

**STATE OF NEW HAMPSHIRE
BANKING DEPARTMENT**

**FINANCIAL AUDIT REPORT
FISCAL YEAR ENDED
JUNE 30, 2011**

**STATE OF NEW HAMPSHIRE
BANKING DEPARTMENT**

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<http://www.gencourt.state.nh.us/LBA/AuditReports/financialreports.aspx>.

STATE OF NEW HAMPSHIRE BANKING DEPARTMENT

Reporting Entity And Scope

The reporting entity and scope of this audit and audit report is the financial operations of the Banking Department for the fiscal year ended June 30, 2011. Excluded from the scope of this audit and audit report is the Public Deposit Investment Pool (PDIP). Pursuant to RSA 383:22, the Bank Commissioner established the PDIP for the purpose of investing the funds of the State and other governmental entities. The PDIP operates under contract with a private investment advisor and receives an independent audit annually.

At June 30, 2011, the Department's Deputy Commissioner was the liquidator of the Noble Trust Company, pursuant to an action by the Department and the Merrimack County Superior Court under RSA 395:2. The Bank Commissioner took control of the Noble Trust in February 2008 after a scheduled examination revealed irregularities in Noble's operations. The financial activity of the Noble Trust Company during fiscal year 2011 is also excluded from the scope of this audit and audit report.

The following report describes the financial operations of the Banking Department during the period under audit. Unless otherwise indicated, reference to the Department or auditee refers to the Banking Department.

Organization

The New Hampshire Banking Department, established pursuant to RSA 383, is a regulatory State agency under the direction of a Commissioner and Deputy Commissioner, both appointed by Governor and Council to six-year terms. The Department, comprised of the Banking and Consumer Credit Divisions, is located at 53 Regional Drive, Concord, New Hampshire.

At June 30, 2011, the Department employed 49 full-time and one part-time employee.

Responsibilities

The New Hampshire Banking Department is responsible for the general supervision of all State chartered financial institutions. These institutions include commercial banks, fiduciary trust companies, mutual savings banks, guaranty savings banks, co-operative banks, merchant banks, and credit unions. The Department is also charged with the licensing and supervision of non-depository first mortgage bankers, brokers, servicers and loan originators, money transmitters, retail sellers, sales finance companies, small loan lenders, and debt adjusters.

State laws mandate that the Department conduct examinations of each financial institution and licensed lender and broker to ensure compliance with State and federal laws and regulations.

State laws also provide the Banking Commissioner with authority to investigate consumer complaints, hold public hearings, and assess administrative fines and order restitution if New Hampshire State laws are violated by institutions under the Commissioner's jurisdiction.

Banking Division

The Banking Division conducts examinations of the financial condition and management of New Hampshire chartered financial institutions, including commercial banks, fiduciary trust companies, mutual savings banks, guaranty savings banks, co-operative banks, merchant banks, and credit unions. The Division processes and investigates applications for bank charters, branches, automated teller machines (ATMs), merger transactions, and interstate acquisitions. It also processes registrations for nonbank cash dispensing machines. The Division publishes a monthly bank activity bulletin, compiles data for inclusion in the Annual Report of the Bank Commissioner, investigates consumer complaints, and responds to inquiries from state and federal regulators, financial institutions, and the public.

Consumer Credit Division

The Consumer Credit Division licenses and supervises nonbank mortgage lenders and brokers, second mortgage lenders, small loan companies, sales finance companies, retail sellers, debt adjusters, and mortgage loan servicers. The Division examines each licensed lender and broker for compliance with state and federal laws and regulations. Administrative staff conducts license application reviews and investigates non-licensed entities. The Division compiles data for inclusion in the Annual Report of the Bank Commissioner, investigates consumer complaints, and responds to inquiries from State and federal regulators, financial institutions, and the public.

Funding

The Department is self-supporting, operating initially from State General Fund appropriations, and subsequently recovering those funds through license and examination fees and assessments on regulated entities, in accordance with RSA 383:11.

A summary of the Department's revenues and expenditures for fiscal year 2011 is shown in the following table.

**Summary Of Revenues And Expenditures
For The Fiscal Year Ended June 30, 2011**

	General Fund
Total Revenues	\$ 4,448,297
Total Expenditures	<u>5,449,216</u>
Excess (Deficiency) Of Revenues Over (Under) Expenditures	<u>\$ (1,000,919)</u>

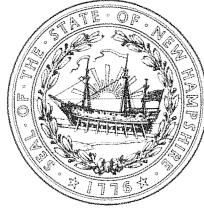
Prior Audit

The most recent prior financial audit of the Banking Department was for the nine months ended March 31, 2002. The appendix to this report on page 39 contains a summary of the current status of the observations contained in that report. A copy of the prior audit report can be accessed online at <http://www.gencourt.state.nh.us/LBA/AuditReports/financialreports.aspx>.

Audit Objectives And Scope

The primary objective of our audit was to express an opinion on the fairness of the presentation of the financial statement of the Banking Department for the fiscal year ended June 30, 2011. As part of obtaining reasonable assurance about whether the financial statement is free of material misstatement, we considered the effectiveness of the internal controls in place at the Department and tested its compliance with certain provisions of applicable State and federal laws, rules, regulations, and contracts. Major accounts or areas subject to our examination included, but were not limited to, revenues and expenditures.

Our report on internal control over financial reporting and on compliance and other matters, the related observations and recommendations, our independent auditor's report, the financial statement, and supplementary information are contained in the report that follows.



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

To The Fiscal Committee Of The General Court:

We have audited the accompanying financial statement of the Banking Department (Department) for the fiscal year ended June 30, 2011, as listed in the table of contents, and have issued our report thereon dated March 28, 2012 which was qualified as the financial statement does not constitute a complete financial presentation of the Department in the General Fund. We conducted our audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States.

Internal Control Over Financial Reporting

In planning and performing our audit, we considered the Department's internal control over financial reporting as a basis for designing our auditing procedures for the purpose of expressing our opinion on the financial statement, but not for the purpose of expressing an opinion on the effectiveness of the Department's internal control over financial reporting. Accordingly we do not express an opinion on the effectiveness of the Department's internal control over financial reporting.

Our consideration of internal control over financial reporting was for the limited purpose described in the preceding paragraph and was not designed to identify all deficiencies in internal control over financial reporting that might be significant deficiencies or material weaknesses and therefore, there can be no assurance that all deficiencies, significant deficiencies, or material weaknesses have been identified. However, as discussed below, we identified certain deficiencies in internal control over financial reporting that we consider to be material weaknesses and other deficiencies that we consider to be significant deficiencies.

A deficiency in internal control exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent or detect and correct misstatements on a timely basis. *A material weakness* is a deficiency, or a combination of deficiencies, in internal control such that there is a reasonable possibility that a material misstatement of the Department's financial statement will not be

prevented, or detected and corrected on a timely basis. We consider the deficiencies described in Observations No. 1 and No. 2 to be material weaknesses.

A *significant deficiency* is a deficiency or combination of deficiencies in internal control that is less severe than a material weakness, yet important enough to merit attention by those charged with governance. We consider the deficiencies described in Observations No. 3 through No. 12 to be significant deficiencies.

Compliance And Other Matters

As part of obtaining reasonable assurance about whether the Department's financial statement is free of material misstatement, we performed tests of the Department's 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 an instance of noncompliance that is required to be reported under *Government Auditing Standards* and is described in Observation No. 13. We also noted immaterial instances of noncompliance which are described in Observations No. 14 through No. 16.

The Department's response is included with each observation in this report. We did not audit the Department's responses and, accordingly, we express no opinion on them.

This report is intended solely for the information and use of the management of the Department, others within the Banking 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

March 28, 2012

Internal Control Comments
Material Weaknesses

Observation No. 1: Regulatory Compliance Controls Should Be Improved

Observation:

This report contains a number of internal control and compliance comments that result from the lack of updated statutes, rules, and policies and procedures affecting the Department's financial and other operations during fiscal year 2011. The lack of current statutes, rules, and policies and procedures placed the Department at significant risk that it would not accurately report its financial operations and efficiently and effectively meet its regulatory responsibilities.

State banking statutes and rules are largely intended to protect the customers of financial institutions operating in the State. While the Department's authority and responsibilities are detailed in those statutes, during the audit period, the Department had not reasonably ensured those statutes remained current and responsive to the changing banking environment, that administrative rules required by statute were adopted and remained current, and that the need to adopt additional rules, allowed for but not required by statute, was regularly reviewed and reconsidered. The status of the Department's regulatory framework during this period posed a material weakness in the Department's internal controls critical to its mission.

A similar comment was noted in the prior audit report.

Recommendation:

The Department should strengthen its internal controls through the adoption of policies and procedures intended to formalize and make routine a process to:

- review statutes for consistency and relevancy,
- request timely revisions to statutes as appropriate,
- adopt administrative rules as required and appropriate, and
- communicate to its employees the processes to be undertaken to achieve the financial and regulatory objectives intended by the statutes and rules.

These actions should allow for better, more effective regulation and efficient enforcement of the State's banking laws.

Auditee Response:

As is the case with a number of the individual audit items within the report, we concur that there are policies, procedures and a variety of rules which need to be addressed – many of which are either in process or have been already corrected.

Fiscal year 2011 encompassed a prolonged period without a commissioner in place, and with significant demands placed upon the Department to respond to numerous special legislative hearings and requests. During this period, resources were redirected to address areas of greatest risk – such as maintaining statutorily mandated examination schedules.

As indicated above, with a commissioner and other key staffing in place, significant energies are being directed to address the areas of concern as identified in this report, and which the Department generally concurs.

Observation No. 2: Revenue Processing Controls Should Be Strengthened

Observation:

Weaknesses in the design and operation of the Department's revenue processing controls expose the Department to increased risks that the loss or theft of revenue will not be prevented or detected.

During review of the Department's revenue processes, the following control deficiencies were noted:

- The two employees who initially process revenues received through the mail and prepare the initial recording of those receipts have incompatible duties as they also record the revenue received in the Department's Cash Receipts database, and regularly input revenue waivers into the Department's revenue databases. These employees have access authorities in the Cash Receipts, Licensing, Banking Examination, and Miscellaneous Revenue databases which allow them to create and reprint invoices, post transactions, and input waivers into those databases. The misuse of these system authorities, combined with access to accumulated receipts, increases the risk that Department revenue could be lost or stolen without detection.
- Revenue checks received through the mail are routinely restrictively endorsed when processed and not when first received. Delaying the endorsement increases the risk that lost or misdirected checks could be misappropriated.
- The Department routinely holds checks undeposited and unprocessed, pending research or final consent agreements. The Department maintains a "Checks Held" spreadsheet to track these held checks. Pursuant to a review of the spreadsheet, the Department held undeposited checks from 1 to 81 business days during the audit period.
- The Department, during fiscal year 2011, did not perform a complete reconciliation of revenue recorded in the State's accounting system, NHFirst, to applicable databases used to record licensing, examination, fine, and miscellaneous income activity. While the Department stated it intended to reconcile this activity, at September 1, 2011, the Department had reconciled one organizational code but had not reconciled the other, reportedly due to a lack of time and readily available data. The Department reported, beginning in fiscal year 2012, these reconciliations were to be performed monthly.

The above control deficiencies increase the risk that the Department's revenues will not be collected, processed, and deposited to the Department's credit.

A similar comment was noted in the prior audit report.

Recommendation:

The Department should strengthen controls over its revenue process.

- Job responsibilities requiring access to revenue items including checks and cash should be segregated from responsibilities that provide access to related record-keeping systems such as the Department's Cash Receipts, Licensing, Banking Examination, Fines, and/or Miscellaneous Revenue Databases or NHFIRST, unless appropriate controls are in place that mitigate associated risks. All waivers of fees and fines identified in the record-keeping systems should be independently reviewed for appropriateness.
- Unprocessed checks should not be held by the Department for any significant period of time. Checks should be restrictively endorsed and deposited or returned in a timely manner to minimize the risk of loss or misappropriation. The Department should review with legal counsel its stated concern that depositing certain checks may constitute an unintended acceptance of an agreement. If it is determined the concern is valid, the Department should consider whether the use of an escrow account or other secure process could be sought that would allow for the safeguarding of checks by deposit without committing the Department to a premature acceptance of a payment.
- Timely and complete reconciliations should be performed between the Department's revenue databases and NHFirst.

Auditee Response:

Concur. While the Department acknowledges opportunities for improvement, it should be noted that no actual instances of misappropriation were identified.

The Department anticipates putting additional controls in place with the new database implementation.

The Department will develop policies and procedures which address the recommendation.

The Department currently performs revenue reconciliations at the close of each month.

Significant Deficiencies

Observation No. 3: Policies And Procedures Should Be Established For Significant Financial Operations

Observation:

The Department has not established documented policies and procedures for some of its significant operations. The Department has largely relied upon the knowledge and experience of its staff to ensure that Department activities are performed in a manner intended by statute, administrative rule, and policy.

1. The Department does not have a documented methodology for setting per-diem rates to charge institutions for examinations performed by Department staff. A senior Department staff person has historically established the per-diem rates based on prior experience setting the rates.
 - During testing, we noted the Department did not implement an updated per-diem rate for fiscal year 2011. The fiscal year 2010 rate used by the Department during fiscal year 2011 was established using several expenditure amounts that could not be supported by the Department. In addition, certain expenditure amounts used to establish the per-diem rate were not properly calculated. The Department was unaware of the errors in the 2010 rate and could not explain why it had not implemented a rate change for fiscal year 2011.

2. The Department reports it allocates administrative and other joint costs to the Banking and Consumer Credit Divisions based on the proportionate number of staff in each Division and the business office's understanding of each Division's use of allocated costs. The Department's process for cost allocations is not supported by documented policies and procedures or other process documents.
 - During testing, we noted the Department did not adhere to its stated practice for allocating costs for 11 out of 28 expenditure transactions (39%) reviewed. The noted differences primarily related to allocations of indirect and information technology costs. For the transactions reviewed, the Department under-allocated costs to the Banking Division and over-allocated costs to the Consumer Credit Division in the amount of approximately \$11,000.

The lack of policies and procedures for critical Department operations, as noted above, increases the risks related to the continued performance of individual staff and significantly increases the risk of inconsistent and inaccurate performance of those operations especially in the event those employees are no longer available to perform those duties.

In addition to the above noted instances where formal policies and procedures are necessary for control purposes, other formal policies required by statute also have not been established.

- The Department reported it has not implemented the policy document required by RSA 383:10-c, II, which requires the Bank Commissioner to develop a formal written policy prohibiting Department examiners from performing outside work for bank directors, officers, or trustees or for banks, bank holding companies, nonbanks and near-banks. While the Department reported it has not developed the required formal policy, none of the ten Bank Examiners interviewed during payroll testing reported having performed work prohibited by the statute.

A similar comment was noted in the prior audit report.

Recommendation:

The Department should implement appropriate controls, including establishing formal, comprehensive policies and procedures, for all of its significant financial operations. The performance of all significant financial operations should be based on management's documented process and should not rely upon the continued good performance of individual employees, who may or may not continue in employment.

The Department should establish policies and procedures required by statute. If the Department determines the policies and procedures are not required, the Department should request an appropriate revision to the statutory requirement.

Auditee Response:

Concur. The Department will develop and implement policies in the areas identified and other areas where determined necessary. The Department will focus more closely on cost allocation and will do so going forward.

The Department is in the process of updating the Employee Handbook. The update will include the policy prohibiting examiners from performing outside work in accordance with the statute.

Observation No. 4: Policies And Procedures For Responding To Consumer Complaints Should Be Established

Observation:

The Department does not have formal policies and procedures or a program to ensure timely and adequate response to consumer complaints. According to the Department, it has initiated the development of a program; however, the program was not in place during the audit period.

The Bank Commissioner has exclusive authority and jurisdiction, per RSA 383:10-d, to investigate conduct that is or may be an unfair or deceptive act or practice, or that may violate provisions of certain laws or rules. In accordance with RSA 383:10-f, a consumer complaint administrator is assigned annually to administer and coordinate the Commissioner's response to such complaints.

While the Commissioner has designated a consumer complaint administrator for each division of the Department, the administration and coordination of responses to complaints was not consistently timely during the audit period.

- One Banking Division complaint filed during the audit period remained open as of September 28, 2011, the date of audit testing. The most recent communication in the file was dated February 28, 2011. A post-it note in the file dated September 12, 2011 indicated the Department was awaiting return phone call.
- Ninety-two of the complaints filed with the Consumer Credit Division (CCD) during the audit period remained open as of the September 28, 2011 date of audit testing. We reviewed a judgmental sample of five of the open complaints for timeliness of Department action.
 - One of the complaints appeared to be addressed timely by the Department.
 - Two of the complaints had significant delays (one more than nine months and the other more than three months) between the time the CCD initially determined the entity was unlicensed and a request for information was issued.
 - Two other complaints had significant delays (one approximately seven months and the other more than two months) between the time the CCD requested information (which requested a response within ten days) and the CCD issuing an Order to Show-Cause and Cease-and-Desist. At the time of testing, the CCD had not yet issued orders for the complaint that was more than two months old.

The lack of timely response and follow up to consumer complaints increases the risk that consumers may be harmed by unfair or deceptive acts or practices.

Recommendation:

The Department should establish policies and procedures to ensure the Department responds timely to consumer complaints of unfair or deceptive acts or practices by regulated financial institutions.

The Department should ensure its policies and procedures include appropriate monitoring activities to allow management to review the timeliness of its consumer complaint activities.

The Department should consult with other State agencies that track customer complaints for possible access to appropriate tracking tools.

Auditee Response:

Concur. The Department has drafted a complaint policy that is in final review.

Observation No. 5: Fraud Risk Mitigation Policies Should Be Established

Observation:

The Department has not established a formal fraud assessment, prevention, deterrence, and detection program and has not established a fraud reporting policy.

Fraud encompasses an array of irregularities and illegal acts characterized by intentional deception. Persons outside or inside the organization can perpetrate fraud for the benefit or to the detriment of the organization. Fraud runs the spectrum from minor employee theft and unproductive behavior to misappropriation of assets, fraudulent financial reporting, and intentional noncompliance with a law or rule leading to an undue benefit.

Management is responsible for assessing the risk of fraud and implementing measures to reduce the risks of fraud to an organization. Fraud assessment, prevention, deterrence, and detection are crucial to the controlled operations of an organization. Management is also 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.

A fraud reporting policy is intended to assist employees in understanding what constitutes fraud, and their responsibility for reporting suspected fraud in a manner that protects employees and the Department from resulting losses.

Recommendation:

The Department should establish formal fraud risk mitigation policies to help limit the Department's exposure to fraud and to promote timely detection. The Department should establish a formal fraud assessment, prevention, deterrence, and detection policy to help limit the Department's exposure to fraud and to promote early detection of fraud that might occur. The Department should establish a fraud reporting policy and provide its employees with fraud awareness training. The Department should take measures to ensure the policy facilitates and encourages reporting and protects all parties involved.

Auditee Response:

Concur. The Department has reviewed the example Department of Administrative Services policy provided by the LBA auditors and will work to establish policies that address the recommendation.

Observation No. 6: Information Technology Controls Should Be Improved

Observation:

The Department has not addressed certain weaknesses in its information technology (IT) control systems, increasing the risk that its IT systems and information could be lost or misused.

- The Department does not have a current IT Plan. The Department's most recent plan expired in 2008 and has not been updated.
- The Department does not have a comprehensive IT disaster recovery plan in place separate from its draft continuity of operations (COOP) plan. While the Department's draft COOP has general disaster recovery elements, as currently drafted, it is not sufficiently comprehensive to serve as an IT disaster recovery plan when implemented.
- The Department utilizes several computer database systems, which contain information on entities regulated by the Department, including Department billings and fine assessments, and Department employee timekeeping information. The Department reported it purchased \$150,000 of software in December 2010, with the intention of replacing the database systems considered to be inadequate for the Department's needs. The Department reported it anticipated implementing the purchased software in July 2013.

The Department's IT systems include highly confidential information. IT risks were noted in the manner that the Department's systems transfer and store this information.

- Information is not encrypted at all points when sent between Department employee laptops and the Department's server. The lack of encryption at all points of information exchange increases the risk that the security of misdirected or intercepted information may be compromised.
- Regularly, some confidential data is temporarily stored on devices received from monitored institutions. The Department does not require encryption of data stored on devices obtained from other entities.
- The physical security of some back-up tapes could be improved.
- The Department does not have a regular process to test the quality of its IT data backups, including periodically restoring backed up files and testing the quality and accuracy of the restored data.

A similar comment was noted in the prior audit report.

Recommendation:

The Department should address the weaknesses in its IT systems. Appropriate and current IT, disaster recovery, and continuity of operations plans should be maintained. Plans should be regularly tested and employees should be regularly trained in their respective plan responsibilities.

The Department should review its plan for the implementation of its new software system. The Department should move forward with the implementation of its new software as soon as reasonably possible to take the most advantage of the new system.

The Department should work with the Department of Information Technology (DoIT) to review the security of its information when transferred between sites and also when stored, both on temporary storage devices and on Department systems. The Department should ensure that its information backup processes are sufficiently secure and efficient to meet the needs of the Department.

The Department should establish a process to periodically test the quality of IT data backups.

Auditee Response:

Concur. The Department will work with DoIT to finalize our IT plan using our recently completed Strategic Plan as a guide for future needs.

The Department will work with DoIT to develop and implement a Disaster Recovery Plan. The plan will be regularly tested and employees will be trained in their respective plan responsibilities.

The Department will continue to work diligently with DoIT in the development and implementation of the new database.

The Department will work with DoIT to implement a point to point encryption solution for employees to transfer information while offsite. Also, institutions are provided access to a secure site to submit confidential data to the Department. They are strongly encouraged to encrypt any data sent on an external storage device.

The Department will revisit the storage of our encrypted backup tapes to ensure the process is efficient to meet our needs. Periodic testing of the quality of IT data backups has been instituted.

Observation No. 7: Monitoring Controls Over Service Organization Should Be Implemented

Observation:

The Department has not established controls to support its reliance upon a mortgage licensing service provider to collect and remit licensing fees to the Department. The Department reports that the Nationwide Mortgage Licensing System (NMLS) was used to collect approximately \$667,000 of license fees during fiscal year 2011.

The Department began using the NMLS as a service organization during fiscal year 2008 to electronically collect licensee application/renewal materials and fees for certain “mortgage” license types. The NMLS is a nation-wide service provider managed by the State Regulatory

Registry, LLC (SRR). Department personnel are able to review licensee applications/renewals in the NMLS and issue licenses to the applicants/licensees.

The Department does not perform control procedures over the NMLS' activities to reasonably ensure that all amounts collected on its behalf by the NMLS are forwarded to the Department. For example, the Department does not reconcile the licensing revenue received through the NMLS to applications/renewals reported by the system or perform any similar control procedures. The Department reports that, during the audit period, the NMLS did not have an available report on controls such as an annual Service Organization Report on Controls (SSAE 16 report). Such a report could describe the design and operational effectiveness of NMLS' controls over the collection and remittance of revenue due the Department.

Without appropriate controls in place, there is increased risk the Department may not receive all revenues it is due from the service organization, without detection.

Recommendation:

The Department should implement controls over the financial activities performed on its behalf by the NMLS to reasonably ensure revenue due from the NMLS is properly remitted.

- The Department should perform periodic reconciliations of licenses issued through the NMLS to revenue recorded in NHFIRST.
- The Department should encourage the NMLS to obtain and provide to the Department an annual Service Organization Controls Report (SSAE 16 report, formerly a SAS 70 report).

Auditee Response:

Concur. With the implementation of the new database, adequate controls will be put in place to reconcile licenses issued to recorded revenue.

The Department will work with CSBS (Conference of State Bank Supervisors) and NMLS to determine what control reports are available.

Observation No. 8: Payroll Controls Should Be Strengthened

Observation:

The Department's current assignment of payroll responsibilities results in a lack of appropriate segregation of duties and other weaknesses, without effective mitigating controls.

- One payroll processor enters all pay-related transactions into the State's payroll system (GHRIS) without a review and approval control being applied. While State payroll policy requires the completion, printing, and dual signing of an Agency Payroll Certification document, no one other than the payroll processor reviews the on-screen Agency Payroll Certification in GHRIS. The certification document is not printed, reviewed by a second

employee, or signed even though these control activities are required by the GHRS payroll manual.

- The payroll processor does not ensure employee performance evaluations have been performed prior to processing employee increments, contrary to N.H. Admin. Rule, Per 901.03(a). While the payroll processor notifies supervisors of upcoming employee anniversary dates, the payroll processor does not receive confirmation that timely evaluations were prepared. According to the Department's payroll processor, increments are processed unless notice is received from an evaluator to withhold an increment.

The weaknesses in the Department's payroll process could allow errors to occur without timely detection and correction.

Recommendation:

The Department should strengthen its payroll procedures by including controls, such as segregation of incompatible duties and review-and-approval controls, intended to reasonably ensure errors are prevented, detected, and corrected in a timely manner. The Department's payroll procedures should also include controls intended to ensure the Department's payroll activities operate in accordance with State policies and procedures.

Auditee Response:

Concur. The Department has developed and implemented procedures which address the recommendation.

Observation No. 9: State's Fiscal Year Closing Instructions Should Be Followed

Observation:

Historically, the Department has not made a distinction between accounts receivable expected to be collected within 60 days of the June 30 fiscal year end and those expected to be collected after 60 days when it reports its accounts receivable to the Department of Administrative Services (DAS) at the close of the fiscal year. The 60-day collectability period is used to determine if an accounts receivable meets the availability criteria for reporting the underlying financial transaction as current-period revenue to the State's General Fund.

1. The State's fiscal year closing directions advise agencies to report accounts receivable expected to be received within 60 days of June 30 on an Exhibit K and to report accounts receivable that are not expected to be collected within 60 days by separate communication to DAS. The distinction for reporting accounts receivable categorized by expected period of collection is critical in determining and reporting accurate fund financial information.

The Department annually reports all of its accounts receivable as meeting the less than 60 day collection criteria, even though, as discussed in Observation No. 14, the Department typically invoices its cost recovery assessment in early September and collects the

assessments approximately 60 days later, well after the end of the 60 day period for measuring fiscal year-end availability. By recording the assessment as current-period accounts receivable and revenue at June 30, 2010 and 2011, the Department overstated June 30, 2010 accounts receivable by \$954,000 and overstated June 30, 2011 accounts receivable by \$1,175,000 resulting in a net overstatement of fiscal year 2011 “Assessment Revenue” of approximately \$221,000, prior to audit adjustment. Inaccuracies in determining and reporting fiscal year 2010 and 2011 accounts receivable amounts also resulted in a net understatement of fiscal year 2011 “Examinations Revenue” of approximately \$139,159.

The Department reported it was not fully cognizant of the 60-day criteria when it reported its accounts receivable at fiscal year end.

2. The Department reported it understood it was not required by State policy to report fines receivable to DAS at each June 30 year-end. While reporting fines issued and outstanding as accounts receivable is not specifically addressed in the State’s policies and procedures for reporting accounts receivable, the DAS Bureau of Financial Reporting advised the auditors that agencies should include an estimate of fines receivable in year-end accounts receivable reporting.
3. The State’s fiscal year closing instructions also advise agencies to report to DAS “any funds or cash/investments in your agency’s custody or your agency’s purview...”. The Department did not report timely to DAS that the Department had taken possession of the assets of a bank which was in liquidation proceedings under RSA 395. When the Department took control of the financial institution in 2008, court filings reported the book net asset value (not market value) of the defunct financial institution to be approximately \$22 million. The Department did report its involvement with the defunct bank to DAS in 2011, as recommended by the auditors. DAS determined that the State was not required to report any responsibility for the assets of the defunct financial institution in the State’s comprehensive annual financial report.

Recommendation:

The Department should remind its accounting staff of the importance of complying with DAS instructions for closing fiscal year financial activity. The Department should ensure that responsible financial accounting staff are aware of and trained in those activities.

Auditee Response:

Concur. The Department will ensure that it complies with the DAS instructions going forward.

Observation No. 10: Financial Activity Should Be Recorded In The Proper Accounts

Observation:

The Department historically has recorded the recovery of out-of-state travel and certain other examination costs as a negative expenditure transaction, which reduces the Department's reported revenues and expenditures.

The Department's examination revenue is based on billings for staff hours worked on an examination and a daily billing rate. The daily billing rate includes costs for staff time, in-state travel costs, and other miscellaneous costs. Out-of-state travel and postal costs are billed at actual incurred costs but are recorded in the State accounting system as negative expenditures, not revenues. By recording these amounts as negative expenditures, the Department is able to pay out-of-state travel and postal costs in excess of its budgeted appropriations. The practice also understates the Department's reported financial activity.

During fiscal year 2011, the Department's out-of-state travel expenditures and examinations revenue were both understated by approximately \$61,500. Accounting for out-of-state travel reimbursements in this manner during the period allowed the Department to spend approximately \$25,000 more than the amount it was appropriated for out-of-state travel.

Recommendation:

The Department should record and report all significant financial activity in the proper accounts.

Auditee Response:

Concur. The Department is working with DAS on the process to map out the necessary steps to address the recommendation. It is the Department's intention to complete this process for Fiscal Year 2013.

Observation No. 11: Necessity For Oversight Of Restitution Payments Should Be Reviewed

Observation:

The Department directs regulated institutions making restitution payments to customers to forward the restitution checks to the Department for review and subsequent disbursement to the customer. The Department reviews the checks for compliance with respective settlement agreements prior to mailing the checks to the customer payees.

During fiscal year 2011, the Department received 28 restitution checks totaling \$35,197 that it reviewed and subsequently forwarded to customers. The Department reported it was important for the Department to receive and review the checks prior to the customers' acceptance of the checks to ensure that payments consistent with settlement agreements are made.

The Department's handling of these checks of which it is not the payor or payee exposes the Department to the risk of being responsible for lost, misdirected, or unnecessarily delayed restitution payments.

Recommendation:

The Department should review the necessity of having restitution payments forwarded to the Department for review and mailing to payees. The Department should implement a more secure and efficient method of gaining confidence that timely and complete restitution payments are made by regulated institutions.

Auditee Response:

Concur. The Department will carefully review the audit recommendation and determine the best course of action going forward.

Observation No. 12: Status Of Strategic Plan Should Be Resolved

Observation:

The Department reported it had not completed its strategic plan document, originally planned for completion in 2007. The Department reported it was working on a strategic plan during fiscal year 2011.

While there is no State requirement for a strategic plan document, the prior audit recommended the Department establish a formal strategic plan document and the Department began that effort. A strategic plan is intended to help an entity establish goals and to monitor progress toward those goals with the intention of thereby efficiently and effectively accomplishing its mission. Written plans provide frameworks for guiding an organization through periods of change helping management communicate fundamental goals to employees.

A written strategic plan could assist the Department's management in establishing goals, and in measuring progress towards those goals, and/or deviations from the plan before conditions become critical.

A similar comment was noted in the prior audit report.

Recommendation:

If the Department determines it appropriate, the Department should continue to finalize its strategic plan. Once completed, the Department will need to periodically update the plan to ensure that the plan remains relevant and useful to the Department in identifying goals and progress toward these goals. The plan should incorporate the goals of the Department, the means of how management intends to meet these goals, and how progress will be measured.

Auditee Response:

Concur. The Department has now completed and adopted the Strategic Plan and objectives have been assigned. The Department will periodically update the plan to ensure it remains relevant and useful.

State Compliance Comments

Observation No. 13: Administrative Rules Should Be Kept Current

Observation:

At June 30, 2011, many of the administrative rules required by statute related to the Department's operations either had not been adopted or had expired. The following table identifies statutorily required administrative rules that were not in effect during all or a portion of the fiscal year ended June 30, 2011.

RSA	RSA Description	N.H. Admin. Rule	Status
361-A:5, II	Retail Installment Sales Of Motor Vehicles	Ban 1000	Expired 10/30/10, rulemaking in progress
361-A:8-a, IV	Balloon Payment Loans	Ban 1005	Expired 10/30/10
383:13, II	Bank Reports	Ban 1103	Expired 11/18/94
383:13-a	Uniform Matrix	Ban 705	Expired 5/20/06
383:14, II	Fidelity Bond Coverage	Ban 1104	Expired 7/2/05 and not readopted until 8/21/10
386:1-b	Savings Banks	Ban 1400	Expired 7/7/92 (with exception of Ban 1450 which is in effect)
386-A:4, II	Petition For Incorporation Of A Savings Bank	Ban 1440	Expired 7/7/92
390:11-a	Reserves And Depositing Securities	Ban 1800	Expired 5/1/09
393:13-a	Building And Loan Associations	No rule	No rulemaking in progress
393:53	Converting a Federal Savings And Loan Association Into A State Building And Loan Association	No rule	No rulemaking in progress
394-A:10	Charter Conversions	Ban 802	Expired 12/28/04
397-A:10-a, I(a)	License Surrender-Mortgage Banker, Mortgage Broker, Or Originator	Ban 2411	Expired 1/27/09
397-B:3, I	Regulation Of Mortgage Loan Servicers	No rule	Rulemaking in progress
397-B:8, I(a)	Surrender Of Mortgage Loan Servicer Registration	No rule	Rulemaking in progress

RSA	RSA Description	N.H. Admin. Rule	Status
399-A:16, II	Regulation Of Small Loans, Title Loans, And Payday Loans	Ban 2400	Expired 8/1/06, rulemaking in progress
399-D:18, I	Debt Adjuster License Surrender	No rule	Rulemaking in progress
399-G:11, I	Money Transmitter License Surrender	No rule	Rulemaking in progress

The Department also identified nine discretionary administrative rules that had expired prior to June 30, 2011.

The lack of current administrative rules leaves the Department's action subject to challenge, and leaves regulated entities with a lack of clear guidance on the rules they are required to follow.

A similar comment was noted in the prior audit report.

Recommendation:

The Department should work with the Joint Legislative Committee on Administrative Rules to adopt required rules.

The Department should establish policies and procedures to ensure, going forward, all required administrative rules and appropriate discretionary administrative rules are adopted and readopted in a timely manner.

If the Department determines certain required rules are not necessary, the Department should request appropriate statutory revisions.

Auditee Response:

Concur. Pursuant to its Strategic Plan, the Department has formed a rules committee for the purpose of developing rules where required.

While the Department agrees that it must do a better job of ensuring that appropriate administrative rules are in place and current, it is important to note that New Hampshire courts have consistently held that a statute may be enforced, notwithstanding the lack of administrative rules, where its requirements or prohibitions are clear on its face.

Observation No. 14: The Department Should Align Assessment Billings With Statute

Observation:

The Department's assessment practices are not in strict compliance with statute. The lack of detailed guidance in statute and administrative rules to support the Department's annual assessment calculation and billings contribute to uncertainty as to how and when the assessment should be billed and collected.

While RSA 383:11 describes an assessment based on appropriations, the Department has historically based its annual assessment on actual expenditures. The statute is silent on the timing of the assessment and there are no administrative rules describing the assessment process. In basing its assessment on expenditures, the Department has delayed its assessment billings and collections on those assessments until well into the following fiscal year, delaying the recovery of the Department's costs of operations and negatively impacting the State's cash flow.

The assessment to recover fiscal year 2011 operating costs was billed in September 2011 and largely collected in November 2011, five months after the end of the fiscal year and seventeen months after the earliest expenditures had been incurred by the Department.

While a prior audit comment recommended the Department calculate and bill its assessments early in the fiscal year, similar to some other State departments that assess operating costs, the Department reported it had not revised its practice due to the financial impact on the paying institutions that would occur in the year the Department implemented a change from end of year to first of year billing. The Department also reported it was unsuccessful in the past in requesting the statute be revised to align with its historical practices.

While the Department's practice of billing and collecting assessments based on expenditures instead of appropriations results in the same amounts being collected over time, if based on appropriations, collections could be accomplished earlier in the fiscal year, allowing revenue to be matched to the Department's expenditures in the State's accounting system consistent with fund-based financial reporting. This would also assist the State's cash flow by recovering costs earlier.

A similar comment was noted in the prior audit report.

Recommendation:

The Department should base its assessments on appropriations as provided for in RSA 383:11.

The Department should establish administrative rules and policies and procedures for its administrative assessments that provide for timely recovery of operating costs.

If the Department determines that it is not in the Department's and State's best interest to charge and collect the assessment in accordance with RSA 383:11, the Department should again request an appropriate change in statute.

Auditee Response:

Concur in part. The Department believes the current practice is the most fair, efficient, and practical means of funding its activities and it will endeavor to change the law to reflect the current practice utilized by the Department. The current practice ensures that the institutions regulated by the Banking Division are being assessed for actual expenditures.

Observation No. 15: Late Fees Should Be Assessed In Accordance With Statute

Observation:

The lack of relevant administrative rules or policies and procedures to describe the application of RSA 383:13 (Bank Reports) contributed to an overcharging of late fees to banks which were late in submitting annual reports during fiscal year 2011.

During fiscal year 2011, the due date of the above mentioned annual reports was Sunday, January 30, 2011. The Department determined, for filing purposes, banks had to have the reports into the Department by Friday, January 28, 2011. The Department charged entities a \$25 per day late fee starting on Saturday, January 29, 2011, rather than on Monday January 31, 2011, which would have been in accordance with the statutory 30 calendar days. Twenty-five entities were overcharged a total of \$1,250 due to the Department's early implementation of the late fee.

The Department agreed the timing of the implementation of the late fee may not have been in accordance with statute, but that the Department had historically used the same date as both the due date and the fine trigger date. When the due date fell on a weekend and the Department recognized the prior Friday as the effective due date, the Department charged for the weekend in keeping with prior practice.

Recommendation:

As recommended in Observation No. 13, the Department should establish administrative rules and policies and procedures to support its assessment of fees.

The Department should assess late fees in accordance with statutory requirements. The Department should refund or credit the overcharged entities as appropriate.

Auditee Response:

Concur. The Department will address the recommendation.

Observation No. 16: Only Statutorily Directed Funds Should Be Deposited Into The Consumer Credit Administration License Fund

Observation:

The Department reports it has historically deposited more than the statutorily-directed funds into the Consumer Credit Administration License Fund, a dedicated fund.

RSA 399-A:5, Consumer Credit Administration License Fund, states, “The bank commissioner shall keep a separate account, in the state treasurer’s office, to be known as the consumer credit administration license fund. Moneys received from payment of fees under this chapter shall be credited to the consumer credit administration license fund. This fund may be expended by the commissioner with the approval of the governor and council for the purpose of supervising persons subject to supervision and licensing by the consumer credit administration division of the banking department.”

The statute directs fees collected by the Department pursuant to RSA 399-A, Regulation of Small Loans, Title Loans, and Payday Loans, be credited to the Consumer Credit Administration License Fund (Fund). The Department reports its practice has been to deposit all exam fees, licensing fees, and fines collected by the Department’s Consumer Credit Division, unrelated to RSA 399-A, into the Fund, for efficiency purposes. The Department reported approximately \$191,000 of the approximately \$219,000 balance in the Fund at June 30, 2011 is unrelated to revenue collected under RSA 399-A.

Recommendation:

The Department should only deposit funds collected pursuant to RSA 399-A into the Consumer Credit Administration License Fund.

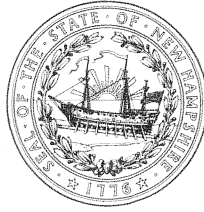
The Department should transfer the excess balance in the Fund to the appropriate accounts.

If the Department determines that for the benefit of the Department and State’s financial operations it should continue to deposit other Consumer Credit Division restricted revenues into the Consumer Credit Administration License Fund, it should request an appropriate legislative change.

Auditee Response:

Concur. The Department has historically deposited revenues related to RSA 361-A:2 III(c), RSA 397-A:5 II(b), RSA 397-B:4 I(a), RSA 398-A:1-d, RSA 399-A:5, RSA 399-D:2 and RSA 399-G:5 II(b), which all contain the following language: “Sums collected under this chapter shall be payable to the state treasurer as restricted revenue and credited to the appropriation for the commissioner, consumer credit administration division”, in the Fund for efficiency purposes.

We agree that the accounting for these revenues should be changed to be in strict compliance with RSA 399-A:5.



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Independent Auditor's Report

To The Fiscal Committee Of The General Court:

We have audited the accompanying Statement of Revenues and Expenditures - General Fund of the Banking Department (Department) for the fiscal year ended June 30, 2011. This financial statement is the responsibility of the management of the Department. Our responsibility is to express an opinion on this financial statement based on our audit.

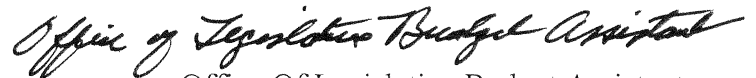
We conducted our audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statement is free of material misstatement. An audit includes consideration of internal control over financial reporting as a basis for designing audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Department's internal control over financial reporting. Accordingly, we express no such opinion. An audit also includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statement, 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 discussed in Note 1, the financial statement of the Department is intended to present certain financial activity of only that portion of the State of New Hampshire that is attributable to the transactions of the Department. The Statement of Revenues and Expenditures - General Fund, does not purport to and does not constitute a complete financial presentation of either the Department or the State of New Hampshire in conformity with accounting principles generally accepted in the United States of America.

In our opinion, 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 Department for the fiscal year ended June 30, 2011, in conformity with accounting principles generally accepted in the United States of America.

Our audit was conducted for the purpose of forming an opinion on the Statement of Revenues and Expenditures - General Fund of the Department. The supplementary information, as identified in the table of contents, is presented for purposes of additional analysis and is not a required part of the financial statement. Such information has been subjected to the auditing procedures applied in the audit of the financial statement. In our opinion, the supplementary information is fairly stated, 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 March 28, 2012 on our consideration of the Department's internal control over financial reporting and on our tests of its compliance with certain provisions of laws, rules, regulations, contracts, and other matters. The purpose of that report is to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing, and not to provide an opinion on the internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* and should be considered in assessing the results of our audit.


Office Of Legislative Budget Assistant

March 28, 2012

**STATE OF NEW HAMPSHIRE
BANKING DEPARTMENT**

**STATEMENT OF REVENUES AND EXPENDITURES - GENERAL FUND
FOR THE FISCAL YEAR ENDED JUNE 30, 2011**

Revenues

Unrestricted Revenues	
Fines	\$ 3,800
Other	427
Total Unrestricted Revenues	<u>4,227</u>
Restricted Revenues	
Examinations	1,977,406
Assessments (Note 2)	956,980
Licenses	777,858
Fines	672,719
Other	59,107
Total Restricted Revenues	<u>4,444,070</u>
Total Revenues	<u>4,448,297</u>

Expenditures

Salaries And Benefits	4,229,409
Information Technology	259,058
Current Expenses	228,697
Building Lease	207,572
Transfers To Other State Agencies	167,417
Travel Reimbursement	133,482
Indirect Costs	128,544
Employee Training	59,018
Other	36,019
Total Expenditures	<u>5,449,216</u>
Excess (Deficiency) Of Revenues Over (Under) Expenditures	<u>(1,000,919)</u>
Other Financing Sources (Uses)	
Net Appropriations (Note 3)	1,005,146
Total Other Financing Sources (Uses)	<u>1,005,146</u>
Excess (Deficiency) Of Revenues And Other Financing Sources Over (Under) Expenditures And Other Financing Uses	<u>\$ 4,227</u>

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

**STATE OF NEW HAMPSHIRE
BANKING DEPARTMENT**

**NOTES TO THE FINANCIAL STATEMENT
FOR THE FISCAL YEAR ENDED JUNE 30, 2011**

NOTE 1 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

The accompanying financial statement of the Banking Department has been prepared in accordance with accounting principles generally accepted in the United States of America (GAAP) and as prescribed by the Governmental Accounting Standards Board (GASB), which is the primary standard-setting body for establishing governmental accounting and financial reporting principles.

A. Financial Reporting Entity

The financial statement reports certain financial activity of the New Hampshire Banking Department (Department) in the State of New Hampshire's (State's) General Fund. Not included in the financial statement is the Public Deposit Investment Pool (PDIP). Pursuant to RSA 383:22, the Bank Commissioner established the PDIP for the purpose of investing the funds of the State and other governmental entities. The PDIP operates under contract with a private investment advisor and annually issues audited financial statements. Also not included in the Department's financial statement is the financial activity of the Noble Trust Company, a financial institution under the possession of the Department, pursuant to an action taken under RSA 395:2 by the Department and the Merrimack County Superior Court. At June 30, 2011, the Department's Deputy Commissioner had been assigned liquidator of the Noble Trust Company.

The financial activity of the Department is accounted for and reported in the State's General Fund in the State'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 General Fund financial statement is not intended to show the financial position or fund balance of the Department in the General Fund.

B. Financial Statement Presentation

The State and Department use funds 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. The Department reports its financial activity in the fund described below.

Governmental Fund Type:

General Fund: The General Fund is the State's primary operating fund and accounts for all financial transactions not specifically accounted for in any other fund.

C. Measurement Focus And Basis Of Accounting

Governmental fund financial statements are reported using the current financial resources measurement focus and the modified accrual basis of accounting. Revenues are recognized as soon as they are both measurable and available. Revenues are considered to be available when they are collectible within the current period or soon enough thereafter to pay the liabilities of the current period. For this purpose, the State generally considers revenues to be available if they are collected within 60 days of the end of the current fiscal period. An exception to this policy is federal grant revenue, which generally is considered to be available if collection is expected within 12 months after period end. Taxes, grants, licenses, and fees associated with the current fiscal period are all considered to be susceptible to accrual and so have been recognized as revenues of the current fiscal period.

Expenditures generally are recorded when a liability is incurred, as under accrual accounting. However, expenditures related to debt service and other long-term obligations including compensated absences, other post-employment benefits, pollution remediation obligations, and claims and judgments are recorded only when payment is due.

D. Revenues And Expenditures

In the governmental fund financial statements, revenues are reported by source. For budgetary control purposes, revenues are further classified as either "unrestricted" (general purpose) or "restricted". Unrestricted revenues are credited directly to the General Fund or other fund balance upon recording in the State's accounting system. Pursuant to the State's operating budget, unrestricted revenues collected by an agency are not used as a direct source of funding for agency operations but are available to fund any activity accounted for in the fund. The recording of unrestricted revenues has no effect on an agency's authorization to expend funds. The Department reported \$4,227 of unrestricted revenue during fiscal year 2011.

Unused restricted revenues at year end are either lapsed or generally recorded as a committed or assigned fund balance. When both unrestricted and restricted funds are available, it is the State's policy to use restricted revenues first.

In the governmental fund financial statements, expenditures are reported by function.

E. Budget Control And Reporting

General Budget Policies

The statutes of the State require the Governor to submit a biennial budget to the Legislature for adoption. This budget, which includes a separate budget for each year of the biennium, consists

of three parts: Part I is the Governor's program for meeting all expenditure needs and estimating revenues. There is no constitutional or statutory requirement that the Governor propose, or that 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 fund types.

In addition to the enacted biennial operating budget, the Governor may submit to the Legislature supplemental budget requests necessary to meet expenditures during the current biennium. Appropriation transfers can be made within a department without the approval of the Legislature; therefore, the legal level of budgetary control is at the departmental level.

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

Unexpended balances of appropriations at year end will lapse to assigned or unassigned fund balance and be available for future appropriations unless they have been encumbered or legally defined as non-lapsing, which means the balances are reported as restricted, committed, or assigned fund balance. The balance of unexpended encumbrances is brought forward into the next fiscal year. Capital Projects Fund unencumbered appropriations lapse in two years unless extended or designated as non-lapsing by law.

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. The Department's unliquidated encumbrance balance at June 30, 2011 in the General Fund was \$414.

A Budget To Actual Schedule - General Fund is included as supplementary information.

NOTE 2 - ASSESSMENTS

RSA 383:11 directs the Department to collect from the institutions it regulates an annual assessment to cover the cost of operating the Department that is not recovered through examination fees. The Department calculates separate assessments for the Banking and Consumer Credit Divisions. Any excess collected in any fiscal year is used to reduce the sum required to be collected in the next succeeding fiscal year.

The Department did not issue an assessment for the Consumer Credit Division during fiscal year 2011 as examination fees, license fees, and fines more than covered the cost of operating the Division.

NOTE 3 - NET APPROPRIATIONS

Net appropriations reflect appropriations for expenditures in excess of restricted revenue. During fiscal year 2011, approximately \$1.0 million was drawn from the available balance in the Consumer Credit Administration License Fund, a dedicated fund accounted for in the State's General Fund, to support the Department's financial activities. At June 30, 2011, this balance was supported by a \$1.1 million deferred revenue accrual related to the Department's September 2011 billing of the fiscal year 2011 administrative assessment.

NOTE 4 - EMPLOYEE BENEFIT PLANS

New Hampshire Retirement System

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

Group I members at age 60 (age 65 for members beginning service on or after July 1, 2011) qualify for a normal service retirement allowance based on years of creditable service and average final compensation (AFC). The yearly pension amount is 1/60 (1.67%) of AFC multiplied by years of creditable service (1/66 of AFC times creditable service for members beginning service on or after July 1, 2011). AFC is defined as the average of the three highest salary years for members vested prior to January 1, 2012 and five years for members not vested on January 1, 2012. 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 10 or more years of creditable service who are between age 50 and 60 or members in service with at least 20 or more years of service, whose combination of age and service is 70 or more, are entitled to a retirement allowance with appropriate graduated reduction based on years of creditable service.

All covered Department employees are members of Group I.

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

Pursuant to RSA 100-A:52, RSA 100-A:52-a, and RSA 100-A:52-b, the New Hampshire Retirement System also provides a postretirement medical premium subsidy for Group I employees and teachers and Group II police officers and firefighters.

A special account was established by RSA 100-A:16, II (h) for additional benefits. Prior to fiscal year 2007, the account was credited with all of the earnings of the account assets in the account plus the earnings of the remaining assets of the plan in excess of the assumed rate of return plus $\frac{1}{2}$ of 1%.

In 2007, legislation was passed that permits the transfer of assets into the special account for earnings in excess of 10.5% as long as the actuary determines the funded ratio of the retirement system to be at least 85%. If the funded ratio of the system is less than 85%, no assets will be transferred to the special account.

In fiscal year 2011, two pieces of legislation passed that impacted the special account. The first required an \$89 million transfer from the special account to the annuity accumulation fund effective May 11, 2011. The other, required the balance remaining in the special account, less funds set aside to comply with the temporary supplemental allowances required by RSA 100-A:41-d, III, to be transferred to the respective components of the State annuity accumulation fund, effective June 30, 2011. This resulted in an additional transfer from the special account to the State annuity accumulation fund totaling \$167.3 million.

The New Hampshire Retirement System issues a publicly available financial report that may be obtained by writing to them at 54 Regional Drive, Concord, NH 03301 or from their web site at <http://www.nhrs.org>.

The Plan is financed by contributions from the members, the State and local employers, and investment earnings. During the fiscal year ended June 30, 2011, Group I members were required to contribute 5% of gross earnings, except for State employees hired after July 1, 2009, who contributed 7% of gross earnings. Employer contributions required to cover the amount of costs not met by the members' contributions are determined by a biennial actuarial valuation by the system's actuary using the entry age normal funding method and are expressed as a percentage of gross payroll. The State's share represents 100% of the employer cost for all of the Department's employees enrolled in the Plan.

The Department's payments for normal contributions for the fiscal year ended June 30, 2011 amounted to 9.09% of the covered payroll for its Group I employees. The Department's normal contributions for the fiscal year ended June 30, 2011 were \$300,097.

Other Postemployment Benefits

In addition to providing pension benefits, RSA 21-I:30 specifies that the State provide certain health care benefits for retired employees and their spouses within the limits of the funds appropriated at each legislative session. These benefits include group hospitalization, hospital medical care, and surgical care. Substantially all of the State's employees who were hired on or before June 30, 2003 and have 10 years of service, may become eligible for these benefits if they

reach normal retirement age while working for the State and receive their pensions on a periodic basis rather than a lump sum. During fiscal year 2004, legislation was passed that requires State Group I employees hired after July 1, 2003 to have 20 years of State service in order to qualify for health insurance benefits. These and similar benefits for active employees are authorized by RSA 21-I:30 and provided through the Employee and Retiree Benefit Risk Management Fund, a single employer defined benefit plan, which is the State's self-insurance fund implemented in October 2003 for active State employees and retirees. The State recognizes the cost of providing benefits by paying actuarially determined insurance contributions into the fund. An additional major source of funding for retiree benefits is from the New Hampshire Retirement System's medical premium subsidy program for Group I and Group II employees. The Department's Medical Subsidy normal contribution rate for the fiscal year ended June 30, 2011 was 0.07% of the covered payroll for its Group I employees. The Department's contributions for the Medical Subsidy for the fiscal year ended June 30, 2011 were \$2,311.

The cost of the health benefits for the Department's retired employees and spouses is initially paid from an appropriation made to the administrative organization of the New Hampshire Retirement System. The Department reimbursed the New Hampshire Retirement System \$77,767 for the Department's share of post-retirement health care costs for fiscal year 2011.

The State Legislature currently plans to only partially fund (on a pay-as-you-go basis) the annual required contribution (ARC), an actuarially determined rate in accordance with the parameters of Governmental Accounting Standard Board (GASB) Statement No. 45. The ARC represents a level of funding that, if paid on an ongoing basis, is projected to cover normal cost each year and amortize any unfunded actuarial liabilities over a period not to exceed 30 years. The ARC and contributions are reported for the State as a whole and are not separately reported for the Department.

**STATE OF NEW HAMPSHIRE
BANKING DEPARTMENT
BUDGET TO ACTUAL SCHEDULE - GENERAL FUND
FOR THE FISCAL YEAR ENDED JUNE 30, 2011**

<u>Revenues</u>	<u>Original Budget</u>	<u>Actual</u>	<u>Favorable (Unfavorable) Variance</u>
Unrestricted Revenues			
Fines	\$ -0-	\$ 3,800	\$ 3,800
Other	-0-	427	427
Total Unrestricted Revenues	-0-	4,227	4,227
Restricted Revenues			
Examinations	2,140,184	1,977,406	(162,778)
Assessments	1,776,697	956,980	(819,717)
Licenses	1,261,129	777,858	(483,271)
Fines	321,655	672,719	351,064
Other	42,713	59,107	16,394
Total Restricted Revenues	5,542,378	4,444,070	(1,098,308)
Total Revenues	5,542,378	4,448,297	(1,094,081)
 <u>Expenditures</u>			
Salaries And Benefits	4,287,051	4,229,409	57,642
Information Technology	315,473	259,058	56,415
Current Expenses	114,518	228,697	(114,179)
Building Lease	209,845	207,572	2,273
Transfers To Other State Agencies	123,118	167,417	(44,299)
Travel Reimbursement	174,702	133,482	41,220
Indirect Costs	64,417	128,544	(64,127)
Employee Training	86,000	59,018	26,982
Other	167,254	36,019	131,235
Total Expenditures	5,542,378	5,449,216	93,162
 Excess (Deficiency) Of Revenues Over (Under) Expenditures	-0-	(1,000,919)	(1,000,919)
 Other Financing Sources (Uses)			
Net Appropriations (Note 2)	-0-	1,005,146	(1,005,146)
Total Other Financing Sources (Uses)	-0-	1,005,146	(1,005,146)
 Excess (Deficiency) Of Revenues And Other Financing Sources Over (Under) Expenditures And Other Financing Uses	\$ -0-	\$ 4,227	\$ 4,227

The accompanying notes are an integral part of this schedule.

Notes To The Budget To Actual Schedule - General Fund For The Fiscal Year Ended June 30, 2011

Note 1 - 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 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.

The budget, as reported in the Budget To Actual Schedule, reports the initial operating budget for fiscal year 2011 as passed by the Legislature in Chapter 143, Laws of 2009.

Budgetary control is at the department level. In accordance with RSA 9:16-a, notwithstanding any other provision of law, every department is authorized to transfer funds within and among all program appropriation units within said department, provided any transfer of \$2,500 or more shall require 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 appropriations at year end will lapse to undesignated fund balance and be available for future appropriations unless they have been encumbered or are legally defined as non-lapsing accounts.

Variances - Favorable/(Unfavorable)

The variance column on the Budget To Actual Schedule highlights differences between the original 12-month operating budget and the actual revenues and expenditures for the fiscal year ended June 30, 2011. Actual revenues exceeding budget or actual expenditures being less than

budget generate a favorable variance. Actual revenues being less than budget or actual expenditures exceeding budget cause an unfavorable variance.

The excess of revenues and other financing sources over expenditures and other financing uses is the amount of unrestricted revenues budgeted to be collected by and actually collected by the Department. Unrestricted revenues are not available, without prior appropriation, to fund the operations of the Department.

As previously noted, the unfavorable expenditure variances shown in the Budget To Actual Schedule represent the difference between actual expenditures incurred during fiscal year 2011 and the original budget in place at the beginning of fiscal year 2011. The State and Department use supplemental appropriations to add appropriations to original budget amounts to reflect changes in levels of operations not provided for in the original budget. During fiscal year 2011, the Department's original expenditure budget amounts were supplemented by approximately \$370,000 of additional appropriations. The unfavorable variances on the Budget To Actual Schedule were supported by these supplemental appropriations.

Note 2 - Net Appropriations

Net appropriations reflect appropriations for expenditures in excess of restricted revenue. During fiscal year 2011, approximately \$1.0 million was drawn from the available balance in the Consumer Credit Administration License Fund, a dedicated fund accounted for in the State's General Fund, to support the Department's financial activities. At June 30, 2011, this balance was supported by a \$1.1 million deferred revenue accrual related to the Department's September 2011 billing of the fiscal year 2011 administrative assessment.

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APPENDIX - CURRENT STATUS OF PRIOR AUDIT FINDINGS

The following is a summary, as of June 30, 2011, of the current status of the observations contained in the financial and compliance audit report of the Banking Department for the nine months ended March 31, 2002. The prior audit report can be accessed on-line at <http://www.gencourt.state.nh.us/LBA/AuditReports/FinancialReports.aspx>.

	<u>Status</u>		
<i>Internal Control Comments</i>			
<i>Reportable Conditions</i>			
1. Segregation Of Duties Control Procedures Need To Be Established (<i>See Current Year Observation No. 2</i>)	●	○	○
2. Formal Policy For Accounts Receivable Should Be Developed And Collection Procedures Should Be Improved	●	●	○
3. Monthly Revenue Reconciliations Should Be Performed (<i>See Current Year Observation No. 2</i>)	●	○	○
4. Initial Controls Over Cash Receipts Should Be Enhanced	●	●	●
5. Cost Allocation Methods Should Be Improved (<i>See Current Year Observation No. 3</i>)	○	○	○
6. An Effective Timekeeping System Should Be Utilized	●	●	●
7. A Formal Information Security Policy And Disaster Recovery Plan Should Be Developed (<i>See Current Year Observation No. 6</i>)	●	○	○
 <i>State Compliance</i>			
8. Department Statutes Should Be Reviewed For Relevancy (<i>See Current Year Observation No. 1</i>)	●	○	○
9. The Number Of Examinations Of Consumer Credit Institutions Needs To Be Increased	●	●	●
10. The Department Should Revise Its Assessment Methodology And Timing Of Collections (<i>See Current Year Observation No. 14</i>)	○	○	○
11. Administrative Rules Should Be Adopted As Required By Statute (<i>See Current Year Observation No. 13</i>)	●	○	○
 <i>Management Issues Comments</i>			
12. Procedures For The Identification Of Unlicensed Institutions And Providing Public Awareness Should Be Improved	●	●	○
13. The Department Should Seek Legislation To Help Enforce Governing Statutes (<i>See Current Year Observation No. 1</i>)	●	○	○
14. A Long-Term Strategic Plan Should Be Developed (<i>See Current Year Observation No. 12</i>)	●	○	○

<u>Status Key</u>	<u>Count</u>			
Fully Resolved	●	●	●	3
Substantially Resolved	●	●	○	2
Partially Resolved	●	○	○	7
Unresolved	○	○	○	2

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