy. The document will be submitted to Department management for approval upon completion. A yearly review of the entire document will be established.

Observation No. 12 - Business Continuity Management Plan Should Include Periodic Testing And Evaluation Of Plan Procedures

Observation:

The Department of Revenue Administration (DRA) does not perform regular and comprehensive tests of its information technology (IT) disaster recovery/Business Continuity Management (BCM) plan. While certain components of DRA's BCM plan may be used by the DRA during the course of a year in response to minor IT failures, DRA does not regularly perform a comprehensive test of its BCM plan.

General support systems require appropriate emergency, backup, and contingency plans. These plans should be tested regularly to ensure the continuity of support in the event of system failure. The results of these tests should be reviewed and the plans appropriately revised to ensure that the plans remain effective. Also, users should be made aware of applicable components of these plans so that appropriate coordination can occur and all employees should be trained in their roles and responsibilities relative to the emergency, disaster, and contingency plans.

Recommendation:

DRA should ensure that it has a tested disaster recovery plan in place for all supporting IT systems and networks. DRA should establish, as part of its BCM/IT disaster recovery plan, a program of regular testing of key provisions of the plan. The testing program should include critiques of the plan's effectiveness and the need for revisions to the plan and employee training in the operation of the plan.

As part of its regular review of its BCM plan, DRA should periodically contact hardware suppliers regarding availability of replacement systems and software vendors regarding necessary software. Agreements for backup processing locations as well as other provisions of DRA's plans should be reviewed for continued relevance and appropriateness to ensure the timely reestablishment of IT services critical to the efficient and effective operations of the DRA in the event of a catastrophic IT-related event.

Auditee Response:

The Department concurs with the observations, but only concurs **in part** with the recommendation.

The Department does not perform regular comprehensive tests of its IT disaster recovery plan. However, certain components of the plan are tested yearly due to IT failures. Risk assessment performed by the Department has determined that the most critical aspect of the Department's BCM is to process the daily mail and deposit money into the bank. The Department has had to perform this manual process at least once a year as a result of the computer systems being down. The manual procedures in place proved to be adequate to accomplish the daily deposit.

The Department does not have a vendor that will guarantee delivery of an AS/400. However, the Department is fully prepared to perform its critical functions without the use of an AS/400 for an extended period of time. Also, no vender will guarantee delivery of an AS/400 unless the state is willing to pay for disaster recovery. This becomes a statewide issue, not an agency issue.

The IS Division contacts all vendors and contractors yearly to ensure proper contact personnel and contact numbers. We also validate off site locations, (4 Hazen Drive and the Armory). The Department believes Hazen Drive and the Armory to be a safe area for recovery from disaster at the current Department location. The Department's disaster recovery plan does not address state or national disasters because it is beyond the scope of Department's authority. The Office of Emergency Management and the Homeland Security Commission are responsible for addressing these concerns.

The recommendation to ensure the disaster recovery plan is tested for all supporting IT functions is deemed too costly to justify. A complete recovery from disaster would take weeks. Testing the plan fully would involve a tremendous amount of time from numerous employees from various divisions within the Department. Again, the Department's risk assessment has determined that the most critical aspect of the Department's BCM is to process the daily mail and deposit money received into the bank. This manual procedure has been tested.

Observation No. 13 - Cash Receipts Should Be Deposited Daily

Observation:

The Department of Revenue Administration (DRA) does not deposit cash (i.e., currency) receipts on a daily basis, contrary to RSA 6:11, II.

RSA 6:11, II, states, "if more than $100 is in the possession of any state department or institution such funds shall be on deposit in the related department's bank account or in a treasury bank account." The statute is intended to expedite cash availability to the State Treasury, and also to limit the State's exposure to the loss or theft of cash.

DRA collected approximately $127,000 in cash during fiscal year 2001. The cash was primarily received from DRA's collections activities. The Department typically collects more than $100 in cash daily and, thus according to statute, cash collected should be deposited daily. The Department's current procedures require cash to be deposited weekly, on Friday, unless amounts greater than $1,000 are received. Undeposited cash is kept in a marked envelope and locked in the DRA vault. Cash received on Monday could be retained by DRA for up to four days, increasing the risk of loss, theft, or misappropriation.

- Compliance Officers in the Collections Division receive payments directly from taxpayers at their place of business. Any cash collected is converted to a bank check made payable to, "Treasurer, State of New Hampshire." In general, the Compliance Officers bring collections to the Concord office weekly; larger amounts collected (greater than $2,000) are brought to Concord immediately.

- While DRA generally deposits checks daily, in some instances, checks received by the Audit Division are locked in a clerk's desk drawer until the responsible auditor determines whether the taxpayer paid the correct amount and the accompanying documentation is complete. Checks reportedly may be held in this manner for a few days and up to two weeks.

Recommendation:

DRA should establish procedures to ensure that cash is deposited daily to expedite cash availability to the State Treasury, reduce the risk of loss, theft, or misappropriation, and to comply with RSA 6:11, II.

DRA should establish procedures to ensure that receipts collected by the Compliance Officers are deposited timely. This may include opening local bank depository accounts for the Compliance Officers or developing a policy for the immediate mailing of receipts to Concord.

The Audit Division should establish procedures requiring the daily deposit of all receipts. Procedures could include: photocopying the checks for audit follow-up purposes prior to remitting the checks to the Document Processing Division for deposit daily. Checks not accompanied by supporting documentation could possibly be processed as incomplete batches. Also, the Division could better communicate its taxpayer check remittance policy to direct taxpayers to remit payments directly to the Document Processing Division.

Auditee Response:

The Department concurs with the observation that it does not deposit cash (currency) receipts on a daily basis when such amount exceeds $100. As indicated in the observation, the Department's procedures are to deposit cash weekly, on Friday, unless amounts greater than $1,000 are received. Since the vast majority of money received by the Department is in the form of checks rather than cash, it is in the State's best interest for the Department to prioritize depositing checks. Doing a minimal daily cash deposit is too costly to justify in terms of a much larger deposit of checks, i.e., $400 in cash versus $400,000 in checks. However, the Department will modify its current procedures regarding the frequency of cash deposits to ensure that a cash deposit will be made when the cumulative cash amount exceeds $1,000, but no less frequently than on a weekly basis. The Department will seek a statutory exception to RSA 6:11, II to authorize this procedure.

In regards to the observation and recommendation concerning checks in custody of Collection Officers, the Department will investigate the use of a local bank depository account.

In regards to the observation and recommendation concerning checks in custody of the Audit staff, the Department has revised its procedures to ensure that all checks are processed within 72 hours of receipt.

<u>**State Compliance Comments**</u>

Observation No. 14 - Applicability Of RSA 617 Should Be Reviewed And Procedures For The Seizure Of Tobacco Products Documented

Observation:

Tobacco products seized by the Department of Revenue Administration (DRA) pursuant to RSA 78:16 are not seized in the manner provided by RSA 617, the statute cited by RSA 78:16.

RSA 78:34 requires any tobacco products sold that do not comply with all applicable federal laws be subject to forfeiture under RSA 78:16. RSA 78:16 provides that tobacco products, not subject to certain exemptions, that are found without the necessary stamps affixed to them be declared contraband goods subject to forfeiture to the state. This statute also provides that "[t]he commissioner, his authorized agents…shall have the power to seize such tobacco products in the manner provided under RSA 617."

RSA 617, titled Forfeitures Of Personal Property, provides the procedures to be followed for the seizure of private property resulting from a violation of law. Procedures include filing a libel before an appropriate court, the issuance of a warrant, and a trial with a decree for the disposition of the property.

DRA does not adhere to the RSA 617 seizure procedures. Tobacco products that are seized by its collection officers are held at the DRA office until destroyed. DRA neither makes a filing with the court nor requires a court decree prior to the destruction of seized tobacco products.

Recommendation:

DRA should review with counsel the provisions of RSA 78:16 and RSA 617 regarding the seizure of tobacco products. The results of this review should be documented in a policy manual as discussed in Observation No. 1 and should form the basis for the procedures used by DRA to seize tobacco products.

If DRA determines that the statutes regarding the seizure of tobacco products are not in the best interests of the State and the Department, then DRA should initiate a request for an appropriate revision to the statute.

Auditee Response:

The Department concurs <u>**in part**</u> with the observation. Tobacco products seized by the Department pursuant to RSA 78:16 are seized prior to obtaining a warrant in the manner provided for in RSA 617:1. RSA 617:1 sets forth the procedure under which an officer may seize property prior to obtaining a warrant. The Department uses this procedure rather than first obtaining a warrant because in all likelihood the illegal product would be sold or removed prior to the Department's receipt of a warrant.

However, in lieu of obtaining a warrant the Department obtains a Settlement Agreement and Release. This Settlement Agreement and Release contains an acknowledgment of ownership of the illegal product by the owner and a transfer of title to the Department in release of all claims that the Department would have for the costs of the forfeiture against the owner under RSA 617:8. Because the Department obtains the Settlement Agreement and Release from the owner, there is no need to file a libel with a court to obtain a warrant.

In certain cases the Department may have lost or inadvertently destroyed the Settlement Agreement and Releases obtained from the owner, or failed to follow the procedure. Therefore, the Department would agree that in certain instances we were unable to prove compliance with RSA 617. However, the procedure used by the Department did in fact comply with RSA 617.

The Department concurs with the recommendation to review with counsel the provisions of RSA 78:16 and RSA 617, and will seek a legislative change if the forfeiture statute is determined to be contrary to the interests of the State. Tobacco Tax seizure policies and procedures will be revised and documented as indicated in our responses to Observations No. 6 and No. 7.

Observation No. 15 - Expired Administrative Rules Related To The Administration Of The Medicaid Enhancement Tax Should Be Revised As Appropriate And Submitted For Adoption

Observation:

The administrative rules related to DRA's administration of the Medicaid Enhancement Tax were last adopted in fiscal year 1992 and therefore expired prior to the start of fiscal year 2001.

RSA 84-A:9 directs the DRA Commissioner to adopt rules pursuant to RSA 541-A relative to the administration of the Medicaid Enhancement Tax including the recovery of any tax, interest on tax, or penalties imposed related to the Medicaid Enhancement Tax.

N.H. Admin. Rules, Rev 2300 *Medicaid Enhancement Tax* were last adopted effective February 26, 1992. According to RSA 541-A:17, I; with only certain exceptions provided by RSA 541-A:17, II, no rule shall be effective for a period of longer than eight years. Therefore, N.H. Admin. Rules, Rev 2300 expired prior to the start of fiscal year 2001.

Recommendation:

DRA should review its administration of the Medicaid Enhancement Tax and submit for adoption, pursuant to RSA 541-A, rules relative to its administration of that tax.

Auditee Response:

The Department concurs with the observation and has initiated the process to readopt NH Administrative Rules Rev. 2300 relative to the Medicaid Enhancement Tax.

Observation No. 16 - Late Filing Fee Should Be Applied To Local Government Entities Submitting Delinquent Reports

Observation:

The Department of Revenue Administration (DRA) does not impose the $5 per day late filing fee required by RSA 21-J:36.

RSA 21-J:34, V, requires each city, town, school district, village district, or county to file reports necessary for the DRA to compute and establish the tax rates. The reports are due September 1st for schools and municipalities filing on a fiscal year basis and April 1st for municipalities filing on a calendar-year basis. RSA 21-J:36 states that the local government units shall pay a penalty of $5 per day for each day's delay in submitting the required information, unless the DRA extends the due date for "just cause".

During fiscal year 2001, some government units failed to file required reports on a timely basis; yet, DRA's Municipal Services Division did not enforce the penalty fee provided by RSA 21-J:36. For example, the City of Manchester filed its fiscal year 2001 MS-5 report 74 days late and the Concord School District filed its fiscal year 2001 MS-25 report 96 days late. Neither of these entities was charged a late filing fee by the DRA nor was there any indication that DRA had extended the filing periods for these entities for "just cause."

The State is losing an indeterminable amount of fee revenue due to its lack of compliance with RSA 21-J:36. In addition, RSA 21-J:35, I, requires the Department to compute the tax rate of each town, city, etc. The late-filed financial reports could impact the Department's ability to carry out its statutory responsibility for setting tax rates in a timely manner.

Recommendation:

The DRA should comply with the penalty fee provisions outlined in RSA 21-J:36 to enhance compliance with the timely filing requirements for financial reports. If the DRA determines that it is not appropriate to charge the late fee, it should document the "just cause" required by the statute for extending the filing period.

If the DRA determines that flexibility is needed in determining when to charge late filing fees without having to document just cause, the DRA should request that the statute be amended to provide that flexibility.

Auditee Response:

The Department concurs with the observation that it does not impose the $5.00 per day late filing fee required by RSA 21-J:36. However, a review of the local government entities that were late in filing the forms required under RSA 21-J:34, indicate that in virtually all cases they were in fact late due to "just cause," and would have been granted an extension.

After this review, the Department has concluded that legislation will be sought to remove the \$5.00 per day penalty. The Department can not certify a municipality's tax rate without these required reports which poses a greater penalty on the municipality than the \$5.00 per day penalty.

Auditor's Report On Management Issues

To The Fiscal Committee Of The General Court:

We have audited the accompanying Combined Statement of Revenues and Expenditures – Budget and Actual – General and Education Trust Funds of the New Hampshire Department of Revenue Administration for the year ended June 30, 2001 and have issued our report thereon dated January 23, 2002, which was qualified with respect to the lack of presentation of the financial position of the Department in the General and Education Trust Funds and the omission of the Medicaid Enhancement Tax collected by the Department.

We conducted our audit in accordance with auditing standards generally accepted in the United States and the standards applicable to financial audits contained in *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 statement is free of material misstatement.

In planning and performing our audit of the financial statement of the New Hampshire Department of Revenue Administration for the year ended June 30, 2001, we noted certain issues related to the operation of the Department that merit management consideration but do not meet the definition of a reportable condition as defined by the American Institute of Certified Public Accountants, and were not issues of noncompliance with laws, rules, regulations, or contracts.

Those issues that we believe are worthy of management consideration but do not meet the criteria of reportable conditions or noncompliance are included in Observations No. 17 and No. 18 of this report.

This auditor's report on management issues is intended solely for the information and use of the management of the Department of Revenue Administration 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.

Office Of Legislative Budget Assistant

Office Of Legislative Budget Assistant

January 23, 2002

Management Issues Comments

Observation No. 17 - Process For Recording Receipts In NHIFS Should Be Made More Efficient

Observation:

The Department of Revenue Administration's (DRA) data transfer process for recording receipts in the State accounting system (NHIFS) is inefficient.

The data entry section of DRA's Documents Processing Division manually keys the majority of the tax information, including receipt information, into DRA's Tax Information Management System (TIMS). Receipt information is accumulated and summary information is electronically transferred into another computerized program that generates a cash receipt form (A-17). The data on the A-17 is then manually keyed into NHIFS.

The current data transfer process for recording receipts is inefficient, as it requires the manual keying of information that is available electronically, increasing the risk of keying errors. The electronic transfer of this receipt information from TIMS to NHIFS would eliminate the necessity for the manual keying of summary data, thereby reducing the risk of keying errors and the need for correcting those errors.

Recommendation:

The Documents Processing Division should work with the Information Services Division, the State Treasury, and the Department of Administrative Services to establish a process to electronically transfer data directly from TIMS to NHIFS. This would improve the efficiency and effectiveness of the data entry.

Auditee Response:

The Department concurs with the observation that the current data transfer process for recording cash receipts is inefficient. The Department previously reviewed the automatic electronic transfer of the A-17 information and determined that there were technical constraints at the Department that prevented it. Because of recent system upgrades, those constraints have been eliminated. A work order has been submitted for this project and it has been assigned a high priority for systems development staff.

Observation No. 18 - Accounts Receivable System Should Be Automated

Observation:

The Department of Revenue Administration's (DRA) method for periodically determining accounts receivable is inefficient and prone to clerical errors.

DRA's business office currently is responsible for determining year-end accounts receivable, primarily taxes due, using assumptions developed from prior tax collection experience and information drawn from the Department's Tax Information Management System (TIMS). DRA's determination of accounts receivable is a process which, because it requires a great deal of manual involvement, is time consuming, relies upon the knowledge and experience of individual DRA employees, and because it is a manual process, it is prone to errors.

An automated process would increase efficiency, reduce the risk of errors, and provide timely information and therefore be a more valuable management information tool.

Recommendation:

The DRA should investigate the feasibility of automating its process for determining and recording accounts receivable.

Auditee Response:

The Department **does not** concur with the observation. Determining accounts receivable is done only once a year. The accuracy of the accounts receivable is important to arrive at a preliminary determination of the State's fund balance. Year-end accounts receivable accruals have always received a high level of management scrutiny from both within and outside the Department. The State's independent auditors review how these accruals are determined and question the accruals on an annual basis. The process cannot be automated because it relies heavily on experience and current economic trends. For example, the Department could simply take last years actual receivable and book that amount the following year. This would be easy to automate, but based on the current revenue shortfall, would likely overstate the accounts receivable by multiple millions of dollars.

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Independent Auditor's Report

To The Fiscal Committee Of The General Court:

We have audited the accompanying Combined Statement of Revenues and Expenditures – Budget and Actual – General and Education Trust Funds of the New Hampshire Department of Revenue Administration for the year ended June 30, 2001. This financial statement is the responsibility of the Department of Revenue Administration’s management. Our responsibility is to express an opinion on this financial statement based on our audit.

We conducted our audit in accordance with auditing standards generally accepted in the United States and the standards applicable to financial audits contained in *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 statement is free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statement. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audit provides a reasonable basis for our opinion.

As more fully discussed in Note 1, the financial statement referred to above is not intended to present the financial position of the Department of Revenue Administration in the General and Education Trust Funds.

The financial statement referred to above does not include $131 million of Medicaid Enhancement Tax revenue collected by the Department and deposited in the Uncompensated Care Fund. The Medicaid Enhancement Tax, while collected by the Department, is budgeted and reported as revenue in the Department of Health and Human Services financial statements.

In our opinion, except for the effect on the financial statement of the omission described above and the matter discussed in the third paragraph, the financial statement referred to above presents fairly, in all material respects, certain financial activity of the Department of Revenue Administration for the year ended June 30, 2001, in conformity with accounting principles generally accepted in the United States.

Our audit was conducted for the purpose of forming an opinion on the financial statement referred to in the first paragraph. The accompanying schedules on pages 45 and 46 are presented for the purpose of additional analysis and are not required parts of the financial statement of the Department of Revenue Administration. Such information has been subjected to the auditing procedures applied in our audit of the financial statement referred to in the first paragraph and, in our opinion, is fairly presented in all material respects in relation to the financial statement taken as a whole.

In accordance with *Government Auditing Standards,* we have also issued a report dated January 23, 2002 on our consideration of the Department of Revenue Administration's internal control over financial reporting and on our tests of its compliance with certain provisions of laws and rules, regulations, and contracts.

Office Of Legislative Budget Assistant

Office Of Legislative Budget Assistant

January 23, 2002

STATE OF NEW HAMPSHIRE
DEPARTMENT OF REVENUE ADMINISTRATION

COMBINED STATEMENT OF REVENUES AND EXPENDITURES
BUDGET AND ACTUAL – GENERAL AND EDUCATION TRUST FUNDS
FOR THE YEAR ENDED JUNE 30, 2001

	General Fund		
	Budget	Actual	Favorable/ (Unfavorable) Variance
Unrestricted Revenues			
Business Profits Tax	$ 175,000,000	$ 179,615,154	$ 4,615,154
Meals And Rooms/Car Rental Tax	157,000,000	157,202,009	202,009
Business Enterprise Tax	77,200,000	122,164,998	44,964,998
Tobacco Tax	74,800,000	61,897,423	(12,902,577)
Interest And Dividends Tax	70,000,000	76,651,256	6,651,256
Real Estate Transfer Tax	65,000,000	59,487,921	(5,512,079)
Legacy And Estate Tax	56,000,000	59,347,091	3,347,091
Communication Services Tax	53,000,000	49,044,534	(3,955,466)
Utility Franchise Tax	10,500,000	8,731,743	(1,768,257)
Other	6,594,500	1,419,099	(5,175,401)
Statewide Property Tax	-0-	-0-	-0-
Utility Property Tax	-0-	-0-	-0-
Total Unrestricted Revenues	**$ 745,094,500**	**$ 775,561,228**	**$ 30,466,728**
Restricted Revenues			
Property Appraisal Fees	983,346	60,980	(922,366)
Flood Control	421,056	202,134	(218,922)
Other	12,000	71,700	59,700
Total Restricted Revenues	**$ 1,416,402**	**$ 334,814**	**$ (1,081,588)**
Total Revenue	**$ 746,510,902**	**$ 775,896,042**	**$ 29,385,140**
Expenditures			
Audit	$ 3,600,974	$ 3,425,891	$ 175,083
Administration	3,346,893	2,020,541	1,326,352
Property Appraisal	1,799,218	1,502,116	297,102
Municipal Services	1,406,564	1,317,175	89,389
Document Processing	1,375,405	1,257,705	117,700
Automated Information	986,363	884,552	101,811
Collections	916,130	887,338	28,792
Hardship Relief	-0-	-0-	-0-
Total Expenditures	**$ 13,431,547**	**$ 11,295,318**	**$ 2,136,229**
Excess (Deficiency) Of Revenues Over (Under) Expenditures	**$ 733,079,355**	**$ 764,600,724**	**$ 31,521,369**

The accompanying notes are an integral part of this financial statement.

Education Trust Fund			Total (Memorandum Only)		
Budget	**Actual**	**Favorable/ (Unfavorable) Variance**	**Budget**	**Actual**	**Favorable/ (Unfavorable) Variance**
$ 15,800,000	$ 15,800,000	$ -0-	$ 190,800,000	$ 195,415,154	$ 4,615,154
10,300,000	6,858,464	(3,441,536)	167,300,000	164,060,473	(3,239,527)
36,700,000	36,700,000	-0-	113,900,000	158,864,998	44,964,998
27,800,000	24,464,833	(3,335,167)	102,600,000	86,362,256	(16,237,744)
-0-	-0-	-0-	70,000,000	76,651,256	6,651,256
26,800,000	29,735,490	2,935,490	91,800,000	89,223,411	(2,576,589)
-0-	-0-	-0-	56,000,000	59,347,091	3,347,091
-0-	-0-	-0-	53,000,000	49,044,534	(3,955,466)
-0-	-0-	-0-	10,500,000	8,731,743	(1,768,257)
-0-	-0-	-0-	6,594,500	1,419,099	(5,175,401)
442,064,000	442,157,660	93,660	442,064,000	442,157,660	93,660
23,900,000	15,620,914	(8,279,086)	23,900,000	15,620,914	(8,279,086)
$ 583,364,000	**$ 571,337,361**	**$ (12,026,639)**	**$ 1,328,458,500**	**$ 1,346,898,589**	**$ 18,440,089**
-0-	-0-	-0-	983,346	60,980	(922,366)
-0-	-0-	-0-	421,056	202,134	(218,922)
-0-	-0-	-0-	12,000	71,700	59,700
$ -0-	**$ -0-**	**$ -0-**	**$ 1,416,402**	**$ 334,814**	**$ (1,081,588)**
$ 583,364,000	**$ 571,337,361**	**$ (12,026,639)**	**$ 1,329,874,902**	**$ 1,347,233,403**	**$ 17,358,501**
$ -0-	$ -0-	$ -0-	$ 3,600,974	$ 3,425,891	$ 175,083
-0-	-0-	-0-	3,346,893	2,020,541	1,326,352
-0-	-0-	-0-	1,799,218	1,502,116	297,102
-0-	-0-	-0-	1,406,564	1,317,175	89,389
-0-	-0-	-0-	1,375,405	1,257,705	117,700
-0-	-0-	-0-	986,363	884,552	101,811
-0-	-0-	-0-	916,130	887,338	28,792
840,758	840,285	473	840,758	840,285	473
$ 840,758	**$ 840,285**	**$ 473**	**$ 14,272,305**	**$ 12,135,603**	**$ 2,136,702**
$ 582,523,242	**$ 570,497,076**	**$ (12,026,166)**	**$ 1,315,602,597**	**$ 1,335,097,800**	**$ 19,495,203**

STATE OF NEW HAMPSHIRE
DEPARTMENT OF REVENUE ADMINISTRATION

NOTES TO THE FINANCIAL STATEMENT
FOR THE YEAR ENDED JUNE 30, 2001

NOTE 1 -- SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

The financial statement of the Department of Revenue Administration has been prepared in conformity with generally accepted accounting principles (GAAP) as applied to governmental units. The Governmental Accounting Standards Board (GASB) is the accepted standard-setting body for establishing governmental accounting and financial reporting principles.

A. Financial Reporting Entity

The Department is an organization of the primary government of the State of New Hampshire. The accompanying financial statement reports certain financial activity of the Department. The financial activity of the Department is accounted for and reported in the General and Education Trust Funds in the State of New Hampshire's Comprehensive Annual Financial Report (CAFR). Assets, liabilities, and fund balances are reported by fund for the State as a whole in the CAFR. The Department, as an organization of the primary government, accounts for only a portion of the General and Education Trust Funds and those assets, liabilities, and fund balances as reported in the CAFR that are attributable to the Department can not be determined. Accordingly, the accompanying financial statement is not intended to show the financial position of the Department in the General and Education Trust Funds and the changes in these fund balances are not reported on the accompanying financial statement.

B. Basis Of Presentation - Fund Accounting

The State of New Hampshire and the Department use funds and account groups to report on their financial position and the results of their operations. Fund accounting is designed to demonstrate legal compliance and to aid financial management by segregating transactions related to certain government functions or activities.

A fund is a separate accounting entity with a self-balancing set of accounts. An account group is a financial reporting device designed to provide accountability for certain assets and liabilities that are not recorded in the funds because they do not directly affect net expendable available financial resources.

Governmental Fund Types

General Fund

The General Fund accounts for all financial transactions not specifically accounted for in any other fund. By law, and with certain exceptions, all revenues of governmental funds are paid daily into the State Treasury.

Education Trust Fund

The Education Trust Fund is one of the State's Special Revenue Funds. In fiscal year 2000, the Education Trust Fund was created in accordance with Chapter 17:41, Laws of 1999. The fund is nonlapsing and is used to distribute adequate education grants to school districts.

Account Groups

General Fixed Assets

The General Fixed Assets Account Group is used to account for the fixed assets of the governmental funds. As of June 30, 2001, the Department had recorded in the General Fixed Assets Account Group the cost of general fixed assets based on available historical cost records. Donated fixed assets are recorded at fair market value at the time donated.

General Long-Term Debt

Activities related to governmental fund unmatured long-term general obligation bonds payable and the cumulative long-term liabilities for compensated absences and uninsured claims, and obligations under capital lease agreements are reflected in the General Long-Term Debt Account Group.

C. Measurement Focus And Basis Of Accounting

The accounting and financial reporting treatment applied to a fund is determined by its measurement focus. All governmental funds are accounted for using the flow of current financial resources measurement focus and reported on a modified accrual basis of accounting. Accordingly, the State of New Hampshire accounts for its financial transactions relating to the General and Education Trust Funds on the modified accrual basis of accounting. Under the modified accrual basis of accounting, revenues are recognized when measurable and available to finance operations of the fiscal period. "Measurable" means the amount of the transaction can be determined and "available" means collectible within the current period or soon enough thereafter to be used to pay liabilities of the current period. Expenditures are recognized in the period in which obligations are incurred as a result of the receipt of goods or services.

D. Budgetary Data

General Budget Policies

The statutes of the State of New Hampshire require the Governor to submit a biennial budget to the Legislature for adoption. This budget, which includes annual budgets for each year of the biennium, consists of three parts: Part I is the Governor's program for meeting all expenditure needs and estimating revenues. There is no constitutional or statutory requirement that the Governor propose, or the Legislature adopt, a budget that does not resort to borrowing. Part II is a detailed breakdown of the budget at the department level for appropriations to meet the expenditure needs of the government. Part III consists of draft appropriation bills for the appropriations made in the proposed budget.

The operating budget is prepared principally on a modified cash basis and adopted for the governmental and proprietary funds, with the exception of the Capital Projects Fund. The Capital Projects Fund budget represents appropriations for individual projects, which extend over several fiscal years. Fiduciary-type funds are not budgeted.

In addition to the enacted biennial operating budget, the Governor may submit to the Legislature supplemental budget requests necessary to meet expenditures during the current biennium. During the 2001 Legislative session, no significant supplemental budget requests affecting the Department were approved. Appropriation transfers can be made within a department without the approval of the Legislature; therefore, the legal level of budgetary control is at the department level. As shown on the Schedules of Budgetary Components – General Fund on page 45 and Education Trust Fund on page 46, the final budgeted amount includes the initial operating budget plus supplemental appropriation warrants, balances brought forward, and transfers.

Additional fiscal control procedures are maintained by both the Executive and Legislative Branches of government. The Executive Branch, represented by the Commissioner of the Department of Administrative Services, is directed to continually monitor the State's financial operations, needs, and resources, and to maintain an integrated financial accounting system. The Legislative Branch, represented by the Joint Legislative Fiscal Committee, the Joint Legislative Capital Budget Overview Committee, and the Office of Legislative Budget Assistant, monitors compliance with the budget and the effectiveness of budgeted programs.

Unexpended balances of appropriations at year end will lapse to undesignated fund balance and be available for future appropriations unless they have been encumbered or are legally defined as non-lapsing which means the balances are reported as reservation of fund balance. Capital Projects Fund unencumbered appropriations lapse in two years unless extended or designated as non-lapsing by law.

Variances - Favorable/(Unfavorable)

The variance column on the Combined Statement of Revenues and Expenditures - Budget And Actual - General and Education Trust Funds highlights differences between budget and actual revenues and expenditures. For revenues, these variances are caused by actual revenue exceeding budget generating a favorable variance or actual being less than budget generating an unfavorable variance. For expenditures, a favorable variance results from actual expenditures being less than the amount budgeted for the fiscal year. The favorable expenditure variances represent a combination of ending available balances and unliquidated encumbrances. Unfavorable expenditure variances represent actual expenditures for the reporting period exceeding the amounts budgeted for the fiscal year.

Encumbrances

Contracts and purchasing commitments are recorded as encumbrances when the contract or purchase order is executed. Upon receipt of goods or services, the encumbrance is liquidated and the expenditure and liability are recorded.

E. Interpretation Of Totals (Memorandum Only) Column

The "total (memorandum only)" columns represent an aggregation of individual account balances. The columns are presented for overview informational purposes and do not present consolidated financial information, since interfund balances and transactions have not been eliminated.

F. Fixed Assets - General

General fixed assets are not capitalized in the funds used to acquire or construct them. Instead, capital acquisition and construction costs are reflected as expenditures in governmental funds, and the related assets are reported in the General Fixed Assets Account Group. For State Comprehensive Annual Financial Report reporting purposes, the State capitalizes equipment that costs $10,000 or more and land, land improvements, buildings, building improvements, and construction in progress with costs of $100,000 or greater. All purchased fixed assets are valued at historical cost and in some instances at estimated historical cost. Donated fixed assets are valued at their estimated fair market value on the date received. Interest costs incurred during construction are not capitalized. Public domain ("infrastructure") general fixed assets consisting of roads, bridges, dams, curbs and gutters, streets and sidewalks, drainage systems, and lighting systems are not capitalized, as these assets are immovable and of value only to the State. Assets in the General Fixed Assets Account Group are not depreciated.

G. Interfund And Intrafund Transactions

The State accounts for interfund and intrafund transactions as described below:

Reimbursements - Various departments charge user fees for such services as centralized data processing, accounting and auditing, purchasing, personnel, and maintenance. In addition, the Department of Administrative Services charges rent to those departments that are housed in state-owned buildings. These fees and rent are not considered material and are recorded as revenue by the servicing department and as expenditures by the user department.

NOTE 2 – GENERAL FIXED ASSETS ACCOUNT GROUP

The following is a summary of fixed assets balances and activity for the year ended June 30, 2001 reported by the Department. As well as reporting general fixed assets as defined by the State for financial reporting purposes, the Department also reports equipment using the criteria required by the State Manual of Procedure, that being equipment with a historical cost of $100 or more and useful life of greater than one year.

As shown in the following table, Department fixed assets include a capital-leased administrative building at 45 Chennell Drive, Concord, N.H. and equipment.

General Fixed Assets	Balance July 1, 2000	Additions	Deletions	Balance June 30, 2001
Buildings And Building Improvements	$ 2,500,000	$ -0-	$ -0-	$ 2,500,000
Equipment	1,204,316	24,323	51,690	1,176,949
Total General Fixed Assets	**3,704,316**	**24,323**	**51,690**	**3,676,949**
Equipment With Original Cost Between $100 And $10,000	1,283,084	122,611	24,568	1,381,127
Total General Fixed Assets And Other Equipment	**$ 4,987,400**	**$ 146,934**	**$ 76,258**	**$ 5,058,076**

NOTE 3 – LEASE COMMITMENT

The Department has a lease commitment for office space located at 45 Chenell Drive in Concord, N.H. This lease qualifies as a capital lease for accounting purposes and therefore, has been recorded at $2.5 million, the fair market value at the inception of the lease, in the General Fixed Assets Account Group. A corresponding $2.5 million obligation has been recorded in the General Long-Term Debt Account Group. The Department paid a total of $470,470 in lease payments for the year ended June 30, 2001. The future minimum lease payments and the net present value of those payments at June 30, 2001, are as follows:

Lease Payments Fiscal Year	Amount
2002	$ 480,480
2003	490,490
2004	500,500
2005	510,510
2006	520,520
Thereafter	1,071,070
Total	3,573,570
Amount Representing Interest	(565,796)
Present Value of Minumum Lease Payments	**$ 3,007,774**

NOTE 4 – EMPLOYEE BENEFIT PLANS

New Hampshire Retirement System

The Department of Revenue Administration, as an organization of the State government, participates in the New Hampshire Retirement System (Plan). The Plan is a contributory defined-benefit plan providing service, disability, death, and vested retirement benefits to members and beneficiaries. The Plan covers substantially all full-time employees of the Department. The Plan qualifies as a tax-exempt organization under Sections 401 (a) and 501 (a) of the Internal Revenue Code. RSA 100-A established the Plan and the contribution requirements. The Plan, which is a cost-sharing, multiple-employer Public Employees Retirement System (PERS), is divided into two membership groups. Group I consists of state and local employees and teachers. Group II consists of firefighters and police officers. All assets are in a single trust and are available to pay retirement benefits to all members.

Group I members at age 60 qualify for a normal service retirement allowance based on years of creditable service and average final compensation (AFC). The yearly pension amount is 1/60 (1.67%) of AFC, multiplied by years of creditable service. AFC is defined as the average of the three highest salary years. At age 65, the yearly pension amount is recalculated at 1/66 (1.5%) of AFC, multiplied by years of creditable service. Members in service with ten or more years of creditable service who are between ages 50 and 60 or members in service with at least 20 or more years of service, whose combination of age and service is 70 or more, are entitled to a retirement allowance with appropriate graduated reduction based on years of creditable service.

Group II members who are age 60, or members who are at least age 45 with at least 20 years of creditable service can receive a retirement allowance at a rate of 2.5% of AFC for each year of creditable service, not to exceed 40 years.

Members of both groups may qualify for vested deferred allowances, disability allowances, and death benefit allowances subject to meeting various eligibility requirements. Benefits are based on AFC or earnable compensation, service, or both.

Pursuant to RSA 100-A:50, the New Hampshire Retirement System also provides a postretirement medical premium subsidy for Group I employees of political subdivisions and teachers and Group II police officers and firefighters.

A special account has been established by RSA 100-A:16, II(h) for additional benefits. The account is credited with all the earnings of the assets in the account plus the earnings of the remaining assets of the plan in excess of the assumed rate of return plus ½ of 1 percent.

The New Hampshire Retirement System issues a publicly available financial report that may be obtained by writing to them at 4 Chenell Drive, Concord, N.H. 03301-8509 or from their web site at http://webster.state.nh.us/retirement.

The Plan is financed by contributions from the members, the State and local employers, and investment earnings. In fiscal year 2001, Group I and II members were required to contribute 5% and 9.3%, respectively, of gross earnings. Employer contributions required to cover that amount of cost not met by the members' contributions are determined by a biennial actuarial valuation by the system's actuary using the open group aggregate funding method and are expressed as a percentage of gross payroll. The State's share represents 100% of the employer cost for all of the Department's employees enrolled in the Plan.

The Department's payments for normal contribution costs for the year ended June 30, 2001 amounted to 3.94% of the covered payroll for its Group I employees. The Department's normal contributions for the year ended June 30, 2001 were $276,064, an amount equal to the required employer contribution for the period.

Post-employment Health Care Benefits

In addition to providing pension benefits, RSA 21-I:30 specifies that the State provide certain health care insurance benefits for retired employees. These benefits include group hospitalization, hospital medical care, and surgical care. Substantially all of the State's employees may become eligible for these benefits if they reach normal retirement age while working for the State and receive their pensions on a periodic basis rather than a lump sum. These and similar benefits for active employees are authorized by RSA 21-I:30 and are provided through an insurance company whose premium is based on the benefits paid during the year. The State recognizes the cost of providing these benefits by paying the entire annual insurance premium.

During the year ended June 30, 2001, the State paid for the full cost of health insurance premiums for the retired employees and spouses on a pay-as-you-go basis. The cost of the health insurance for Department employees and spouses is a budgeted amount and is paid from an appropriation made to the administrative organization of the New Hampshire Retirement System. Accordingly, the cost of health insurance benefits for retired Department employees and spouses is not included in Department's financial statement.

NOTE 5 – LITIGATION

Interest And Dividends Tax

Smith, et al. v. Department of Revenue Administration

A consolidated action against the Department in which the taxpayers challenged the constitutionality, under both the State and Federal Constitutions, of the interest and dividends tax law in effect from 1989 through June 30, 1994 was tried in the Merrimack County Superior Court in June 2000. That trial resulted in a judgment rejecting the Plaintiffs' broad claims for in excess of $100 million and ordered the State to provide Plaintiffs with a refund of taxes paid on interest and dividends received from out-of-state instruments *only*.

The Plaintiffs appealed the Superior Court's Order to the New Hampshire Supreme Court, claiming that a refund is due for taxes paid on interest received from a broader range of financial instruments. The State cross-appealed, contending that no refund is required. The Supreme Court accepted both appeals, and the matter has been scheduled for briefing in early 2002. A decision is unlikely before June 2002. Should the Supreme Court rule in favor of the Plaintiffs, the matter would be remanded to permit the trial court to determine the amount of any additional refund due. The State estimates that its maximum exposure is unlikely to exceed $5 million.

STATE OF NEW HAMPSHIRE
DEPARTMENT OF REVENUE ADMINISTRATION

SCHEDULE OF BUDGETARY COMPONENTS
GENERAL FUND
FOR THE YEAR ENDED JUNE 30, 2001

	Operating Budget	Supplemental Appropriation Warrants	Balances Brought Forward	Net Transfers In/(Out)	Budget
Revenues					
Unrestricted Revenues					
Business Profits Tax	$ 175,000,000	$ -0-	$ -0-	$ -0-	$ 175,000,000
Meals And Rooms/Car Rental Tax	157,000,000	-0-	-0-	-0-	157,000,000
Business Enterprise Tax	77,200,000	-0-	-0-	-0-	77,200,000
Tobacco Tax	74,800,000	-0-	-0-	-0-	74,800,000
Interest And Dividends Tax	70,000,000	-0-	-0-	-0-	70,000,000
Real Estate Transfer Tax	65,000,000	-0-	-0-	-0-	65,000,000
Legacy And Estate Tax	56,000,000	-0-	-0-	-0-	56,000,000
Communication Services Tax	53,000,000	-0-	-0-	-0-	53,000,000
Utility Franchise Tax	10,500,000	-0-	-0-	-0-	10,500,000
Other	6,594,500	-0-	-0-	-0-	6,594,500
Total Unrestricted Revenues	**$ 745,094,500**	**$ -0-**	**$ -0-**	**$ -0-**	**$ 745,094,500**
Restricted Revenues					
Property Appraisal Fees	$ 948,552	$ 34,794	$ -0-	$ -0-	$ 983,346
Flood Control	421,056	-0-	-0-	-0-	421,056
Other	12,000	-0-	-0-	-0-	12,000
Total Restricted Revenues	**$ 1,381,608**	**$ 34,794**	**$ -0-**	**$ -0-**	**$ 1,416,402**
Total Revenue	**$ 746,476,108**	**$ 34,794**	**$ -0-**	**$ -0-**	**$ 746,510,902**
Expenditures					
Audit	$ 3,546,511	$ 106,638	$ 2,118	$ (54,293)	$ 3,600,974
Administration	1,328,628	(25,950)	2,079,505	(35,290)	3,346,893
Property Appraisal	1,632,186	(31,941)	208,417	(9,444)	1,799,218
Municipal Services	1,383,729	17,081	4,898	856	1,406,564
Document Processing	1,387,579	27,748	24,748	(64,670)	1,375,405
Automated Information	950,747	33,700	31,489	(29,573)	986,363
Collections	888,693	(1,496)	12,000	16,933	916,130
Total Expenditures	**$ 11,118,073**	**$ 125,780**	**$ 2,363,175**	**$ (175,481)**	**$ 13,431,547**
Excess (Deficiency) Of Revenues Over (Under) Expenditures	**$ 735,358,035**	**$ (90,986)**	**$ (2,363,175)**	**$ 175,481**	**$ 733,079,355**

STATE OF NEW HAMPSHIRE
DEPARTMENT OF REVENUE ADMINISTRATION

SCHEDULE OF BUDGETARY COMPONENTS
EDUCATION TRUST FUND
FOR THE YEAR ENDED JUNE 30, 2001

	Operating Budget	Supplemental Appropriation Warrants	Balances Brought Forward	Net Transfers In/(Out)	Budget
Revenues					
Unrestricted Revenues					
Business Profits Tax	$ 15,800,000	$ -0-	$ -0-	$ -0-	$ 15,800,000
Meals And Rooms/Car Rental Tax	10,300,000	-0-	-0-	-0-	10,300,000
Business Enterprise Tax	36,700,000	-0-	-0-	-0-	36,700,000
Tobacco Tax	27,800,000	-0-	-0-	-0-	27,800,000
Real Estate Transfer Tax	26,800,000	-0-	-0-	-0-	26,800,000
Statewide Property Tax	442,064,000	-0-	-0-	-0-	442,064,000
Utility Property Tax	23,900,000	-0-	-0-	-0-	23,900,000
Total Revenue	**$ 583,364,000**	**$ -0-**	**$ -0-**	**$ -0-**	**$ 583,364,000**
Expenditures					
Hardship Relief	-0-	769,014	71,744	-0-	840,758
Total Expenditures	**$ -0-**	**$ 769,014**	**$ 71,744**	**$ -0-**	**$ 840,758**
Excess (Deficiency) Of Revenues Over (Under) Expenditures	**$ 583,364,000**	**$ (769,014)**	**$ (71,744)**	**$ -0-**	**$ 582,523,242**

APPENDIX

CURRENT STATUS OF PRIOR AUDIT FINDINGS

The following is a summary, as of January 23, 2002, of the status of the observation contained in the audit report of the Department of Revenue Administration for the fiscal year ended June 30, 1995, this observation was a carry forward from our previous audit of the Department for the fiscal year ended June 30, 1992. A copy of the prior report can be obtained from the Office of Legislative Budget Assistant, Audit Division, 107 North Main Street, State House Room 102, Concord, NH 03301-4906.

Management Issues	**Status**
1. Prior Audit Observation	
• Tax Notice System	● ● ●
• Matching Information With Other Tax Authorities	● ● ●

Status Key

Fully Resolved	● ● ●
Substantially Resolved	● ● ○
Partially Resolved	● ○ ○
Unresolved	○ ○ ○

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