STATE OF NEW HAMPSHIRE
INSURANCE DEPARTMENT

FINANCIAL AND COMPLIANCE
AUDIT REPORT
FOR THE YEAR ENDED
JUNE 30, 2000

STATE OF NEW HAMPSHIRE
INSURANCE DEPARTMENT

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STATE OF NEW HAMPSHIRE
INSURANCE DEPARTMENT

INTRODUCTION

Organization

The Insurance Department (Department) was established as an independent regulatory agency in 1851. The Department is under the executive direction of a commissioner who is appointed by the Governor, with the advice and consent of the Council, to a five-year term. In addition, the commissioner is authorized to appoint a deputy commissioner, subject to the approval of the Governor, to a five-year term. An assistant commissioner, director of examinations, actuary, workers' compensation analyst, health care policy analyst, health care statistician, and legal counsel are appointed by the commissioner to aid in the enforcement and execution of the insurance laws of the State.

At June 30, 2000, the Department employed 51 classified and seven unclassified employees and was organized into the following four divisions: Administration, Consumer Services, Regulatory Compliance, and Licensing and Examinations. At June 30, 2000, the Department also had oral agreements with 14 insurance examiners whom the Department regards as independent contractors. The Department underwent a reorganization during the fiscal year ended June 30, 2000. Prior to January 3, 2000, the Department was organized into seven divisions including: Administration, Consumer Services, Licensing, Examination, Life Accident and Health, Property and Casualty, and Fraud.

Responsibilities

The Department's responsibilities are enumerated in Title 37 of the Revised Statutes Annotated (RSA) and include, but are not limited to, the following:

- processing annual insurance company financial statements, premium tax returns, and collecting related premium tax revenues;
- processing new and renewal license applications for insurance companies, agents, brokers, adjusters, and consultants, and collecting the related licensing revenues;
- determining and enforcing statutory compliance with insurance laws, rules, and regulations;
- performing financial and market conduct examinations of licensed insurance companies to determine the company's financial condition, fulfillment of contractual obligations, and/or compliance with applicable laws;
- providing consumer assistance with complaints, inquiries, and resolutions; and
- regulating all segments of the insurance industry as it performs in the marketplace, particularly in the treatment of policyholders and claimants.

Funding

The Department is funded by appropriations in the State's General Fund. The cost of administering the Department is recovered through an administrative assessment and examination billings. The assessment is levied on insurance companies domiciled in the State and covers the administrative costs of operating the Department. The assessment is collected in advance on May 1 of each year. Examination costs are billed directly to the companies examined during the year. Fiscal year 2000 appropriations combined with supplemental warrants, balances forward, and transfers resulted in spending authority of $4,119,380 in the General Fund. Estimated restricted revenue combined with supplemental warrants and balances forward resulted in anticipated fiscal year 2000 restricted revenue of $3,689,211 in the General Fund. Fiscal year 2000 estimated unrestricted revenue totaled $63,005,500. Premium tax revenues for fiscal years 1995 through 2000 and total fiscal year 2000 revenues collected by type are presented graphically on page three. Financial activity for the Department for the year ended June 30, 2000 is summarized below:

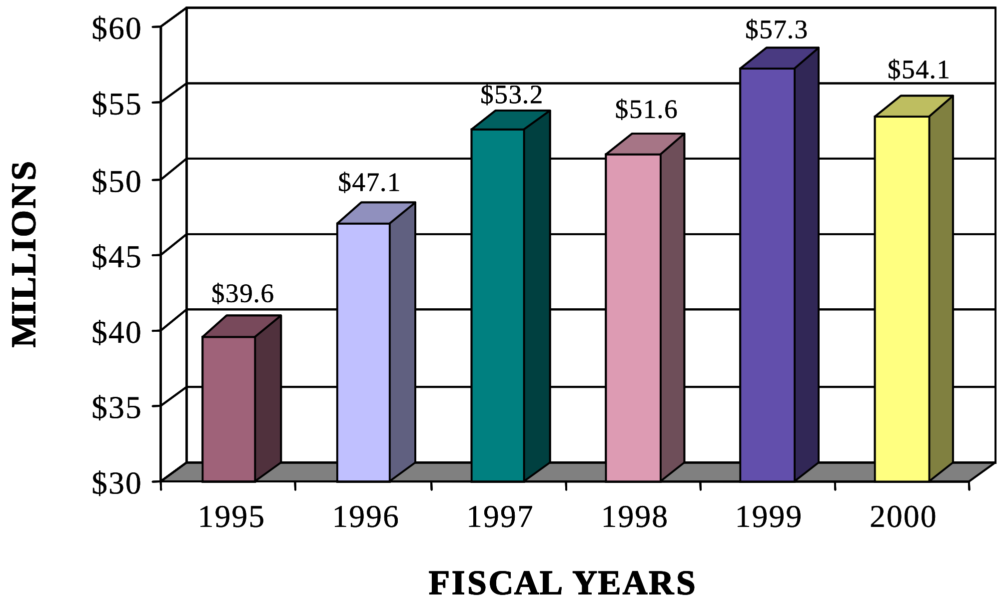
Summary Of Revenues And Expenditures
For The Year Ended June 30, 2000

	General Fund
Unrestricted Revenues	$ 59,162,224
Restricted Revenues	4,345,372
Total Revenues	**$63,507,596**
Expenditures	**$ 4,297,383**
Excess (Deficiency) Of Revenues Over(Under) Expenditures	**$59,210,213**

Prior Audit

The most recent prior financial and compliance audit of the Department was for the eighteen months ended December 31, 1994. The appendix to this report on page 53 contains a summary of the current status of the observations 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.

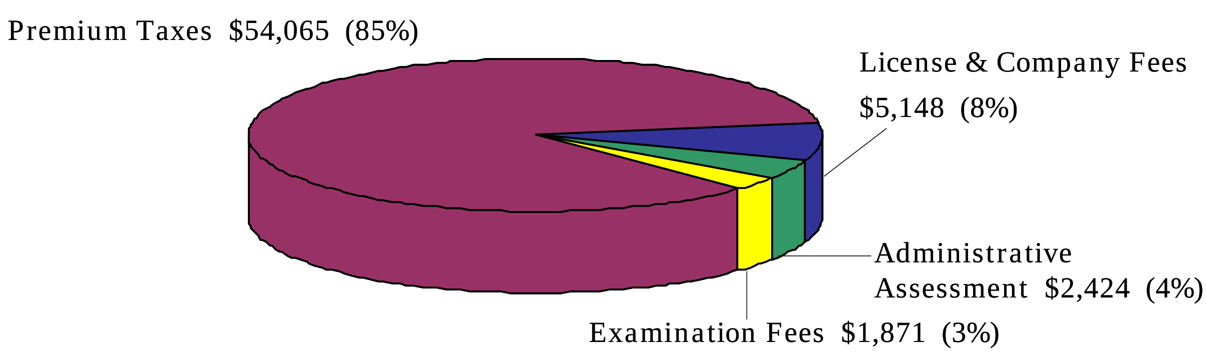
INSURANCE DEPARTMENT
PREMIUM TAX REVENUES
FISCAL YEARS 1995 - 2000



Source: FY 1995 – 2000 Unrestricted Revenue Reports

GENERAL FUND – RESTRICTED AND UNRESTRICTED REVENUES
YEAR ENDED JUNE 30, 2000

(Amounts Shown In Thousands)



TOTAL REVENUES $63,508

Source: Statement Of Revenues And Expenditures – Budget And Actual

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. As part of obtaining reasonable assurance about whether the financial statement is free from material misstatement, we considered the effectiveness of the internal controls in place at the Department 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:

- Internal controls,
- Revenues and appropriations,
- Expenditures,
- Equipment, and
- State compliance.

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 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 Statement Of Revenues And Expenditures – Budget And Actual – General Fund of the New Hampshire Insurance Department for the year ended June 30, 2000, and have issued our report thereon dated May 31, 2001, which was qualified with respect to the lack of presentation of the financial position of the Department in the General Fund and a limitation on the scope of our audit caused by the lack of documentation to support the amounts reported for fixed assets. Except as discussed in the preceding sentence, we conducted our audit in accordance with generally accepted auditing standards 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 Insurance Department'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. 15 through No. 18 of this report.

Internal Control Over Financial Reporting

In planning and performing our audit, we considered the Insurance Department'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 Insurance Department'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. 14 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, of the reportable conditions described above, we consider Observation No. 1 to be 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 Insurance Department 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

May 31, 2001

Internal Control Comments
Examination Division - Material Weakness

Observation No. 1 – Inadequate Review Of Premium Tax Returns Demonstrates Need For Additional Staff And Audit Function

Observation:

The errors, noncompliance issues, inconsistencies, and lack of supporting documentation noted during our review of 30 premium tax returns demonstrates the need for additional staff resources, including an internal audit function in the Department's premium tax area. During fiscal year 2000, premium taxes raised $54.1 million in general fund unrestricted revenue. While we were able to conclude that premium tax revenues were fairly stated for fiscal year 2000, we believe there was a material weakness in the premium tax area during our audit period.

The organizational structure of the premium tax area allows one individual to perform all premium tax duties with essentially no management oversight. During fiscal year 2000, one insurance taxation officer was solely responsible for processing over 1,400 calendar year 1999 premium tax returns, which accounted for approximately $54.1 million, or 85%, of the Department's total revenues. The processing of premium tax returns encompasses a variety of duties including recalculating taxes due, implementing retaliatory tax provisions, ensuring compliance with numerous Department statutes and regulations, ensuring tax credits and deductions from gross premiums are adequately supported, processing quarterly estimated tax payments, etc.

The insurance taxation officer's job description states that responsibilities shall include **audits** (emphasis added) of annual tax returns and financial statements. Our procedures revealed that the Department did not have an effective audit function in place for premium tax returns, especially in the area of health maintenance organizations (HMOs). A thorough audit/review of tax returns would have detected many of the errors we noted. The Department reported that, due to timing constraints, it was often unable to perform audits of premium tax returns which resulted in the Department accepting significant risks regarding the accuracy of the amounts reported on the tax returns.

During our audit, it became apparent to us that the Department was placing undue reliance upon one employee. The current structure of the Department's premium tax area in combination with the technical nature of the insurance industry and related laws, rules, and regulations is conducive to an environment that allows for errors to occur and go undetected in the normal course of business as one person appears to be in control of/responsible for the entire operation. We question the Department's ability to process premium tax returns without significant disruption in operations if the current insurance taxation officer were to terminate employment with the Department.

Tax returns are the primary supporting documentation for the $54.1 million in premium tax revenues collected by the Department during fiscal year 2000. An effective audit process for premium tax returns and accompanying supporting documentation is critical to ensure the accuracy of the reported amounts and compliance with Department statutes.

Observation No. 1 – Inadequate Review Of Premium Tax Returns Demonstrates Need For Additional Staff And Audit Function (Continued)

Recommendation:

The Department should reevaluate the current structure of its premium tax area to determine if sufficient resources have been dedicated to support management's intentions with respect to review procedures for premium tax returns and the ultimate collection of significant State revenue. Points of consideration could include whether or not the current structure effectively reduces risks of errors or frauds in the accounting records to an acceptable level, whether or not the Department is effectively determining the accuracy of the reported tax return amounts, and whether the Department has sufficiently cross-trained employees so that it is not overly reliant upon one individual.

The Department may want to consider utilizing existing insurance company examiners to perform audits/reviews of premium tax returns and communicating findings to the insurance taxation officer. Additionally, the Department may wish to consult with the Department of Revenue Administration (DRA) to investigate the nature of DRAs audit functions for tax returns.

Auditee Response:

While the Department concurs that a material weakness existed during fiscal year 2000, there is no ongoing material weakness.

The Department did not have the benefit of a clerk typist to keypunch the premium tax forms. There was no initial review by the taxation officer and no review by a senior and/or management person. The taxation officer keypunched all premium tax forms without assistance and initial review was cursory. Hence, some minor irregularities went undetected. However, the electronic spreadsheet continued to provide an independent calculation of all monetary items included on the premium tax form. As a result of personnel deficiencies the secondary review/audit was not satisfactorily completed.

On December 11, 2000, responsive to preliminary feedback from the Audit Team, management transferred the taxation officer to the administrative section of the Department. As of this date, the premium tax collection function has been reinforced with the experienced and capable support of a senior examiner with substantial experience in federal and state taxation pertinent to insurance companies.

While it is true that internal controls and accounting procedures deteriorated during calendar year 2000, any material abnormalities in this calendar year would most certainly be detected in subsequent calendar years. Should a company have a material error understating its tax liability, this condition would normally trigger a refund of estimated payments. Current review procedure involves the review of tax returns for a five year period prior to the year of the refund. Should an anomaly have occurred during fiscal year 2000 that involved a refund, the anomaly would have been detected during the review and approval process for refunds.

Observation No. 1 – Inadequate Review Of Premium Tax Returns Demonstrates Need For Additional Staff And Audit Function (Continued)

Auditee Response (Continued):

The methodology for the receipt of premium tax forms due March 1, 2001, consisted of two individuals reviewing the tax forms and inputting data into the premium tax database. The program provides an automatic calculation of all premium tax return monetary items, and a recalculation of the tax. Any clerical errors made by the company are corrected at this point prior to further processing of the data.

In addition to the clerical accuracy check by the program, the two individuals involved conducted a preliminary review of each tax return prior to inputting the data into the database. A review was made for all required documents, and adjustments made if such documents were not included in the filing.

As of March 31, 2001, all premiums tax returns had been subjected to an initial review for clerical accuracy, required documents, appropriate tax rates and taxable premiums. Any questionable items were individually reviewed. In addition, the electronic files that had been completed for Life, Property & Casualty, and Medical companies filing premium tax returns provided an additional resource for the testing of all calculations included in the return and have the capability to provide a NH summary of the tax return in those cases in which changes and/or corrections were made to the premium tax return.

Examination Division - Other Reportable Conditions

Observation No. 2 – Examiner Hours Worked And Travel Expenses Should Be Subject To A Documented Review Procedure

Observation:

The Department does not consistently perform and document a review and approval of examiner hours and expenses charged to insurance companies.

In accordance with RSA 400-A:37, the Department bills insurance companies undergoing financial or market conduct examinations to recover the cost of administering the Department's Examination Division (Division). During fiscal year 2000, the Department collected approximately $1.2 million from companies that were examined. A majority of the Division's administration costs are tracked through the State accounting system and include salaries, benefits, and current expenses. These costs are allocated to each insurance company under examination based upon the number of hours worked on the examination multiplied by a per-diem rate calculated by the Division. Examiner travel expenses are not included in the per-diem rate calculation, however, these expenses are necessary costs of conducting an examination. The examiner bills the company directly to obtain reimbursement for travel expenses incurred.

During our review of the examination billing process, we noted the following issues relating to salary and travel expenditures incurred by the Division:

- State employee and contract examiners are not required to sign their weekly timesheets to evidence their certification of and accountability for the hours worked on examinations. The weekly timesheets are used by the Division to compile quarterly hours worked which become an integral component of the quarterly per-diem rate calculation.

- The hours worked by contract examiners on examinations are not reviewed or approved by a supervisor prior to inclusion in the quarterly insurance company billings. However, the Division does review and approve State employee examiner hours.

- State employee and contract examiner travel expenses billed to insurance companies under examination are not reviewed for reasonableness and approved by the Division prior to submission to the insurance companies for reimbursement. In accordance with RSA 400-A:37, VIII, examiners are permitted to receive reimbursement for travel expenses directly from the company under examination.

Procedures to ensure that employees document and supervisors review and approve, in writing, examiner certification of and accountability for hours worked on the job are crucial in the examination billing process as insurance companies are relying on the integrity of the hours worked when making payment. This documented review and approval procedure is as equally important for examiner travel expenses.

Observation No. 2 – Examiner Hours Worked And Travel Expenses Should Be Subject To A Documented Review Procedure (Continued)

Recommendation:

The Department should establish procedures to ensure that:

- all State employee and contract examiners sign their weekly timesheets. In addition, the Department should institute a procedure for reviewing quarterly hours worked by contract examiners that is consistent with the current procedure in place for State employee examiners. Signed timesheets and documented supervisory review and approval of hours worked provide accountability and help to ensure compliance with RSA 400-A:37, VII.

- all examiner travel expenses receive supervisory review and approval prior to the examiner's submission of the expenses to insurance companies for reimbursement. The supervisor's review and approval should be documented for accountability purposes.

Auditee Response:

We concur. Current practice by the market conduct and financial examiners is for the examiner-in-charge to review and approve timesheets and travel expenses on location at an examination site and to forward documents to the central office for review. See auditee response to Observation No. 23.

Observation No. 3 – Administrative Assessment And Examination Billing Processes Should Be Improved

Observation:

The Department's Examination Division (Division) does not document its review and approval of the annual administrative assessment (assessment) and quarterly examination billings to insurance companies nor does the Department initiate efforts to collect late payments from delinquent companies in a timely manner.

In accordance with RSA 400-A:39, the Department bills New Hampshire domestic insurance companies annually for their proportionate share of the cost of operating the Department's Administrative Division. As noted in Observation No. 2, the Department also bills insurance companies undergoing financial or market conduct examinations for the cost of the Department's Examination Division pursuant to RSA 400-A:37.

Division procedures for calculating the assessment and examination billings involve the accumulation of data from various sources, the completion of detailed spreadsheets, and for examination billings, the compilation of hours worked by examiners. Finance assistants and insurance company examiners are responsible for accumulating and compiling the data used in the calculation of the billings. The billings are prepared by the finance assistants.

Observation No. 3 – Administrative Assessment And Examination Billing Processes Should Be Improved (Continued)

Observation (Continued):

During our review of the assessment and examination billing processes, we noted the following:

- Although Division personnel reported that assessment and examination billings and related supporting documentation are reviewed and approved by Division management prior to submission to the insurance companies, we were unable to determine if this review and approval procedure took place during fiscal year 2000 since there was no documentation on file at the Department to evidence that a review had occurred.

- The Department does not initiate efforts to collect late assessment and examination payments from delinquent insurance companies until 30 days after the due date of the invoices which appears to be an excessive delay in pursuing collection efforts. The Department's delay in pursuing collection efforts may have contributed to the insurance companies' apparent disregard of the 30-day payment deadline stated on the invoices as noted below:

  - Four of nine (44%) assessment receipts and three of four (75%) examination receipts tested were not collected timely. The assessment receipts ranged from five to 25 days late and the examination receipts ranged from nine to 31 days late.

Written evidence of management's review and approval will document compliance with State statutes and adherence to proper internal controls. Proper internal controls also include procedures to ensure that revenues are collected and recorded in a timely manner.

Recommendation:

The Department should establish procedures to ensure that:

- documentation of management's review and approval of administrative assessment and examination billings and related supporting documentation is maintained on file at the Department.

- late administrative assessment and examination payments are pursued in a more timely manner. These procedures will provide the controls needed to administer the recent modification to RSA 400-A:39 which requires foreign insurance companies to pay a portion of the administrative assessment.

Auditee Response:

We concur, but note that Senate Bill 40 (Chapter 52, 2001) substantially modifies RSA 400-A:39 and dramatically alters the method of assessing insurance companies. The new law provides regulations for the billing and collection of this assessment. The new law also contains provisions for late payment penalties and interest.

Observation No. 3 – Administrative Assessment And Examination Billing Processes Should Be Improved (Continued)

Auditee Response (Continued):

For examination billings the Department has implemented a revised process effective July 1, 2001. Each examiner will have a personal electronic timekeeping file. This file will produce weekly timesheets and expense reports that will be reviewed and approved by the examiner-in-charge prior to submission to the company. The same files will provide the input for quarterly time files for the financial and market conduct sections. The end product will be a quarterly summary of time and expenses for quarterly billing purposes. Companies will be re-billed at thirty and sixty days. Any amounts remaining outstanding at ninety days will be returned to the respective section with copies to the Commissioner and Assistant Commissioner.

Observation No. 4 – Written Policy Needed For Late Premium Tax Filers

Observation:

The Department has no written policy in place for imposing or waiving penalties on licensed insurance companies that file their premium tax returns and tax payments late.

RSA 400-A:32, II, establishes quarterly due dates of on or before March 1, June 1, September 1, and December 1 of each year for estimated premium tax payments remitted by licensed insurance companies. RSA 400-A:31, I, establishes a due date of on or before March 1 of each year for the tax return.

The Department gives licensed insurance companies a five day grace period for late filing without assessing a late filing penalty. RSA 400-A:32, IV, requires the Department to impose a late filing penalty equal to ten percent of the tax amount due on insurance companies that <u>intentionally</u> fail to remit the proper tax when due. The "intent" of the late filing is used to determine if a penalty is waived or imposed by the Department. Late filers are handled by the Department on a case-by-case basis.

The Department's internally established five-day grace period policy and method of determining "intent" for late filers has not been formalized by the Department in writing. Written policies can help ensure consistency in processing transactions and adherence to established controls.

Recommendation:

The Department should establish and adhere to a written policy for late premium tax filers. This policy should address the Department's internally established grace period provisions for late premium tax filers and the Department's method for determining "intent" of late filing insurance companies when imposing or waiving a late filing penalty.

Observation No. 4 – Written Policy Needed For Late Premium Tax Filers (Continued)

Auditee Response:

We concur in part. While we concur that the Department policy should be reduced to writing, we do not concur that a more equitable system would result from a strict adherence to a written policy. The ten percent late payment fee is necessary as leverage to motivate companies to pay the premium tax. In all cases common sense judgment should be applied to provide the equitable relief appropriate for some cases.

The imposition of the ten percent late fee is applied by the tax officer. The fact that one individual determines whether the late fee will be added provides an element of even-handedness that would not be true if two or more individuals were involved.

The Department would like to maintain discretion with regard to the application of this provision of law. The Department will confer with the Attorney General with respect to the definition of “intentionally”.

Licensing Division – Other Reportable Conditions

Observation No. 5 – Licensing Receipts Should Be Recorded And Deposited More Timely And Handling Of Receipts Should Be Limited

Observation:

Licensing receipts that are collected over-the-counter or received through the mail by the Department are not immediately recorded on a Record of Daily Receipts (Form A-15) in accordance with N.H. Admin Rule, Adm 402.02 (expired), the receipts are not always deposited daily in accordance with RSA 6:11, II, and the handling of licensing receipts by Department personnel is excessive.

The Department's Licensing Division (Division) processed over 35,000 agent, broker, adjuster, and consultant licenses and collected approximately $4.2 million in license fees during fiscal year 2000. License applications and the corresponding checks received through the mail or collected over-the-counter are immediately forwarded to the Division for a review prior to the business office recording the cash receipts on a Form A-15. The Division's review is performed to ensure that the correct fees and required documentation are included with the application.

The handling of licensing receipts by the Department is excessive as checks often change hands three or four times prior to their initial recording by the business office. The checks are initially received by a mail clerk, then are forwarded to a licensing clerk for input into the licensing database, then are sometimes forwarded to the licensing supervisor for review, and are finally remitted to the business office for preparation of the Form A-15 and deposit. Checks pending processing by the Division are sometimes retained in a fireproof safe for several days prior to being remitted to the business office for initial recording on a Form A-15 and deposit into the Department's bank account.

During our testing of licensing revenue, we noted the following:

- Ten of the 16 (63%) licensing receipts tested through the State accounting system were not date stamped and the timeliness of processing could not be determined (see Observation No. 11). The six licensing receipts that were date stamped were not deposited timely by the business office. The untimely deposits ranged from one to 26 business days late.

N.H. Admin Rule, Adm 402.02 (expired) requires revenue to be recorded daily on a Form A-15 as it is received and at the point of receipt. 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 Department's Licensing Division typically collects more than $100 per day and, thus, receipts collected by that Division should be deposited daily in accordance with statute.

Observation No. 5 – Licensing Receipts Should Be Recorded And Deposited More Timely And Handling Of Receipts Should Be Limited (Continued)

Recommendation:

The Department should record all licensing receipts on a Form A-15 when received and deposit all licensing receipts daily. This will help to ensure that errors or fraud are detected and corrected, and licensing receipts are deposited, by the Department in a timely manner.

The Department should also keep the handling of licensing receipts to a minimum to reduce the risk that assets could be lost, stolen, or misappropriated. Alternative procedures should be implemented by the Department whereby applications could be reviewed by licensing personnel without the physical checks attached to the applications. If the Department wishes to continue its current practice of remitting licensing receipts to Licensing Division personnel prior to recording of these receipts by the business office, it should understand the associated risks and consequences of maintaining this practice.

Auditee Response:

The Department concurs that a very important control procedure requires that all receipts be deposited intact daily.

Mail is received at the Department in the forenoon period. The minimum processing time required for cash receipts received by mail is one full eight hour day. It is impossible to receive, process, and deposit cash received (primarily checks) before closing on the day of receipt. Therefore, it is almost impossible to make a same day deposit.

The Department is currently in the process of phasing in a Producer Licensing Law to replace the Agents' Licensing Law. The complete implementation of this process will have a positive impact on the current Licensing process. It will take up to twenty-four months to complete the transition to the Producer Licensing procedure. As part of the transition to the Producer Licensing Law, the Department will review the flow of documents and cash with the intent and goal of recording and depositing all receipts intact within one twenty-four hour period.

Observation No. 6 – Duties Should Be Properly Segregated In Licensing Process

Observation:

Employee duties in the Department's Licensing Division (Division) are not properly segregated.

Two Division employees perform the incompatible functions of approving licenses, handling the cash receipts for those licenses, and recording the license transactions in the Division's database.

Observation No. 6 – Duties Should Be Properly Segregated In Licensing Process (Continued)

Observation (Continued):

The *State of New Hampshire Internal Controls Tool Kit* prepared by the Department of Administrative Services lists three incompatible functions in the revenue process that must be segregated for proper internal controls: 1) authorization, 2) custody of assets, and 3) recording or reporting of transactions. The two licensing employees discussed above have the ability to perform all three of the incompatible functions.

The improper segregation of duties in the licensing process increases the risk that fraud or errors could occur and not be detected and corrected by the Department in a timely manner.

Recommendation:

The Department should properly segregate duties in the licensing process. The duties of approving licenses, handling cash receipts, and recording licenses into the licensing database should be reassigned to reduce the risk that fraud or errors could occur and not be detected and corrected by the Department in a timely manner.

Auditee Response:

We concur. The Department concurs with this recommendation, but notes that effective segregation cannot realistically be accomplished until the new producer licensing law has been fully implemented. At that time, the Department will accommodate this recommendation within the personnel constraints placed upon this section by the Department budget. In the meantime, the Department will analyze if there are ways to increase the segregation of duties while maintaining an adequate workflow.

Observation No. 7 – Licensing Employee Access Levels Should Be Reviewed

Observation:

The Department has not established effective controls within the licensing computer system to limit Licensing Division (Division) employee access to necessary functions based upon current job responsibilities.

The Division supervisor and four licensing clerks all have the same level of access to various functions within the licensing computer system. In addition to having the ability to add, edit, delete, and browse license records in the licensing computer, all Division employees also have the ability to approve licenses for agents, brokers, adjusters, and consultants. Three of the five Division employees do not approve licenses in the normal course of their assigned duties and, thus, should not have access to the license approval function.

Observation No. 7 – Licensing Employee Access Levels Should Be Reviewed (Continued)

Observation (Continued):

Basic information system's access controls, used to safeguard systems and data, require that access be restricted and controlled to ensure protection from both intentional or unintentional misuse or loss.

Recommendation:

The Department should review licensing employee access levels within the licensing computer system for appropriateness. The Department should eliminate access permissions that are determined to be inappropriate based upon the employees' current job responsibilities. Procedures should be implemented to periodically monitor access levels based upon changes in job responsibilities.

Auditee Response:

We concur. The Department is currently undergoing a change-over to a new licensing system initiated by RSA 402-J and separate authorization levels were deactivated as a source of system malfunction during the on-going programming and debugging process. Once the transition to the new licensing system has been completed, access levels will be reviewed and adjusted accordingly. It should be noted, however, that during this transition process the system only allows for the printing of licenses once a day and that the supervisor performs this function and reviews every license printed.

Administration Division – Other Reportable Conditions

Observation No. 8 – Formal Fraud Deterrence And Detection Program Should Be Established

Observation:

The Department has no formal fraud deterrence and detection program. The reported July 2000 fraud in the Licensing Division involving an employee allegedly embezzling approximately $700 indicates a need for a formal fraud deterrence and detection program.

Fraud encompasses an array of irregularities and illegal acts characterized by intentional deception. Persons outside or inside the organization can perpetrate it for the benefit, or to the detriment, of the organization.

Deterrence consists of those actions taken to discourage the perpetration of fraud and limit the exposure if fraud does occur. The principal mechanism for deterring fraud is the establishment of effective internal controls. Management has the primary responsibility for establishing and maintaining controls.

Detection consists of identifying indicators of fraud sufficient to warrant recommending an investigation. These indicators may arise as a result of controls established by management, tests conducted by internal auditors, and other sources both within and outside the entity.

Management is responsible for assisting in the deterrence and detection of fraud by examining and evaluating the adequacy and effectiveness of controls, commensurate with the extent of the potential exposure/risk in the various segments of an entity's operations. In carrying out this responsibility, management should, for example, determine whether:

- the organizational environment fosters control consciousness;
- realistic organizational goals and objectives are set;
- written policies (e.g. code of conduct, fraud reporting policy) exist that describe prohibited activities and the action required whenever violations are discovered;
- appropriate authorization policies for transactions are established and maintained;
- policies, practices, procedures, reports, and other mechanisms are developed to monitor activities and safeguard assets, particularly in high-risk areas;
- communication channels are developed to provide management with adequate and reliable information; and
- recommendations are made for the establishment or enhancement of cost effective controls to help deter fraud.

As noted above, the principal mechanism for deterring and detecting fraud is the establishment and operation of effective controls. An integral factor of an entity's control environment is the control consciousness of its people. Management is responsible for establishing controls and monitoring compliance, and is the primary influence on the degree of importance its employees attach to controls. High control consciousness at all levels of an entity is a significant factor in deterring fraud.

Observation No. 8 – Formal Fraud Deterrence And Detection Program Should Be Established (Continued)

Recommendation:

The Department should establish a formal fraud deterrence and detection program. Establishing a formal program should help limit the Department's exposure to fraud and should promote timely detection. The Department should also take measures to foster a high degree of control consciousness among its employees and ensure that its employees understand that adhering to controls is a primary concern of management.

Auditee Response:

We concur. The Department is in the process of developing an appropriate fraud deterrence and detection program. Inherent to this program would be a fraud reporting program. See auditee response to Observation No. 9. Opportunities for fraud within the Department are limited to issues related to cash receipts, property inventories and property surplus.

The Department has established procedures for recording all cash received by licensing, verified and initialed by accounting on a daily basis and locked in a safe pursuant to a Memorandum issued July 19, 2000. More generally, the Department will engage in enhanced employee sensitivity to fraud awareness and appropriate reporting policies in all areas.

Observation No. 9 – Formal Fraud Reporting Policy Should Be Established

Observation:

The Department has no formal fraud reporting policy. The lack of a written policy may delay the reporting of fraudulent activity.

The attributes of an effective fraud reporting policy include:

- the policy is in writing;
- the reporting policy describes fraudulent activities and the actions required when fraud is suspected or detected;
- the policy is communicated to all employees; and
- management obtains written assurance from each employee that the policy and related reporting mechanism is understood.

The effectiveness of a fraud reporting policy is enhanced when employees have a clear understanding of fraud indicators and what constitutes a fraudulent act. It is important that the reporting procedure is non-threatening for the reporter and provides for the reasonable protection of all parties.

Observation No. 9 – Formal Fraud Reporting Policy Should Be Established (Continued)

Recommendation:

The Department should establish a formal fraud reporting policy and provide its employees with fraud awareness training. The Department should take measures to ensure that the policy facilitates and encourages reporting and protects all parties involved.

Auditee Response:

We concur. The Department will develop a formal fraud reporting policy for the Department. See auditee response to Observation No. 8.

Observation No. 10 – Equipment Should Be Surplused In A Timely Manner

Observation:

The Department has not established policies and procedures to surplus obsolete or unused equipment in a timely manner.

A $2,176 computer selected for testing was identified by the Department as obsolete during May 2000. This computer was included in a pile of obsolete equipment items, valued at approximately $8,200, near the back door of the building. The obsolete equipment items were not properly safeguarded as evidenced by an incident occurring at the Department in the Fall of 2000 when some components of computer memory were stolen from the pile of obsolete equipment. The Department did not plan on surplusing the obsolete inventory until January 2001, over six months after the items had been declared unusable/obsolete.

RSA 21-I:12 and N.H. Admin Rule, Adm 607 describe the State's surplus property program. According to Adm 607.01, all governmental units shall dispose of all surplus or unused items. All replaced or surplus items shall immediately be declared surplus on a declaration of surplus Form P-11.

Recommendation:

The Department should establish procedures to surplus obsolete or unusable equipment items in a timely manner. These procedures should include the proper safeguarding of all equipment items including those awaiting surplus.

Auditee Response:

We concur. The Department currently complies with RSA 21-I:12 and Adm 607.01, whereas, required forms are completed and forwarded to the proper agencies. The Department is charged a transportation fee, therefore, when the Department only has one or two items to be surplused we have held the item until there were more items.

Observation No. 10 – Equipment Should Be Surplused In A Timely Manner (Continued)

Auditee Response (Continued):

The Department will transport items in a timely manner and establish a secure area where equipment pending removal will be retained.

Observation No. 11 – Date-Stamping Policy Should Be Adhered To

Observation:

The Department does not always adhere to its internal policy of date-stamping all documentation received through the mail.

The Department has an unwritten policy of date-stamping all incoming mail. Documents supporting revenue collections and documents requiring timely submission in accordance with statute are reportedly date-stamped upon receipt.

The Department collected approximately $63 million in revenues during fiscal year 2000, a majority of which was received via check through the mail with accompanying supporting documentation (i.e. copy of invoice, licensing application, premium tax return, etc.). We noted the following instances where the Department did not date-stamp documentation supporting revenue collections and timely filings:

- Five of 28 (18%) calendar year 1999 premium tax returns and 18 of 23 (78%) calendar year 1999 annual insurance company financial statements tested were not date-stamped. Thus, we were unable to determine if the tax returns and annual statements were filed timely and whether late filing penalties should have been imposed for insurers that may have filed late.

- For ten of 16 (63%) licensing receipts tested, we were unable to determine if the receipt was deposited by the business office timely as the license renewal listing or license application accompanying the receipt was not date-stamped and no alternative method for determining timely deposit was available.

The Department reported that a cover letter included with the tax return or annual statement may have been date-stamped rather than the original documentation supporting the revenue collection or timely filing. The cover letters were apparently not retained by the Department as evidence of the timely filings.

Strict adherence to a date-stamping policy is crucial for regulatory agencies like the Insurance Department that are responsible for determining statutory compliance with timely filing requirements and imposition of late filing penalties.

Observation No. 11 – Date-Stamping Policy Should Be Adhered To (Continued)

Recommendation:

The Department should strictly adhere to its internal date-stamping policy. At a minimum, the original documentation supporting revenue collection and timely report filing should be date-stamped immediately upon receipt.

Auditee Response:

We concur. The Department will take measures necessary, including the purchase of additional date stamping machines, to accommodate this recommendation.

Observation No. 12 – Expenditure Allocation Methods Should Be Improved

Observation:

The Department incorrectly allocated costs between its Administrative and Examination Divisions during fiscal year 2000.

The Department incurred approximately $4.3 million in expenditures during fiscal year 2000. Department expenditures are allocated to either the Administrative Division or the Examination Division, both of which are funded by insurance companies and not the State's General Fund. New Hampshire domestic insurance companies are billed for the cost of the Administrative Division as required by RSA 400-A:39 and foreign or domestic insurance companies that are examined by the Department are billed for the cost of the Examination Division as outlined in RSA 400-A:37.

During our testing of the Department's fiscal year 2000 expenditures, we noted the following errors:

- In October 1999, the Department paid $5,211 for retiree health insurance and charged the entire cost to the Administrative Division. This appears unusual as three of the 13 (23%) retirees on the invoice worked in the Department's Examination Division prior to retirement. For fiscal year 2000, the Department allocated approximately $11,000 in Examination Division retiree health insurance costs to the Administrative Division.

- During fiscal year 2000, the Department allocated 12% of rent expenditures to the Examination Division and 88% to the Administrative Division. These allocation percentages were based upon the amount of square footage occupied by each Division. Our review of the Department's floor plan indicated that the space occupied by two Examination Division employees was not included in the 12% rent allocation to the Examination Division. It appears the Department should have allocated 14% of the rent to Examination and 86% to Administration. The Department's improper allocation of rent for fiscal year 2000 resulted in the Administrative Division being charged for $2,693 of Examination Division rent expenditures.

Observation No. 12 – Expenditure Allocation Methods Should Be Improved (Continued)

Observation (Continued):

- During fiscal year 2000, all photo copier lease expenditures for the Examination Division were improperly charged to the Administrative Division. A minimum of $1,012 in Examination Division copier lease expenditures were improperly allocated to the Administrative Division for fiscal year 2000.

The above errors resulted in approximately $15,000 of fiscal year 2000 expenditures being improperly allocated to the Administrative Division. The effect of not properly allocating expenditures between Divisions is that insurance companies are not being accurately charged for their proportionate share of Department expenditures. In addition, management may have difficulty budgeting expenditures in the future as the true cost of its expenditure categories is currently unknown.

Recommendation:

The Department should establish procedures to improve its accounting for expenditures. These procedures could include management's thorough review of documentation supporting State payment voucher forms to ensure that expenditures are properly classified and posted to the proper accounts and a periodic review of cost allocation information to ensure that the percentages are kept current with changes in telephone usage, office space, etc.

Auditee Response:

We concur. With respect to the allocation of expenses between the Administrative PAU and the Examination PAU, the Department is in the process of implementing a Cost Center (Functional Job Cost) System for the purpose of developing an activity based costing and budgeting system. This system will provide an accurate accumulation of costs by functional cost center and an equally accurate accumulation of actual costs by PAU. There will be a periodic adjustment to adjust the Administrative PAU and Examination PAU to the cost centers. The objective and intent is to compile accurate costs for each cost center as well as each PAU.

An appropriate methodology for the allocation of all expenditure classifications will be developed. In some cases, this methodology may combine various accounts of both PAUs and allocate the combined expenses to the cost centers.

Observation No. 13 – Standard Operating Procedure Manuals Should Be Established And Updated Regularly

Observation:

During fiscal year 2000, the Department's Licensing Division had no standard operating procedure manual available for employees to use as guidance when processing licenses. The Examination Division had a standard operating procedure manual for processing premium taxes, but the manual was outdated.

- Licensing Division personnel reported that the Division may have had a standard operating procedure manual many years ago, but the manual has not been periodically updated. Five individuals in the Division responsible for processing over 35,000 agent, broker, adjuster, and consultant licenses were without a standard operating procedure manual during fiscal year 2000.

- Examination Division personnel reported that the Division has a premium tax manual, but the manual needs revision as it was last updated more than five years ago. One individual in the Examination Division is responsible for processing over 1,400 premium tax returns annually. If this individual was to terminate employment, we question the Department's ability to efficiently review and process tax returns without an updated manual. An updated manual would help prevent a significant disruption in business operations if personnel changes were to occur.

Nonexistent, or outdated, standard operating procedure manuals could contribute to inconsistencies or inefficiencies in processing transactions, especially if the Department experiences employee turnover in the Licensing or Examination Divisions.

Recommendation:

The Department should take measures to establish or update its standard operating procedure manuals for the Licensing and Examination Divisions to continue to provide consistency and efficiency in processing transactions and useful guidance to both new and existing employees. Once established, procedure manuals should be updated regularly to reflect any changes in procedures.

Auditee Response:

We concur. The Standard Operating Procedures Manual for the Premium Tax Section will be updated. Additionally, once the transition to the new producer licensing system has been completed the Department will update the February 26, 1993 license application procedure manual.

Observation No. 14 – Accounting For Equipment Should Be Improved

Observation:

The Department has not affixed all equipment items costing more than $100 with an inventory identification (ID) tag, documentation is not maintained on file to support the cost of all equipment inventory, and no physical inventory of equipment was performed for fiscal year 2000 contrary to State policy.

We noted the following during our testing of the Department's equipment inventory:

- Two of 40 (5%) equipment items tested were not affixed with an ID tag. One item, a computer, was purchased during May 1998 and an ID tag was affixed to the item subsequent to our inventory observation. The other item, a chair, appeared to have a value of greater than the $100 State threshold for capitalization but was not included in the Department's inventory.

- The Department did not have documentation on file to support five of 20 (25%) equipment items tested. The Department's retention policy does not require supporting documentation to be retained for equipment items over seven years old.

- As of December 8, 2000, the Department had not completed a physical inventory of equipment for fiscal year 2000, reportedly due to staffing constraints. The Department's most recent completed physical inventory of equipment was performed in July 1999 for the fiscal year ended June 30, 1999.

Chapter 7 of *the State of New Hampshire Internal Controls Tool Kit* recommends assets be affixed with a State ID tag when acquired. The *State of New Hampshire Fixed Asset Policies and Procedures Manual* requires agencies to: establish effective controls over fixed assets, take a complete physical inventory of fixed assets at the end of each fiscal year, and keep in a permanent file folder documentation to support the recorded cost of equipment inventory items until the asset is disposed of.

Recommendation:

The Department should adhere to State equipment policies and procedures to ensure that: documentation supporting equipment costs is maintained on file at the Department until the asset is disposed of, a physical count of equipment inventory is completed annually as required, and each equipment item costing more than $100 is properly assigned a separate ID tag.

Auditee Response:

We concur. The Department has established the policy of maintaining a permanent supporting documentation file pertaining to inventory. The Department currently ensures that all acquired items with a value over $100 is assigned an ID tag, however, the value of items such as upgrades to existing computers is added to the value of the computer and the ID tag assigned to it.

Observation No. 14 – Accounting For Equipment Should Be Improved

Auditee Response (Continued):

The Department experienced a unique problem during the period of the audit. In previous fiscal years, the physical inventory has been completed in accordance with the rules of Purchase and Property which concur with Policy N of the State Fixed Asset Policies.

State Compliance Comments

Observation No. 15 – Compensation Payments To Contract Examiners Should Be Made In Compliance With State Statute

Observation:

The Department's normal practice of allowing its contracted insurance company examiners to be compensated directly by the insurance companies under examination is not in compliance with RSA 400-A:37, VIII, which states, "the compensation allowance shall be paid directly to the state." In addition, this practice raises a potential conflict of interest and may create confusion of loyalty between the Department employing the examiners and the examined companies who directly pay the examiners' compensation.

Contract examiners regularly bill the insurance companies undergoing financial or market conduct examinations for their compensation which is paid by the insurance companies directly to the contract examiner. During fiscal year 2000, contract examiners received approximately $623,000 from the insurance companies under examination. None of the contract examiners' compensation was recorded by the Department in the State accounting system as required by State statute.

The Department's lack of compliance with RSA 400-A:37, VIII, resulted in the Department's revenues and expenditures being understated in the State accounting system by approximately $623,000 as of June 30, 2000. The accompanying financial statement has been adjusted to properly reflect contract examiner activity.

Recommendation:

The Department should comply with RSA 400-A:37, VIII, and implement procedures to ensure that all contract examiner compensation payments are paid directly to the State so that the actual cost of the Department's Examination Division is accounted for within the State accounting system. In addition, compliance with the statute will reduce the risk of creating potential conflicts of interest as it must remain clear that the allegiance of the examiner is to the Department and not to the entity being examined and paying the examiner's compensation.

Auditee Response:

We concur in part. Historically, the Department's practice for contract examiner(s) compensation has allowed for the direct payment by the company under examination to the contract examiner(s). That payment is made based upon the time and travel records as noted in Observation No. 3. On a quarterly basis the Department bills the company directly for all time and expenses, including administrative and overhead costs, crediting for payments already made directly to the contract examiner(s), and the company remits the balance directly to the State. Currently, the Department is developing an internal cost basis accounting system that will more accurately track and reflect expenses associated with company examinations and is exploring other payment options, including elimination of the direct payment by companies to the examiner component.

Observation No. 16 – Rules And Regulations Should Be Adopted As Required

Observation:

The Department has not adopted administrative rules or regulations as required by the Department's statutes.

The Department has numerous laws, rules, and regulations that it must comply with. We reviewed Department statutes that require the adoption of administrative rules or regulations and noted the following rules were not adopted as required.

STATUTE	DESCRIPTION OF RULE
RSA 402:30-a	Financial solvency standards, valuation standards, and reporting requirements for investments of domestic insurance companies (excluding life insurance companies)
RSA 402-E:7	Managing General Agents
RSA 402-F:11	Reinsurance Intermediaries
RSA 403-A:12	Disposal of Assets
RSA 403-B:9	Conversion of Mutual Insurers
RSA 415-C:7	Legal Services Insurance
RSA 420-C:6	Preferred Provider Agreements
RSA 420-F:17	Delta Dental Plan
RSA 420-G:14	Portability, availability, and renewability of health coverage

State departments adopt rules and regulations in order to communicate their policies, procedures, and practices to persons both inside and outside the department. Rule making allows for public and legislative oversight of department operations. The lack of required rules and regulations could result in the Department functioning without the proper authority.

Recommendation:

The Department should adopt administrative rules or regulations as required for the statutes noted above. If the Department determines the adoption of rules or regulations is not necessary, the Department should seek to amend or repeal the statute.

Auditee Response:

We concur in part. The Department interprets that some rulemaking authority language provides the Commissioner with discretion as to the necessity of rule promulgation.

Additionally, the Department must meet accreditation standards of the National Association of Insurance Commissioners (NAIC) which requires the adoption of certain model laws and rules. At the present time the Department is fully accredited.

Observation No. 16 lists the following rules and the Department provides comments thereto:

Observation No. 16 – Rules And Regulations Should Be Adopted As Required (Continued)

Auditee Response (Continued):

RSA	*Description*	*Authority*	*Action*
402:30-a	Investments & Reserves NAIC Accreditation Std.	"shall adopt"	Rules that address in part: Ins 2900; Ins 2400; the Department will assess opportunity for statutory revision; no NAIC model rule exists
402-E:7	Managing General Agents NAIC Accreditation Std.	"shall adopt rules, necessary"	Discretionary interpretation – the Department does not contemplate rulemaking at the present time; no NAIC model rule exists
402-F:11	Reinsurance Intermediaries NAIC Accreditation Std.	"shall adopt"	The Department will assess opportunity for statutory revision; no NAIC model rule exists
403-A:12	Disposal of Assets	"shall, prescribe the rules necessary"	Discretionary interpretation – the Department does not contemplate rulemaking at the present time.
403-B:9	Conversion of Mutual Insurers	"shall adopt rules, as may be necessary"	Discretionary interpretation – the Department does not contemplate rulemaking at the present time.
415-C:7	Legal Services Insurance	"shall adopt rules as are necessary"	Discretionary interpretation – the Department does not contemplate rulemaking at the present time.
420-C:6	Preferred Provider Agreements	"shall adopt"	The Department will assess opportunity for statutory change.
420-F:17	Delta Dental Plan	"shall adopt rules which are reasonable and necessary"	Discretionary interpretation – the Department does not contemplate rulemaking at the present time.
420-G:14	Portability etal. health coverage	"shall adopt rules, necessary"	Rules that address in part: Ins 2200, Ins 2700; Discretionary interpretation – the Department does not contemplate rulemaking at the present time.

Observation No. 17 – Organizational Rules Should Be Revised To Reflect Current Operating Structure

Observation:

The administrative rule describing the various divisions within the Department is inconsistent with the Department's current organizational structure.

During fiscal year 2000, the Department underwent a reorganization. On January 3, 2000, the Department began operating under the following four divisions:

- Administration
- Consumer Services
- Regulatory Compliance
- Licensing and Examination

N.H. Admin Rule, Ins 102 describes the organization of the Department. Pursuant to N.H. Admin Rule, Ins 102, the Department is organized into the following seven divisions:

- Administration
- Consumer Services
- Licensing
- Examination
- Life, Accident and Health
- Property and Casualty
- Fraud

The Department's current administrative rule appears to be outdated as it does not reflect the Department's current organizational structure.

Recommendation:

The Department should revise N.H. Admin Rule, Ins 102 to reflect the four divisions currently operating at the Department. An administrative rule that reflects the Department's current organizational structure will help to ensure clear lines of authority and responsibility and timely reporting of information to the appropriate personnel.

Auditee Response:

We concur. The Department's organizational rules currently reflect the following: Licensing Division; Consumer Services Division; Life, Accident & Health Division; Property & Casualty Division; Fraud Division; Examination Division; Administrative Division. The Department will amend Ins 102 in a future rulemaking proceeding to properly reflect its new organizational structure and establish clarity for authority, responsibility and reporting.

Observation No. 18 – Insurance Vending Machine Fees Should Be Reviewed

Observation:

The Department's fee statute establishes fees that have not been collected by the Department in 30 years.

RSA 400-A:29, XII, establishes a $50 application fee, $50 initial license fee, and $50 annual renewal fee for insurance vending machine vendors. Department personnel reported that the Department has not issued applications, licenses, or collected insurance vending machine fees for the past 30 years and the Department does not anticipate collecting these fees in the future.

Recommendation:

The Department should determine if a market exists for licensing insurance vending machine vendors. If the Department determines that no market exists, it should seek to repeal the provisions in RSA 400-A:29, XII, relating to insurance vending machine fees.

Auditee Response:

We concur. The Department has begun a review of the status of vending machine use in the State.

Auditor's Report On Management Issues

To The Fiscal Committee Of The General Court:

We have audited the Statement Of Revenues And Expenditures – Budget And Actual – General Fund of the New Hampshire Insurance Department for the year ended June 30, 2000 and have issued our report thereon dated May 31, 2001, which was qualified with respect to the lack of presentation of the financial position of the Department in the General Fund and a limitation on the scope of our audit caused by the lack of documentation to support the amounts reported for fixed assets.

Except as discussed in the preceding paragraph, we conducted our audit in accordance with generally accepted auditing standards 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 Insurance Department for the year ended June 30, 2000, 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. 19 through No. 23 of this report.

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

May 31, 2001

Management Issues Comments

Observation No. 19 – Independent Contractors Should Be Classified As Employees For Tax Purposes

Observation:

As of June 30, 2000, the Department had oral agreements with 14 workers whom the Department regards as independent contractors, and not as employees, for tax purposes. The 14 workers, along with 13 State employees, perform financial and market conduct examinations of insurance companies.

Making the determination of whether a worker is an employee or independent contractor for tax purposes is sometimes difficult. To assist agencies in making this determination, the Department of Administrative Services (DAS) developed a 20-question questionnaire using IRS criteria to attempt to measure the degree of employer control over a worker. "Yes" answers to the questions tend to indicate employee status and "No" answers tend to indicate independent contractor status. We applied the 20-question questionnaire to the 14 workers and noted "Yes" answers to essentially all of the questions.

Applying the questionnaire to the work characteristics of the 14 workers that perform examination/audit services for the Department indicates that it is likely an employer – employee relationship exists between the Department and the workers. The Department has not completed the questionnaire for the 14 workers to determine their status for tax purposes.

Department personnel reported that, although the 14 workers are classified as independent contractors for tax purposes, these workers are treated more like employees of the Department. Our review of hours worked by contract examiners during fiscal year 2000 indicated that the examiners regularly worked 37.5 hours per week similar to the standard work week for state employees. Additionally, the contract examiners carry State of New Hampshire business cards, are provided with State-supplied equipment, and were paid a total of $21,500 in State holiday pay during fiscal year 2000.

The effect of not properly classifying workers can be significant to both the employer and the worker. Independent contractors are responsible for all payroll taxes. Employers that are found to misclassify workers for tax purposes may be subject to IRS sanctions.

Recommendation:

The Department should work with DAS to determine the proper employment status of the 14 workers whom the Department regards as independent contractors. Based upon the determination, the appropriate steps should be taken.

Observation No. 19 – Independent Contractors Should Be Classified As Employees For Tax Purposes (Continued)

Auditee Response:

We do not concur. Contract examiners are compensated pursuant to the provisions of RSA 400-A:37 VII and RSA 400-A:37 III (d). Contract examiners supplement the Department's workforce.

Observation No. 20 – Written Contracts Should Be Required For Independent Contractors

Observation:

There are no written contracts between the Department and the contract examiners that are hired to perform financial and market conduct examinations for the Department.

As noted in Observation No. 19, as of June 30, 2000, the Department had oral agreements with 14 workers whom the Department classifies as independent contractors for tax purposes. Apparently the oral agreements made during fiscal year 2000 included various employment issues such as hours worked, per-diem rate of pay, health insurance benefits, and reimbursable expenses. Department personnel reported that no written contract between the Department and the independent contractors exists describing the terms and conditions of the oral agreement.

Written contracts that are signed by both contracting parties help to provide assurance that each party is aware of and understands the terms and conditions of the agreement. A written contract can also be especially helpful when determining if a breach of contract has occurred.

Recommendation:

If the Department determines that its contract examiners should continue to be classified as independent contractors for tax purposes, the Department should establish procedures to ensure that all oral agreements are formalized by the Department in writing. The written contracts should describe all the terms and conditions of the employment agreement and be signed by both contracting parties. In addition, personnel services contracts exceeding $2,500 should be submitted to Governor and Council for approval as required by State policy.

Auditee Response:

We concur. As noted in the response to Observation No. 21, the Department has developed engagement letters for contract examiners outlining the customary understanding the Department has had with its contract examiners.

Observation No. 20 – Written Contracts Should Be Required For Independent Contractors (Continued)

Auditee Response (Continued):

RSA 400-A:10 II and RSA 400-A:37 III (d) enables the Commissioner to retain professional services as needed; it is the Department's opinion that these negotiated agreements are not subject to Governor and Council approval as they do not represent standard contracts for services such as equipment repair.

Observation No. 21 – Part-Time Contract Examiner Health Insurance And State Holiday Pay Should Be Reviewed

Observation:

During fiscal year 2000, a part-time contract examiner working for the Department appeared to be inappropriately receiving health insurance benefits and State holiday pay that was fully funded by the insurance companies under examination.

During our review of the examination billing process, we noted the following:

- One part-time contract examiner received 100% fully funded health insurance during fiscal year 2000. [Pursuant to RSA 400-A:10, II, contract examiners receive fully funded health insurance through the State.] The contract examiner worked on a part-time basis at an average of 30 hours per week during the fiscal year, but was not required to pay a pro-rata share of health insurance benefits as would be the case for part-time State employees who worked 30 hours or more per week in accordance with RSA 98-A:6-a. Health insurance for contract examiners is initially paid through the State accounting system, but these costs are subsequently billed to insurance companies undergoing examination on a quarterly basis. The insurance companies under examination paid approximately $550 of fiscal year 2000 health insurance premiums that should have been paid by the examiner.

- During fiscal year 2000, the same part-time contract examiner billed insurance companies under examination $2,500 for State holidays which appears to be an unusual practice for independent contractors, especially part-time independent contractors.

We were unable to determine the appropriateness of part-time contract examiners receiving State holiday pay and fully funded health insurance as there are no written contracts between the Department and the contract examiners describing the terms and conditions of their employment agreement.

Observation No. 21 – Part-Time Contract Examiner Health Insurance And State Holiday Pay Should Be Reviewed (Continued)

Recommendation:

The Department should review its compensation practices for part-time contract examiners. Compensation practices for all contract examiners should be addressed in a written contract between the Department and the contract examiners.

Auditee Response:

We concur. Contract examiners are engaged pursuant to RSA 400-A:10 II. That section states that the commissioner may authorize, in his/her discretion, the payment of medical and other benefits. Upon determination by the commissioner that health benefits are warranted, the Department shall apply the provisions of RSA 98-A:6-a, and when appropriate, arrive at a contractor's pro-rata share of their health benefits; or make arrangements to purchase an individual policy for the contractor.

Traditionally, contract examiners have followed the state holiday schedule. However, because most insurance companies are closed on national holidays which do not necessarily coincide with state holidays, the Department has directed that contract examiners will conform to the holiday schedule of the company under examination. Additionally, the NAIC examination manual recommends that in the instances where a contract examiner is available for work, but the company is closed for business, the contract examiner will be paid for that day.

The Department has developed engagement letters for contract examiners outlining the customary understanding the Department has had with its contract examiners.

Observation No. 22 – Fraud Prosecutor Should Be Treated More Like A Department Employee

Observation:

The Department provides funding for a fraud prosecutor employee that it exercises very little control over.

The Department pays for the salary, benefits, and current expenses of a fraud prosecutor employee that is permanently situated at the Attorney General's Office. The funding for this employee is effected through an annual interagency transfer from the Department to the Attorney General's Office. The purpose of the fraud prosecutor position is to provide the prosecutorial capacity to meet the increasing load of insurance fraud cases being developed by the Insurance Department fraud unit.

Although the fraud prosecutor employee is included in the Department's organizational chart, the fraud prosecutor's personnel records are maintained at the Attorney General's Office.

Observation No. 22 – Fraud Prosecutor Should Be Treated More Like A Department Employee (Continued)

Observation (Continued):

The Department reported that, while some sit-down meetings with the fraud prosecutor occurred during fiscal year 2000, the fraud prosecutor regularly reported to the chief of the criminal bureau at the Attorney General's Office rather than reporting to Department management.

Department personnel expressed concerns regarding the Department's lack of control over the fraud prosecutor's daily activities. During fiscal year 2000, the Department apparently sent ten insurance fraud cases to the fraud prosecutor but the Department has no evidence to determine if the fraud prosecutor spent all of his time working on these cases. The Department reportedly is aware of one case not related to insurance fraud that the fraud prosecutor worked on during fiscal year 2000.

The Department did not require submission of timesheets or status reports from the fraud prosecutor during fiscal year 2000 to determine the appropriateness of the fraud prosecutor's duties.

Recommendation:

The Department should treat the fraud prosecutor more like an employee of the Department. This treatment could include periodically monitoring the fraud prosecutor's duties through increased communications with the fraud prosecutor, review of status reports or timesheets prepared by the fraud prosecutor, or permanently situating the fraud prosecutor at the Department so that more oversight can be exercised by management.

Auditee Response:

We concur. Insurance Department control should be enhanced. We understand the concern in this area, however, the position of Fraud Prosecutor is unique in that the position is funded through the Insurance Department's administrative PAU, while the position itself exists in the Attorney General's Office. It is the Insurance Department's intention that the fraud prosecutor be designated full-time to working on insurance fraud-related matters in conjunction with the Insurance Department Fraud Division. Improved coordination would include increased communication, review of status reports, timesheets, and expanded fraud prosecutor presence at the Department. The Attorney General's Office and the Department have negotiated a protocol/reporting procedure which will govern the fraud prosecutor activities.

Observation No. 23 – Automated Timekeeping/Billing System Needed For Examination Billings

Observation:

The Department's examination billing process is inefficient, cumbersome, and susceptible to errors. The Department has not investigated the feasibility of implementing an automated timekeeping/billing system to replace its current system.

As of June 30, 2000, the Department's 13 state employee and 14 contract examiners were responsible for performing financial and market conduct examinations of domestic and foreign insurance companies. The hours worked by the examiners, in combination with current expenses and other costs of conducting the examination, are included in a per-diem rate calculation that is used by the Examination Division to bill insurance companies under examination in accordance with RSA 400-A:37. Insurance companies undergoing examination are billed quarterly for the costs incurred by the Examination Division.

The examination billing function is performed by the Examination Division and the business office. The timekeeping/billing function is summarized below.

- Examiners submit weekly timesheets that are summarized and manually keyed by a finance assistant into quarterly spreadsheets organized by company, examiner, and week. The spreadsheets are used to calculate billable days to insurance companies under examination.
- The business office prepares a separate spreadsheet of quarterly examination expenditures per the State accounting system. The insurance company examiner II uses the information on this spreadsheet to calculate the per-diem rate.
- The finance assistant prepares a quarterly billing spreadsheet of billable days for each insurance company under examination.
- Invoices are prepared by a finance assistant and mailed out. Copies of the invoices are sent to the business office at which time the business office manually keys the invoice information into a spreadsheet that is used to track receipts. The business office re-bills any delinquent companies.

The Department's current examination timekeeping/billing process is inefficient and prone to error as it involves several employees manually keying amounts into various spreadsheets. The Department reported that the feasibility of implementing an automated timekeeping system for examination billings has not been investigated due to timing constraints.

An automated timekeeping/billing system, whether developed in-house or purchased off-the-shelf, will eliminate the duplication of efforts that currently exists within the examination billing process, reduce the risk of keying errors, and be a useful management monitoring tool.

Observation No. 23 – Automated Timekeeping/Billing System Needed For Examination Billings (Continued)

Recommendation:

The Department should investigate the feasibility of implementing a new automated timekeeping/billing system to improve the efficiency and effectiveness of the examination billing process.

Auditee Response:

We concur. The Department has enhanced its present timekeeping system.

The market conduct and financial examiners are currently using a timekeeping system where examiners-in-charge review and approve work hours and expenses prior to the submission to companies.

The enhanced system provides automatic updating of quarterly timekeeping and billing files for each examination section. The system provides a quarterly summary for each examiner as well as a quarterly summary for all examiners combined. The quarterly summaries for each examiner and the combined quarterly summaries are to be reviewed and approved and retained on file. The end product is a billing summary for each section that will also be reviewed and approved prior to the production of company invoices.

Independent Auditor's Report

To The Fiscal Committee Of The General Court:

We have audited the Statement Of Revenues And Expenditures – Budget And Actual – General Fund of the New Hampshire Insurance Department for the year ended June 30, 2000. The financial statement is the responsibility of the Insurance Department's management. Our responsibility is to express an opinion on the financial statement based on our audit.

Except as discussed in the fourth paragraph, we conducted our audit in accordance with generally accepted auditing standards 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 Insurance Department in the General Fund.

As discussed in NOTE 3, the Department does not have complete financial records to support the amounts reported for fixed assets. Accordingly, we were unable to examine sufficient evidential matter to support such amounts.

In our opinion, except for the effects of such adjustments, if any, as might have been determined to be necessary had our audit not been limited in scope as discussed in the fourth paragraph and except for the matter discussed in the third paragraph, the financial statement referred to above presents fairly, in all material respects, certain financial activity of the Insurance Department for the year ended June 30, 2000, in conformity with generally accepted accounting principles.

Our audit was conducted for the purpose of forming an opinion on the financial statement referred to in the first paragraph. The accompanying Schedule Of Budgetary Components General Fund on page 51 is presented for the purpose of additional analysis and is not a required part of the financial statement of the Insurance Department. 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 May 31, 2001 on our consideration of the Insurance Department's internal control over financial reporting and on our tests of its compliance with certain provisions of laws, rules, regulations, and contracts.

Office Of Legislative Budget Assistant

May 31, 2001

STATE OF NEW HAMPSHIRE
INSURANCE DEPARTMENT

STATEMENT OF REVENUES AND EXPENDITURES
BUDGET AND ACTUAL – GENERAL FUND
FOR THE YEAR ENDED JUNE 30, 2000

	General Fund		
	Budget	Actual	Favorable/ (Unfavorable) Variance
Revenues			
Unrestricted Revenues			
Premium Taxes	$ 57,905,500	$ 54,065,090	$ (3,840,410)
Producer License Fees	4,415,000	4,165,081	(249,919)
Insurance Company Fees	497,000	609,960	112,960
Miscellaneous Fees	188,000	322,093	134,093
Total Unrestricted Revenues	**$ 63,005,500**	**$ 59,162,224**	**$ (3,843,276)**
Restricted Revenues			
Administrative Assessment	$ 2,163,728	$ 2,423,768	$ 260,040
Examination Fees	1,459,372	1,248,198	(211,174)
Contract Examiner Reimbursement (NOTE 2)	-0-	623,000	623,000
Continuing Education Fees	25,000	48,782	23,782
Other	41,111	1,624	(39,487)
Total Restricted Revenues	**$ 3,689,211**	**$ 4,345,372**	**$ 656,161**
Total Revenues	**$ 66,694,711**	**$ 63,507,596**	**$ (3,187,115)**
Expenditures			
Salaries And Benefits	$ 3,421,187	$ 3,095,129	$ 326,058
Contract Examiner Compensation (NOTE 2)	-0-	623,000	(623,000)
Rents And Leases	166,923	144,252	22,671
Consultants And Indirect Costs	140,274	99,256	41,018
Current Expense And Maintenance	122,831	111,620	11,211
Other	84,121	72,900	11,221
Equipment	70,262	68,800	1,462
Travel	69,532	52,381	17,151
Continuing Education And Training	44,250	30,045	14,205
Total Expenditures	**$ 4,119,380**	**$ 4,297,383**	**$ (178,003)**
Excess (Deficiency) Of Revenues Over (Under) Expenditures	**$ 62,575,331**	**$ 59,210,213**	**$ (3,365,118)**

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

STATE OF NEW HAMPSHIRE
INSURANCE DEPARTMENT

NOTES TO THE FINANCIAL STATEMENT
FOR THE YEAR ENDED JUNE 30, 2000

NOTE 1 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

The financial statement of the Insurance Department 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 in the General Fund 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 small portion of the General Fund and those assets, liabilities, and fund balances as reported in the CAFR that are attributable to the Department cannot be determined. Accordingly, the accompanying financial statement is not intended to show the financial position of the Department in the General Fund and the change in the fund balance is 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. All such revenues, other than certain designated revenues, are credited to the General Fund. Annual expenditures that are not allocated by law to other funds are charged to the General Fund.

NOTE 1 -- SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

B. Basis Of Presentation - Fund Accounting (Continued)

Account Groups

General Fixed Assets

General fixed assets acquired for use by the Department for the performance of its operations are reflected in the General Fixed Assets Account Group at the time of acquisition. As of June 30, 2000, 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.

C. Measurement Focus And Basis Of Accounting

The accounting and financial reporting treatment applied to a fund is determined by its measurement focus. All government 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 Fund 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 as well as estimating revenues to be received. 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 fund types with the exception of the Capital Projects Fund. The Capital Projects Fund budget represents appropriations, which extend over several fiscal years, for individual projects. Fiduciary-type funds are not budgeted.

NOTE 1 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

D. Budgetary Data (Continued)

General Budget Policies (Continued)

The New Hampshire biennial budget is composed of the initial operating budget, supplemented by additional appropriations. These additional appropriations and estimated revenues from various sources are authorized by Governor and Council action, annual session laws, and existing statutes which require appropriations under certain circumstances. As shown on the Schedule of Budgetary Components - General Fund on page 51, the final budgeted amount includes the initial operating budget plus supplemental appropriation warrants, balances brought forward, and transfers.

Budgetary control is at the department level. All departments are authorized to transfer appropriations within their departments with the prior approval of the Joint Legislative Fiscal Committee and the Governor and Council. 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 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 appropriation 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 accounts. Capital Projects Fund appropriations are scheduled to lapse two years from the date appropriated unless extended or designated as non-lapsing by law.

A Statement Of Revenues And Expenditures - Budget And Actual - General Fund is presented as the Insurance Department's financial statement. The Department has no activity recorded in the Special, Capital Projects, Proprietary, or Fiduciary Funds.

Variances - Favorable/(Unfavorable)

The variance column on the Statement Of Revenues And Expenditures - Budget And Actual - General Fund highlights differences between budget and actual revenue and expenditures. For revenue, 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.

NOTE 1 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

D. Budgetary Data (Continued)

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. Fixed Assets – General

General fixed assets are not capitalized in the funds used to acquire or construct them. Instead, capital acquisition costs are reflected as expenditures in governmental funds, and the related assets are reported in the General Fixed Assets Account Group. All purchased fixed assets are valued at cost where historical records are available and at an estimated historical cost where no historical records exist. Donated fixed assets are valued at their estimated fair market value on the date received. Interest costs incurred during construction are not capitalized. Assets in the General Fixed Assets Account Group are not depreciated.

F. 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 – CONTRACT EXAMINER COMPENSATION

The actual restricted revenue and expenditure amounts in the Statement Of Revenues And Expenditures - Budget And Actual - General Fund on page 43 reflect $623,000 of revenue and expenditures related to the payroll costs of the Department’s contract examiners. These amounts are paid directly by the examined insurance companies to the contract examiners and are not budgeted.

NOTE 3 - GENERAL FIXED ASSETS ACCOUNT GROUP (UNAUDITED)

Equipment is recorded at historical cost if known, estimated cost if historical cost is unknown, or fair market value at date of acquisition if the asset is donated.

The following is a schedule of equipment balances and activity reported by the Insurance Department to the Department of Administrative Services for the year ended June 30, 2000. Equipment purchases are funded through budgeted appropriations. Currently, the Department does not have complete financial records to support the amounts included in its General Fixed Assets Account Group.

Equipment Balance at July 1, 1999	$ 423,116
Additions	40,810
Deletions	(8,935)
Equipment Balance at June 30, 2000	**$ 454,991**

NOTE 4 - EMPLOYEE BENEFIT PLANS

New Hampshire Retirement System

The Insurance Department, as an organization of the State government, participates in the New Hampshire Retirement System (Plan). The Plan is a defined benefit plan and 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 employees and teachers. Group II consists of firefighters and police officers.

Group I - Members contributing through age 60 qualify for a normal service retirement allowance based on years of creditable service. The yearly pension amount is 1/60 (1.67%) of average final compensation (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 are entitled to a retirement allowance with appropriate graduated reduction based on years of creditable service. In addition, any Group I member who has completed at least 20 years of creditable service that, when combined with his or her age equals at least 70, is entitled to retire and have benefits commence immediately at a reduced service retirement allowance.

Group II - After attaining the age of 45, members with 20 years of creditable service qualify to receive a retirement allowance at a rate of 2.5% of AFC for each year of creditable service, not to exceed 40 years. Members in service at age 60 qualify to receive a prorated retirement allowance.

NOTE 4 - EMPLOYEE BENEFIT PLANS (Continued)

New Hampshire Retirement System (Continued)

Members of both groups are entitled to disability allowances and also death benefit allowances subject to various requirements and rates based on AFC or earnable compensation. All covered Department employees are members of Group I.

The Plan is financed by contributions from the members, the State and local employers, and investment earnings. During fiscal year 2000, Group I and II members were required to contribute 5% and 9.3%, respectively, of gross earnings. The State funds 100% of the employer cost for all of the Department's employees enrolled in the Plan. The annual contribution required to cover any normal cost beyond the employee contribution is determined every two years based on the Plan's actuary.

The Department's payments for normal contribution costs for the year ended June 30, 2000 amounted to 3.94% of the covered payroll for its Group I employees. The Department's contributions for the year ended June 30, 2000 were $94,729, equal to the required employer contributions for the period. The Plan does not make separate measurements of assets and pension benefit obligation for individual employers.

The New Hampshire Retirement System Comprehensive Annual Financial Report contains detailed information regarding the Plan as a whole, including information on payroll, contributions, actuarial assumptions and funding method, and historical trend data. The New Hampshire Retirement System operates on a fiscal year ending June 30.

Post-employment Health Care Benefits

In addition to the benefits described above, the Insurance Department, as an organization of the State government, provides post-employment health care benefits, in accordance with RSA 21-I:30, to all retired employees and their spouses on a non-contributory basis, as authorized by State statute.

During the year ended June 30, 2000, 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. The Department reimburses the New Hampshire Retirement System for its share of post-employment health care benefits. The amount reimbursed for the year ended June 30, 2000 totaled $47,128.

NOTE 5 – LEASE COMMITMENTS

The Department has lease commitments for office space requirements which are accounted for as operating leases. These leases, subject to continuing appropriation, extend forward several years and may contain renewal options. Rent expenditures for the year ended June 30, 2000 were approximately $135,000.

NOTE 5 – LEASE COMMITMENTS (Continued)

The following is a schedule of future minimum payments required under operating leases that have lease terms in excess of one year as of June 30, 2000:

Fiscal Year	Lease Amount
2001	$ 134,647
2002	134,647
2003	89,765
Total	**$ 359,059**

STATE OF NEW HAMPSHIRE
INSURANCE DEPARTMENT

SCHEDULE OF BUDGETARY COMPONENTS
GENERAL FUND
FOR THE YEAR ENDED JUNE 30, 2000

	Operating Budget	Supplemental Appropriation Warrants	Balances Brought Forward	Net Transfers In (Out)	Budget
Revenues					
Unrestricted Revenues					
Premium Taxes	$ 57,905,500	$ -0-	$ -0-	$ -0-	$ 57,905,500
Producer License Fees	4,415,000	-0-	-0-	-0-	4,415,000
Insurance Company Fees	497,000	-0-	-0-	-0-	497,000
Miscellaneous Fees	188,000	-0-	-0-	-0-	188,000
Total Unrestricted Revenues	**$63,005,500**	**$ -0-**	**$ -0-**	**$ -0-**	**$63,005,500**
Restricted Revenues					
Administrative Assessment	$ 2,681,792	$ -0-	$ (518,064)	$ -0-	$ 2,163,728
Examination Fees	1,377,935	-0-	81,437	-0-	1,459,372
Contract Examiner Reimbursement	-0-	-0-	-0-	-0-	-0-
Continuing Education Fees	25,000	-0-	-0-	-0-	25,000
Other	10,000	-0-	31,111	-0-	41,111
Total Restricted Revenues	**$ 4,094,727**	**$ -0-**	**$ (405,516)**	**$ -0-**	**$ 3,689,211**
Total Revenues	**$67,100,227**	**$ -0-**	**$ (405,516)**	**$ -0-**	**$66,694,711**
Expenditures					
Salaries And Benefits	$ 3,421,187	$ -0-	$ -0-	$ -0-	$ 3,421,187
Contract Examiner Compensation	-0-	-0-	-0-	-0-	-0-
Rents And Leases	145,423	-0-	-0-	21,500	166,923
Consultants And Indirect Costs	180,214	-0-	8,560	(48,500)	140,274
Current Expense And Maintenance	120,500	-0-	2,331	-0-	122,831
Other	84,121	-0-	-0-	-0-	84,121
Equipment	29,500	-0-	13,762	27,000	70,262
Travel	69,532	-0-	-0-	-0-	69,532
Continuing Education And Training	44,250	-0-	-0-	-0-	44,250
Total Expenditures	**$ 4,094,727**	**$ -0-**	**$ 24,653**	**$ -0-**	**$ 4,119,380**
Excess (Deficiency) Of Revenues Over (Under) Expenditures	**$63,005,500**	**$ -0-**	**$ (430,169)**	**$ -0-**	**$62,575,331**

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APPENDIX

Current Status Of Prior Audit Findings

The following is a summary, as of May 31, 2001, of the status of the observations contained in the audit report of the Insurance Department for the eighteen months ended December 31, 1994. 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.

		Status
Internal Control Structure		
	Reportable Conditions	
1.	Premium Tax Revenue – Unpaid Retaliatory Taxes *(See current year Observation No. 1)*	● ○ ○
2.	Computer Equipment Loaned To The Insurance Department	● ● ●
3.	Accounts Receivable – Uncollectible Invoices	● ● ○
State Compliance		
4.	Failure Of Board Members To File Statements Of Financial Interests	● ● ○
5.	Special Fund No Longer Required	● ● ●

Status Key

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

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