

**STATE OF NEW HAMPSHIRE  
DEPARTMENT OF STATE  
REVENUES DEPOSITED AND EXPENDITURES PAID**

**FINANCIAL AND COMPLIANCE  
AUDIT REPORT  
FOR THE TEN MONTHS ENDED APRIL 30, 2007**



**STATE OF NEW HAMPSHIRE  
DEPARTMENT OF STATE  
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This report can be accessed in its entirety on-line at [www.gencourt.state.nh.us/lba/audit.html](http://www.gencourt.state.nh.us/lba/audit.html)

**STATE OF NEW HAMPSHIRE  
DEPARTMENT OF STATE  
REVENUES DEPOSITED AND EXPENDITURES PAID**

**Reporting Entity And Scope**

The reporting entity and scope of this audit and audit report are the revenues deposited and expenditures paid of the New Hampshire Department of State (Department) for the ten months ended April 30, 2007. Not included in the reporting entity are the State boards and commissions that are related to the Department by statute.

The following report describes certain financial activity of the Department of State, as it existed during the period under audit. The Department prepared the auditee responses included in the constructive service comments section of this report.

**Organization**

The Department of State was established under the executive direction of the Secretary of State by Chapter 5, of the Revised Statutes Annotated. Part 2, Articles 67 and 69, of the New Hampshire Constitution, requires the Secretary of State to be chosen by joint ballot of the senators and representatives, and to appoint a deputy secretary to perform the duties of the office, if the Secretary of State is unable.

The Department of State is organized into the six Divisions of Administration, Elections, Corporate, Uniform Commercial Code, Archives and Records Management, Vital Records Administration, and a Bureau of Securities Regulation.

At April 30, 2007, the Department of State employed 98 full-time and 18 part-time employees.

**Responsibilities**

The major duties and responsibilities of the Department are as follows.

The Division of Administration is responsible for keeping the great seal, attesting to the governor's signature and affixing the great seal on all official documents, engrossing public acts, attending Governor and Council meetings, performing clerical duties for the Board of Claims and the Ballot Law Commission, and for preparing and issuing all notary public and justice of the peace commissions.

The Elections Division is responsible for administering State elections, printing ballots and election forms, and instructing local election officials. The Division also publishes the manual for the general court (the Redbook), the New Hampshire election laws, and, with the approval of the attorney general, the political calendar and the elections procedure manual.

The Corporate Division oversees the receipt of corporate returns and related fees, tracks delinquent corporations for dissolution purposes and records all statutory filings of business entities, trademarks and tradenames, and miscellaneous filings.

The Uniform Commercial Code Division serves the commercial lending/banking community by acting as a repository for filed documents which perfect security interests in certain personal property used as collateral for loans. These filings help a secured creditor establish priority claims on assets in the event of debtor bankruptcy, insolvency, or default. The Division is responsible for providing a universally accessible, secured transaction registry for users and beneficiaries of the Uniform Commercial Code process.

The Division of Archives and Records Management, established by RSA 5:27, is responsible for establishing and maintaining programs for the storage, retention, and ultimate disposal of agency records, and for accepting, arranging, describing, and making available the public archives of permanent historical value.

The Division of Vital Records Administration, established by RSA 5-C:2, is responsible for providing access to vital records and vital records data while assuring the privacy of all New Hampshire citizens.

In accordance with RSA 421-B:21, the Secretary of State is responsible for administering the State laws related to the sale of securities in the State. The Bureau of Securities Regulation handles the annual licensing of agents, broker dealers, and investment advisors as well as the licensing of securities sold in the State. The Bureau is responsible for examining each domestic broker-dealer as well as the New Hampshire branches of any foreign broker-dealers.

## Funding

The financial activity of the Department of State is accounted for in the General Fund and the Capital Projects Fund of the State of New Hampshire.

The following table summarizes the revenues deposited and expenditures paid during the ten months ended April 30, 2007 for the Department of State.

### Department Of State Summary Of Revenues Deposited And Expenditures Paid For The Ten Months Ended April 30, 2007

	<b>General Fund</b>	<b>Capital Projects Fund</b>	<b>Total</b>
Total Revenues Deposited	\$ 42,891,963	\$ -0-	\$ 42,891,963
Total Expenditures Paid	8,117,825	519,436	8,637,261
<b>Excess (Deficiency) Of Revenues Deposited Over (Under) Expenditures Paid</b>	<b><u>\$ 34,774,138</u></b>	<b><u>\$(519,436)</u></b>	<b><u>\$ 34,254,702</u></b>

## Prior Audit

The most recent prior financial and compliance audit of the Department of State was for the ten months ended April 30, 1996. The scope of that audit included the Department of State and related boards and commissions. Appendix A to this report on page 67 contains a summary of

the current status of the observations contained in that report. A summary of the prior audit report can be accessed at, and printed from, the Office of Legislative Budget Assistant website. [www.gencourt.state.nh.us/lba/audit.html](http://www.gencourt.state.nh.us/lba/audit.html)

The constitutional duties of the Secretary of State, as a constitutional officer, are exempt from program results audits by RSA 14:31-a, I(d).

### **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 Department of State for the ten months ended April 30, 2007. 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 related to the Department. Major accounts or areas subject to our examination included, but were not limited to, the following:

- Revenues Deposited and
- Expenditures Paid.

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

## **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 Statement Of Revenues Deposited And Expenditures Paid - General Fund And Capital Projects Fund of the Department of State for the ten months ended April 30, 2007 and have issued our report thereon dated July 18, 2008. 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 our audit, we considered the Department of State'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 of State'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 would not necessarily identify all deficiencies in internal control over financial reporting that might be significant deficiencies or material weaknesses. However, as discussed below, we identified certain deficiencies in internal control over financial reporting that we consider to be significant deficiencies.

A control deficiency 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 misstatements on a timely basis. A significant deficiency is a control deficiency, or combination of control deficiencies, that adversely affects the entity's ability to initiate, authorize, record, process, or report financial data reliably in accordance with generally accepted accounting principles such that there is more than a remote likelihood that a misstatement of the entity's financial statements that is more than inconsequential will not be prevented or detected by the entity's internal control. We consider the deficiencies described in Observations No. 1 through No. 25 to be significant deficiencies in internal control over financial reporting.



A material weakness is a significant deficiency, or combination of significant deficiencies, that results in more than a remote likelihood that a material misstatement of the financial statements will not be prevented or detected by the entity's internal control.

Our consideration of the internal control over financial reporting was for the limited purpose described in the first paragraph of this section and would not necessarily identify all deficiencies in the internal control that might be significant deficiencies and, accordingly, would not necessarily disclose all significant deficiencies that are also considered to be material weaknesses. However, we believe Observations Nos. 1, 2, 3, 4, 6, 7, 8, 14, 17, and 20 are material weaknesses.

### Compliance And Other Matters

As part of obtaining reasonable assurance about whether the Department of State'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*, which is described in Observation No. 26, and certain immaterial instances of noncompliance, which are described in Observations No. 27 through No. 30.

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

This report is intended solely for the information and use of management and others in the Department of State and the Fiscal Committee of the General Court and is not intended to be used by anyone other than these specified parties.

Office Of Legislative Budget Assistant

July 18, 2008

**Internal Control Comments**  
**Significant Deficiencies**

**Observation No. 1: Internal Controls Must Be Improved**

*Observation:*

The lack of an effective system of internal controls puts the Department's objectives of achieving efficient and effective operations, reliable financial reporting, and compliance with laws and regulations at significant risk.

Internal control is defined as a process, effected by an entity's people, designed to accomplish specified objectives. The definition is broad, encompassing all aspects of controlling a business, yet facilitates a directed focus on specific objectives. Internal control consists of five interrelated components, which are inherent in the way management runs an enterprise. The components are linked, and serve as criteria for determining whether the system is effective.<sup>1</sup> As noted on the table of contents, this report contains 25 internal control comments describing significant deficiencies, including material weaknesses, in the financial operations of the Department of State.

The Department's operations are hampered by significant weaknesses in each of the five generally recognized interrelated internal control components of:

1. Control environment,
2. Risk assessment,
3. Control activities,
4. Information and communication, and
5. Monitoring.

**Control Environment**

The control environment encompasses a number of factors that have a pervasive influence on the way business activities are structured, objectives are established, and risks are assessed. The control environment influences employees' control awareness and instills an enterprise-wide attitude of integrity and control consciousness.

- As noted in Observations No. 3, No. 14, No. 19 and No. 25, RSA 21-I:18, I(c) and other statutes exempt significant aspects of the Department's operations from much of the State's normal control processes. The lack of central State controls combined with the lack of effective Department instituted controls is a significant control deficiency which can result in a pervasive negative effect on employee control consciousness and appreciation, increasing the risk that errors or frauds will occur and not be detected.

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<sup>1</sup> Committee of Sponsoring Organizations of the Treadway Commission, Internal Control-Integrated Framework, May 1994, page 13.

## **Risk Assessment**

An entity's performance can be at risk due to internal or external factors. These factors can affect the entity's ability to reach and maintain adherence to its stated or implied objectives. External factors include economic changes having an effect on decisions related to financing, capital expenditures, changing customer needs or expectations, new legislation, natural catastrophes, etc. Internal factors including disruption of information systems, quality of personnel hired and methods of training and motivation, and change in management responsibilities of the entity can also affect the way certain controls are affected. Risks increase at times of change including changes in personnel and changes in procedures.

Over time, the Department's responsibilities have increased significantly. Most recently, the Department was given the responsibility for the State's vital records operations. However, there is no clear indication that the Department has regularly reviewed its operations for its exposure and response to risk.

- As noted in Observation No. 4, the Department does not have formal risk assessment and mitigation processes. While the Department has experienced significant change over time, it has not periodically and formally reviewed its operations to assess where and how things could go wrong, what is the likelihood of those occurrences, and what is the reasonable response to those potential occurrences.

## **Control Activities**

An entity's control activities are the policies and procedures used to ensure that the entity's objectives are attained and that management's directives identified as necessary to address risk are carried out. Controls are categorized as preventative, detective, manual, computer, and management controls. In State government, control activities are a combination of general State control and department control activities. However, at the Department, RSA 21-I:18, I(c) and other statutes exempt significant aspects of the Department's operations from general State control activities, making the successful design, implementation and continued effectiveness of Department control activities critical.

- As noted in Observations No. 3, No. 7, No. 17, No. 22, and No. 25, the Department's control activities are generally informal and are not supported by documented policies and procedures. As is often the case with informal policies and procedures, the control activities were not consistently performed or were performed with insufficient care to provide a level of assurance necessary to have reasonable confidence that the control objectives were being met during the ten months ended April 30, 2007. As noted in the following observations in the report, revenue reports were not prepared and analyzed, error reports were not reviewed, effective reconciliations were not performed, and segregation of incompatible functions was not established and maintained. Each of these control deficiencies, as discussed in the following observations, increases the risk the Department would not reach and maintain its operating objectives.

## **Information and Communication**

Information is needed at all levels of an organization to run its operations and to move toward achievement of the entity's objectives. Financial information is used not only in developing financial statements for external reporting but is also used as a basis for operating decisions, such as monitoring performance and allocating resources.

- As noted in Observations No. 3, No. 7, No. 8, and No. 13, the Department has opportunities to improve its controls over its information technology (IT) based systems.

### **Monitoring**

Monitoring ensures that internal controls continue to operate effectively and as intended by management. This involves assessments by appropriate personnel of the design and operation of the controls on a timely basis and taking necessary actions.

- As noted in Observation No. 20, the Department did not effectively monitor the performance of its control over payroll as management did not recognize and take corrective action when control procedures became less than effective.

### *Recommendation:*

The Department must take steps to establish and maintain appropriate controls to safeguard its operations. The Department should review the fundamentals of internal controls to understand how effective controls would assist the Department in establishing and meeting its objectives.

- The Department should expand its management level staffing to include a senior financial manager with the training and experience required to strengthen the Department's financial control structure. As the sophistication and complexities of the Department's financial activities have increased over time with the addition of responsibilities for administering State laws related to the sale of securities in the State, and the more recent additions of the Help America Vote Act program and the Division of Vital Records, so does the level of financial management expertise necessary to properly review, control, evaluate, and report these and the other financial activities of the Department.
- In addition to the senior financial manager position, the Department must adequately staff its financial accounting and reporting functions with trained accountants who bring to the positions the knowledge and experience needed to assist the Department in properly accounting for and reporting the financial activity of the Department.
- The Department should take advantage of the Statewide controls provided by the Department of Administrative Services' purchasing and other control procedures.
- The Legislature should consider limiting the exemption granted to the Secretary of State under RSA 21-I:18, I(c), regarding Department of Administrative Services' statewide controls over purchasing and personnel matters, to only those areas specifically related to carrying out the provisions of the election laws.
- The Department must review its control activities and establish formal policies and procedures to ensure the Department's objectives are attained. The Department should not be primarily dependent upon employees' experience and judgment to perform Department controls. Critical controls must be documented to provide reasonable assurance that the controls will be performed as management intends, regardless of the experience of the employee that fills the control position.
- The Department must improve its communication and information systems and the controls over those systems. The effects of the limitations of the Department's primary information system (Secretary of State Knowledge Base - SOSKB), the vital records information system (New Hampshire Vital Records Information Network - NHVRIN), and Securities Regulation Database systems should be mitigated until corrected. The Department must be reasonably

certain the systems are secure and provide complete and accurate information for the needs of the Department and others.

- The Department should partner with the Office of Information Technology (OIT) to obtain additional resources for the operation and improvement of the Department's information technology (IT) systems. The Department's continued and increasing reliance on critical IT systems will require close control and support to ensure efficient, effective, and safe operations. The Department should regard the State's OIT as a primary resource for that control and support.
- The Department must improve its control monitoring efforts to ensure the controls are operating as intended. Management should attend to problems evidenced through monitoring efforts in a timely manner to demonstrate its concern for controlled operations.

*Auditee Response:*

Since the last audit the Department of State has been expanded by two new divisions.

In the area of elections, federal mandates have required the implementation of a statewide, centralized voter database that is interactive with town clerks and supervisors of the checklist, the purchase and placement of accessible voting equipment in all polling places and extensive local election official and poll worker training.

The Department has absorbed the division of Vital Records from the Department of Health and Human Services and has been working to improve services provided to the general public and the cities and towns.

The Department has implemented on-line customer service technology within the Corporations division dramatically reducing long lines at the service windows, busy signals on the telephone system and eliminating the months-long backlogs to have some applications processed.

The Bureau of Securities has been extremely active protecting the citizens of New Hampshire with several complex, high profile, enforcement actions. At the same time the Bureau of Securities has greatly increased its investor education activities and has continued to generate record revenues for the state since coming to the Department.

Information technology has also become critically important to the Department with major technology initiatives to improve operations in elections, corporations, vital records and securities.

The Department has absorbed all of this growth with a limited increase in additional resources. It is also worth noting, the Department performs extremely well in every division in terms of delivering the services with which they are charged.

While we agree that controls can always be improved and some weaknesses exist within the Department's internal controls, we disagree as noted in a number of our responses with the severity and scope of the corresponding observations. We also believe that we have struck a balance between maintaining a minimal staff and reasonable internal controls. The Department will take the recommendations stated in this audit seriously and will work to address deficiencies.

**Observation No. 2: All Significant Aspects Of The Department’s Control Structure Should Be Documented**

*Observation:*

The Department has not documented significant aspects of its control structure, increasing the risk of disruptions to Department operations from unanticipated employee changes and other events.

The Department has not established formal policies and procedures manuals for many of its important functions. During initial audit inquiry, the Bureau of Securities Regulation was the only area of the Department that reported having formal policies and procedures manuals. The Department relies upon the continued performance of key personnel to carry on the controlled operations of the Department to effectively meet its goals. The continued success of the Department is in large part dependent upon the incumbents in the positions and not on established policies and procedures in place at the Department. The organization faces significant risks to operations if the incumbent becomes unwilling or unable to continue in service.

Along with policies and procedures, comprehensive job descriptions are an integral component of an entity’s control environment and overall control system. The Department has not developed formal, detailed job descriptions for its senior financial management employees. Comprehensive job descriptions enable the distinguishing of positions, delineation of tasks, and the determination and substantiation of pay levels. Well-developed job descriptions can become a primary component of an agency’s succession and business continuity plans. Without job descriptions, efforts to staff, develop, and evaluate performance can be without basis and direction, with ongoing job performance again becoming increasingly dependent upon the continued performance of the incumbent.

*Recommendation:*

The Department should undertake an effort to establish and document the performance of its important functions and tasks, including its control structure, to both meet its responsibility to the State for succession planning and also to lessen the risks of disruptions to operations from unanticipated employee changes and other unexpected disruptive events.

As part of its documentation effort, the Department should develop formal and detailed job descriptions, with suitable detail narrative of position responsibilities and duties performed, for all of its senior financial management employees. These descriptions should be regarded as a fundamental component of the Department’s control structure and the Department’s efforts to provide reasonable assurance of the continued performance of the Department’s critical functions.

*Auditee Response:*

The Department acknowledges suitable detail narrative of position responsibilities and duties performed by senior financial management employees would be helpful.

### **Observation No. 3: Appropriate IT Controls Must Be Adopted**

*Observation:*

The Department has not established a suitable control structure over its information technology (IT) systems.

The Department uses several significant IT systems to process and record corporate filings and revenues, vital records filings and revenues, voter registration information, as well as other systems critical to the Department's operations. A review of the controls over these systems indicated a lack of even elementary control concerns and processes. For example, the Department has not established strong logical and physical access controls, strong change controls, and strong recovery controls for the hardware, applications, and data in most of its systems. With the exception of the Vital Records system, the Department's IT backup and recovery procedures are not documented and backup copies of data are not maintained in a building sufficiently removed from the Department's operations to ensure access in the event of a disaster. IT responsibilities in the Department are shared between the IT group, which is responsible for all systems other than the Secretary of State Knowledge Base (SOSKB) system, and a contracted project manager who oversees the SOSKB system with no clear Department technical oversight provided. In addition, the Department has not prepared a current IT plan required by RSA 9:4-b.

The Department, based on its exemption by RSA 21-I:18, I(c) from many Department of Administrative Services control requirements, considers itself to be exempt from the normal State IT control policies and procedures promulgated by the Office of Information Technology (OIT). The Department has not adopted any formal IT control policies and procedures in lieu of those established by OIT. The result is that the Department has placed its operations at considerable risk of IT failure that may result from accidental or deliberate breakdown of its significant IT systems.

*Recommendation:*

The Department must recognize the risk associated with the operation and maintenance of its critical IT systems and establish a suitable control structure that will provide reasonable assurance that the systems will operate as intended and be protected from foreseeable failure. The Department should establish and enforce policies and procedures intended to limit the risk to operations from misuse of IT systems and information such as unauthorized access and the risk to the Department's continuity of operations if IT systems fail and need to be recovered. The Department should consider adopting the OIT standard State IT control policies as a baseline for appropriate IT control policies and procedures.

The Department should also provide technical oversight over its contracted project manager's activities. While operationally it may be appropriate for the contracted project manager to report to the Deputy Secretary of State, the Department's IT group should become sufficiently involved in the development of the SOSKB system to ensure the Department obtains the knowledge and experience that will be required to support the ongoing operation of the SOSKB system post development and also to ensure that the contractor is performing its functions in a controlled and technically appropriate manner.

The Department should, as one of its first steps in improving its IT control structure, prepare a current IT plan as required by RSA 9:4-b.

*Auditee Response:*

While we believe that controls can be improved over the IT structures in place today and during the period this audit covered, we also believe we have struck a balance between maintaining a minimal staff and proper IT control structures. We will review our current IT control structures with those promulgated by OIT to see if it would be prudent to enhance our IT controls keeping in mind that implementing additional IT controls over that which already exist will require additional staff. The Department has also begun to document the IT controls that are in place although it is highly unlikely that simply lacking written documentation places our operations at considerable risk of failure.

With the introduction of the SOSKB (Secretary of State Knowledge Base) software system, for the first time in many years, business filings are current. The Statewide voter registration software performed extraordinarily for our city and town clerks, supervisors of the checklist, and other elected officials in response to our first-in-the-nation presidential preference primary this past January. The Securities division staff are in the process of bringing new software on line that will allow for better monitoring of registered securities, brokers, and transactions. Vital Records processing systems are maintained and monitored by both OIT and the Department.

The Department recognizes the risk associated with having these software systems and has implemented strong physical access controls. The department utilizes two security card access only computer rooms within security card accessible buildings – the State House Annex and the Archives Building on the State Office Park South. Only a limited number of IT staff have been given access to these areas. The Department also has servers housed at the OIT Data Center at the Hazen Drive State Office Park which too is behind a security card accessed building and a security card accessed computer room. Users' desktop computers are inside non-public rooms behind locked doors within secured locked buildings during non-business hours. Passwords are required to log onto the Department network that is behind a statewide firewall managed by OIT.

The Department utilizes a data backup scheme for both the Annex and Archive computer rooms where each server is backed up each night. Those backup tapes are then taken off-site the next morning. Two week cycles are used for backups so that each week day tape is kept for two weeks. Weekly backup tapes are kept for two months. Monthly backup tapes are kept for one year. The Department relies on the services of OIT to back up our servers at the Data Center.

Each PC model by division has an "image" on CD which means that a PC whose systems are no longer functioning within normal parameters can be rebuilt to original configured condition and put back into service with little to no effort in as little as twenty minutes.

Each of the server's many event logs are pro-actively reviewed every work day to check for activity and anomalies that may have occurred.

IT responsibilities are not shared. For the ongoing build of our SOSKB system used primarily by our corporate staff, a contracted project manager was hired to guide, track and report on the progress of the implementation of this new system. Since the responsibility for a successful



implementation of this system was placed on this project manager, a wide latitude was given in cooperation with our subject matter experts in how the software was to be structured. The IT staff has always had the possession of and the responsibility for the hardware along with the monitoring and performance of that hardware mentioned earlier.

The contracted project manager, corporate staff and in house IT personnel have been meeting in regular weekly meetings, and more often as necessary, for appropriate input, guidance and understanding of the Corporations software systems.

The Department is currently working on updating our IT plan pursuant to RSA 9:4-b.

**Observation No. 4: Formal Risk Assessment Policies And Procedures Should Be Established**

*Observation:*

The Department does not have formal policies and procedures in place for recognizing and responding to risks potentially affecting its operations. Management’s assessment of risks facing the organization is an integral component of internal control.

The Department does not have formal policies and procedures in place for periodically reviewing its operations for risks that could jeopardize its ability to continue to function as management intends. Currently, when risks are identified the Department may review the risk area and make recommendations; however, there are no formal policies and procedures to continuously review operations for risks. A lack of understanding of risks generally pushes an entity toward a reactive mode when significant risks are realized/occur. A reactive mode may compromise the efficiency and effectiveness of a response due to the lack of prior identification and understanding of the risks and ramifications.

The purpose of an entity’s risk assessment is to identify, analyze, and where appropriate, respond to risks and thereby manage risks that could affect the entity’s ability to reach its objectives. Effective risk assessment practices should be a core element of management’s planning activities. Risk assessment should be an ongoing activity.

An entity faces many risks. Risk can be defined as, the threat that an event or action will adversely affect an entity’s ability to achieve its objectives. Risk can be classified in many ways. For example:

*External risks* - threats from broad factors external to the entity including changes in the political arena, changes in statutes and rules, and illegal activity external to but affecting the organization.

*Operational risks* - threats from ineffective or inefficient processes for acquiring and providing goods and services, as well as loss of physical, financial, or information assets.

*Information risks* - threats from the use of poor quality information for operational, financial, or strategic decision-making within the entity and providing misleading information to others.

A continuous review of the Department's processes and activities using a risk-based approach would promote effective planning and assist in resource allocation decision-making. Risks identified should be analyzed to determine whether current internal controls mitigate risk to a level desired by management or whether other actions are required in response to the risk.

*Recommendation:*

The Department should establish risk assessment policies and procedures that formalize its risk assessment process and provide for a regular and continuous risk assessment of its operations. A formal risk assessment process is a necessary tool to assist in the effective management of risks. Identifying risks significant to Department operations and strategies to mitigate those risks should enhance the effectiveness of the Department's planning and resource allocation processes and its control processes.

*Auditee Response:*

The Department does have informal risk assessment policies and procedures within some divisions, but agrees it would benefit from having a more comprehensive formal policy.

**Observation No. 5: Formal Fraud Reporting Policy Should Be Established**

*Observation:*

The Department has not established a formal fraud reporting policy. The lack of a written policy may delay the reporting of fraudulent activity.
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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. 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.

The attributes of an effective fraud reporting policy include:

- The policy is in writing,
- The 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.

*Recommendation:*

The Department should establish a 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:*

The Department does have informal fraud reporting policies within some divisions, but agrees it would benefit from having a more comprehensive formal policy.

**Observation No. 6: Controls Must Be Improved Over Revenue Processing**

*Observation:*

Significant deficiencies in the Department's processing of revenues increases the risk that errors or frauds could occur and remain undetected.

During the ten months ended April 30, 2007, the Department reported that it collected and deposited approximately \$43 million of revenue; of which, \$21 million was processed directly by the Department with the remainder processed by service organizations.

- Four service organizations process the initial recording of certain business activities on behalf of the Department, including the collection of related revenues. During the ten months ended April 30, 2007, these service organizations processed approximately \$22 million of certain mutual fund registration and investment licensing activity for the Department. One service organization provided the Department with a service auditor's report covering the services provided to the Department. The Department did not receive, and did not request, service auditor reports covering the controls affecting the transactions processed by the three other service organizations. Service auditor reports, commonly referred to as SAS 70 reports, generally describe controls placed in operation, and the operating effectiveness of those controls, that may be relevant to a user organization, such as the Department.
- The Department does not reconcile and review for data consistency the revenue collected and reported in the State's accounting system (NHIFS) to available Department records.
- The Department's Bureau of Securities Regulation does not have a process to reasonably ensure that revenue forwarded on its behalf to the State Treasury is received by the Treasury and recorded in NHIFS in a timely and accurate manner.
- The revenue deposit process used by the Corporate and Uniform Commercial Code Divisions is inefficient and increases the risk of errors and frauds as the process allows cash and checks to be handled by up to six employees prior to being deposited.
- Segregation of duties weaknesses caused by either limited personnel performing revenue processing or by excess authorizations in automated systems increases the risk that revenue transactions are not subject to an effective review and approval process.

Weaknesses in the Department's processing of revenues were noted in our prior 1996 audit of the Department of State. In that report we noted both a weakness in segregation of duties over

the Department's processing of revenues and a lack of reconciliations between revenue deposited by the Business Office and the revenues recorded by the Corporate Division and the Bureau of Securities Regulation. While certain of the specific segregation of duties issues addressed in the prior audit report have been corrected by the Department, weaknesses reported during the prior audit remained in the Department's revenue process approximately ten years later.

*Recommendation:*

The Department must improve its controls over revenue processing.

The Department should perform a Department-wide review of its revenue processing with an intention to establish appropriate controls.

- The Department should request SAS 70 reports from all of its service organizations. The requested reports should describe the controls in place, whether those controls were suitably designed to achieve specified control objectives, whether those controls had been placed in operation, and whether the controls tested were operating with sufficient effectiveness to provide reasonable assurance that the related control objectives were achieved during the period specified.
- Reconciliations should be performed between revenues collected and deposited and the records of transactions that resulted in that revenue. The reconciliations should serve to provide reasonable assurance that the revenues from known transactions are being properly processed and recorded.
- The Department should actively monitor the transfer of revenue from its service organizations to the State Treasury to ensure that revenue is deposited and recorded timely in the Department's account. The Department should initiate action to ensure accurate and timely revenue processing.
- Cash and check handling procedures should be revised to improve accountability over amounts collected, lessen the number of employees with access to accumulated receipts, and generally make the deposit process more efficient.
- Segregation of duties controls should be improved over revenues collected, recorded, and deposited. In enhancing its segregation of duties controls, the Department will need to consider and match the responsibilities of employees in the revenue process with their authorities and abilities within the systems and processes. Unneeded and excess information technology system authorizations should be eliminated to limit unintended and unforeseen segregation of duties risks from developing.

*Auditee Response:*

The service organizations referenced in this observation do not process the initial recording of certain business activities on behalf of the department. Two of the organizations are actually third-party administrators working on behalf of mutual fund companies. These administrators submit mutual fund registration information and fees to the Bureau and state treasury via electronic means. The other third party administrator is the Financial Institutions Regulatory Authority (FINRA).

FINRA collects and remits electronically all broker-dealer and investment advisor licensing fees. This centralized registration and remittance service is utilized by all state securities regulators and administration is coordinated by the North American Association of Securities Administrators (NASAA). Contrary to the state audit observation, the Bureau does in fact receive “auditor reports” from FINRA. Similar reports from the other third party filers are readily available for the Bureau’s inspection and copies of same are now on file.

The Department of State believes that generally accepted practices of processing revenue are in place and do not increase the risks so specified. Of the \$42.9 million of total revenue we collected, the Department processed the entire amount directly and timely. The Department was responsible for and did record the receipt of cash, checks, and credit cards for the entire amount received. The Department balanced each and every receipt against statutory guidelines to ensure that the proper amount was collected and accounted for.

For mail that is processed through the main office, amounts received are immediately recorded on an A-15. The deposit slip is prepared by that same person and is given to another employee who deposits the funds with the Treasury Department. The A-15 is given to the Department accountant by the preparer of the A-15 and the deposit slip is given to the Department accountant by the person who made the deposit. The Department accountant is then able to reconcile the amounts received with the deposit slip and compare that to what has been entered and accepted in the state’s accounting system (NHIFS).

The Department worked with Treasury in establishing this efficient method and it is used widely throughout the state. As the auditors documented in their observation, over \$21 million was received by the Department using this method and it has been functioning extremely well over the last number of years. Each morning Treasury reviews their bank accounts and notifies us if a deposit has been made for this Department. Typically the deposit is received once a week. The Department then creates the required deposit slip to account for the funds received.

The Corporation Division uses a similar process for cash and checks received over the counter or through the mail. With our new SOSKB system, a visual image of the payment document along with the paper forms submitted is taken and stored electronically. Each person responsible for opening the mail or receiving payment is also responsible for creating an A-15. One process that has been altered that was deemed inefficient by the auditors was for the cash and checks to follow the A-15 as it moved through the SOSKB process. Currently the A-15 along with the cash and checks are sent to the Department accountant for deposit preparation. Another individual then makes the deposit with the Treasury Department thus maintaining the segregation of duties.

This observation implies that material weaknesses described in the prior audit still exist. With a single exception, it should be made clear that the specific recommendations in the last audit were addressed and were not an issue in this audit. Review of that prior audit reveals that we did mitigate and create a sufficient segregation of duties at that time “so that no one individual was in a position to commit and conceal errors or irregularities” (cite from prior audit) as documented below.

“A. Revenue should be recorded on an A-15 immediately upon receipt”. Revenues are recorded on an A-15 immediately upon receipt.

“B. Duties over revenue processing should be segregated ...” Duties are segregated. The person responsible for opening the mail and creating the A-15 has been segregated from the person who creates the deposit slip which has been segregated from the person who physically makes the deposit.

“C. The Department should perform a periodic reconciliation between the amount of revenue recorded and the amount of license and fee activity recorded to ensure that the revenue deposited agrees to the revenue generating transactions recorded by the Corporate Division and the Bureau of Securities Regulation.” Each and every deposit made is completely reconciled to the deposit amount which is then reconciled to the amount that has been recorded in the State’s financial system (NHIFS). For the 10 months ended April, 2007, the Department performed an analysis of all corporate revenue received and documented the reconciliation of revenue received and deposited to filings recorded in its SOSKB system.

The Bureau of Securities Regulation negotiated the purchase and installation of a new securities software administration system that will allow the Bureau to perform revenue reconciliations with NHIFS that will strengthen our current method of reconciling each receipt of funds and subsequent deposits.

**Observation No. 7: Controls Over Processing Mutual Fund Registrations Must Be Improved**

*Observation:*

The Department does not have a financial accounting system, other than the State’s accounting system, NHIFS, to record mutual fund registration revenues. The database used by the Department to record the registration status of mutual funds does not record relevant revenues and the Department does not reconcile posting in the database to revenues collected by the Department.

The Department uses an unsophisticated database application to record the licensing and registration of mutual funds offered for sale in the State. The application was developed internally by the Department and has been used for a number of years. The application is in part intended to provide a level of efficiency in accumulating information from the approximate 19,000 initial and renewal registrations it receives annually. While the application provides the Department with certain current data lookup capability, the application suffers significantly from the lack of professional information technology insight into its development and design. Because of its design limitations, the application cannot provide prior period information necessary to support prior period activity. While it is possible in a tightly controlled system to gain reasonable assurance on reported prior period information, the application designed and operated by the Department is relatively open and is not sufficiently controlled to be able to provide that assurance. As noted in Observation No. 6, the Department does not reconcile revenues recorded in the Department’s mutual fund database to revenues recorded by the Department’s Business Office in the State’s accounting system, NHIFS.

Limitations in the application were noted and reported in our prior 1996 audit of the Department of State. In that report we noted there were only limited controls in place to ensure the information entered into the application was appropriate and correct, passwords were not utilized to ensure that only authorized personnel have access to the system, and there were no manuals that documented how the system operated. All three of those listed application weaknesses reported during the prior audit remained in the application approximately ten years later.

*Recommendation:*

The Department must improve its controls over its processing of mutual fund registrations. The Department should establish appropriate controls to provide reasonable assurance that revenues it collects for the registration of mutual funds are complete and accurate. To accomplish this the Department should:

- Develop or obtain a more sophisticated information system that would provide efficient and comprehensive management information on mutual fund registration activity.
- Ensure that its information systems, both current and proposed, are operated in a controlled manner that provides reasonable assurance that information in the systems is complete, accurate, and secure. Passwords should be used to ensure only authorized operators access the systems and access to the systems is regularly monitored and reviewed for continued appropriateness. Data entry, calculations, and data should be subject to review and approval processes including reconciliations with corresponding information.
- An appropriate indexing system should be developed to enable reasonably efficient referencing of the automated information systems to the paper records maintained by the Department.

*Auditee Response:*

The Bureau has utilized a database system known as RBase for the recordation of broker-dealer, investment advisor, issuer dealer, mutual funds and other securities registrations. Although the system is old, it has served its purpose for well over a decade.

The RBase system, particularly as it relates to mutual fund registrations, requires that certain renewal registration data must be overwritten each year to reflect current year registration status. All mutual fund registrations renew on May 1 of each year. Although the vast majority of renewal registration fees are received via electronic filers during the second or third week of April, some renewals and fees are received beyond the renewal due date. In some cases, renewal fees may not be paid as the firm may have elected to non-renew the registration. Also, every mutual fund record on R-Base must be manually updated to reflect receipt of renewal fees and the new renewal due date.

During the course of the audit, examiners requested and received a data download of all mutual fund registrations on file with the Bureau. The data was only a snapshot of registrations on file for that given day. It is the Bureau's understanding that the auditors created a series of assumptions to arrive at numbers that may reflect total active mutual funds during the audit period of July 1, 2006 through April 30, 2007 and where fees may have been received. That number was then multiplied by a factor of \$1,000 (annual registration fee per fund) to determine the total revenues that should have been realized from those mutual fund registrations. Further,

that sum total was then compared to the account balance in the State's NHIFS system mutual fund fees account #1354. Note that NHIFS and RBase are systems that operate independent of each other.

However, the Bureau recognized the need to upgrade its system and initiated a search in 2004 for a securities administration system. On June 20, 2007, the Bureau entered into an agreement with ACO Information Services, LLC of Mobile, Alabama to purchase a state of the art and fully integrated securities administration system. This system will assist with the administration of all firm registrations, securities registrations as well as Enforcement and Field Audit functions. The STAR Revenue Room module will fully integrate with the State's general ledger and address those concerns raised in this audit observation, as well as Observation No. 6 relative to Bureau of Securities revenue administration.

The STAR system is equipped with a robust audit trail feature that will track all transactions and entries. Access to the system will be password protected and controlled by the Bureau's system administrator. Users will be granted access only to those areas of the system necessary to carry out their assigned duties.

### **Observation No. 8: Controls Over The Operation Of The New Hampshire Vital Records Information Network System Must Be Improved**

*Observation:*

Recognized and unrecognized weaknesses exist in a critical information technology (IT) system impairing the controlled operation of the system and increasing the risk of errors and frauds to occur without reasonable assurance of detection.

RSA 5-C:2 establishes the Department's Division of Vital Records Administration (Division). The Division is responsible for the establishment and support of the statewide vital records registration, issuance, and dissemination program. Vital records include a certificate or report of a birth, adoption, death, fetal death, marriage, divorce, legal separation, and civil annulment.

The Division is responsible for issuing certified copies of these events for a statutorily set fee. Revenues collected by the Division, as noted in Observation No. 9, are intended to be deposited into the Vital Records Improvement Fund established under RSA 5-C:15. The Division reported it collected approximately \$1 million of vital records revenue during the 10 months ended April 30, 2007.

Most New Hampshire town and city clerks participate with the Department in the operation of the New Hampshire Vital Records Information Network (NHVRIN) system. NHVRIN is a statewide data collection and reporting system for vital record events. NHVRIN provides hospitals and funeral homes in the state with access to record vital record events online and provides participating town and city clerks access to record and search records and print certificates. During our review of the vital records revenue collection process we noted the following:



1. Town and city clerks are required to remit the State portion of applicable vital records fees to the Department's Business Office by the 15<sup>th</sup> of the month following the month of collection. At April 30, 2007, there were approximately 223 town/city clerks that utilized the NHVRIN system. The Department does not have procedures to ensure that clerks file the appropriate reports and remit the proper amounts timely, increasing the risk for errors and frauds. For example:
  - The Department does not reconcile and agree the amount of revenue remitted by a clerk to the respective vital record activity for that clerk's location reported in the NHVRIN system. The Department has identified instances where the monthly reports from the NHVRIN system have indicated differences between the revenues forwarded by a town or city clerk and the activity reported in the NHVRIN system. The Department indicated it has not been able to identify the causes of these differences, which appear sporadic in terms of timing and locations. Known but unresolved differences in a critical system are indicative of a high-risk situation.
  - The Division does not use the document control numbers on the certificate paper to review for the accuracy of revenue reported and collected.
  - The Division does not review pending and free vital records transactions for appropriateness. If a transaction is substantially processed with NHVRIN (search complete, certificate printed, payment collected) and the counter clerk closes out the screen instead of clicking "update" (i.e. update saves a record to the collected file and summary of daily receipts file), the transaction is placed in a "suspense" status, also known as a pending transaction. Pending transactions are not reported on the daily summary of receipts even though the clerk may have collected revenue for the transaction. Instead of requiring clerks to resolve and report the resolution of pending transactions, during the ten months ended April 30, 2007, the Division periodically allowed the clerks to clear the pending transactions from the NHVRIN system without resolution. Pending transactions could represent underreported revenues.
  - A test of remittances from 30 town and city clerks indicated 13 of the 30 (43%) remitted vital records receipts from one to 196 days late. One location apparently was submitting filings only once every six months. It was not clear from the documentation reviewed whether the Department recognized or reacted to these late filings.
2. At April 30, 2007, the Division had not established written agency agreements or other memorandum of agreements with the town and city clerks using the NHVRIN system. The lack of a written agreement increases the risk that the NHVRIN system will not be operated as intended by the Division and that town and city clerks may not process vital record transactions and revenue as required by statute and Division policy.
3. A supervisory review is not performed of the closeout completed by the counter clerks at the Division's Concord Vital Records Office. Supervisors do not review the activity recorded and the revenue collected by the clerks, including reviewing the propriety of any revenue overages or shortages for indications of errors or frauds.
4. In 1988, a firm established a relationship with the State agency then responsible for vital records whereby the firm provided a check printer to the agency to allow customers walking into the agency to pay for copies of documents with a credit card. The service provided by the firm was subsequently expanded to allow transactions to be initiated through the firm's

website. This working relationship continued during the ten months ended April 30, 2007, apparently without documented revision or reestablishment during the 19 years the agreement was in effect. The Division was unable to provide a copy of the agreement document. The firm did provide a copy of a one-page document executed in June of 1988 as support for its agreement with the State.

At the time of the audit, the Department indicated that it was in the process of developing an invoicing project that will be used to invoice town and city clerks for the State share of revenues related to activity recorded in the NHVRIN system. If that project is to become effective, it will be essential that the Department ensure the NHVRIN system reports accurate activity information.

*Recommendation:*

The Department must improve its controls over the NHVRIN system. The Department should establish controls that provide reasonable assurance that the activity reported by the system and the revenue collected from that activity is accurate.

Procedures should include:

1. Ensuring town and city clerks remit vital records receipts timely and accurately. The Department should react timely in response to late and inaccurate filings to ensure that information in the NHVRIN remains accurate and current and that town and city clerks understand and appreciate the need for timely and accurate remittances.

The Division should consider if additional user resources are necessary to help resolve apparent problems in transaction processing that resulted in pending transactions during the ten months ended April 30, 2007. The Division should ensure that adequate training and well-designed and comprehensive training and operating policies and procedures manuals are provided to town and city clerks, Division employees, and others that interact with the NHVRIN system.

2. Establishing sufficiently detailed memorandums of agreements with the town and city clerks to reasonably ensure that both the Division and the clerks understand their respective responsibilities and expectations.
3. Establishing reasonable accounting control procedures including supervisory reviews and approvals of significant activities.
4. Ensuring working relationships with outside entities are fully documented and periodically reviewed to ensure the relationships continue to serve the needs of the Department and New Hampshire citizens.

*Auditee Response:*

The Division of Vital Records is a new addition to the Department of State, and through the transition the division maintained the same practices it utilized at the Department of Health and Human Services. Since arriving here, the Department has followed through on the completion

and implementation of NHVRIN (NH Vital Records Information Network) by working closely with the Office of Information Technology. The Department recognized the issues related to the reconciliation of vital records activity at the local level before this audit and has been working on improvements. The Department has been building a compatible SOSKB financial management software module to work with NHVRIN to reconcile local vital records activity. This program will invoice each town monthly, and will not permit adjustments at the local level without clearance from the division.

SOSKB will provide the statewide accounting that generates the Record of Daily Receipts to ensure that revenues collected by the Office of Vital Records are reconciled by the city and town clerks that have collected moneys for any vital records transactions performed through the NHVRIN software. Any timeliness and accuracy findings will be resolved with the institution of the SOSKB software.

The pending transactions will be resolved through adequate training of clerk users of the NHVRIN system. The Town and City Clerks are given administrative access to be able to see the pending transactions that any municipal user of NHVRIN has created within their office. Administrative users in the city/town office, can now view pending records and make sure they are rapidly completed and resolved. This is especially helpful for those pending records where a fee may have been collected; which would result in an erroneous end of day financial report. City and Town Clerks will be immediately aware of their need to complete these pending searches. In addition to transparency at the city/town level, Division staff are able to see all of the pending records that any NHVRIN user has created. As the need arises, the Division will interact with any city/town to reconcile their pending records.

Online training manuals are available that describe the use of the NHVRIN system and twice monthly training events are now scheduled for City and Town Clerks and their staff. This is possible due to the training space made available in the new addition on the archives building. Additionally, the Division has acquired a software training tool that produces online step-by-step demonstrations of any function that a clerk may perform in NHVRIN. These online training “videos” will be produced and made available to all NHVRIN users through the NHVRIN system.

Before a user is issued a login id and password for the NHVRIN system every applicant signs a user acceptance form that stipulates the responsibilities of a NHVRIN user and describes our expectations of them when they interact with the Division through its software. This will be modified to include language on processing vital records fees and the correct remittance of vital records revenue in addition to the current language.

The Counter Clerk Supervisor’s duties include daily supervisory reviews of the financial transactions that our front office performs. Backup supervisory review coverage is provided if she is absent for any reason. Division administrators have also taken a more active role in the review process.

The 1988 third party service relationship created by DHHS that was noted in the Audit Report is out-of-date and was not a state contract or any other formal state relationship. The service provided to customers at the Vital Records desk by the provider does not cost the Department any money, nor does it generate any revenue. The specific business function that this service

provider performs is to allow a customer to use a credit card to pay for a New Hampshire vital record transaction. The Division does not prohibit other third party service providers to offer this very same business function to customers, but the service provider that was observed during the audit has a universal presence in every state vital records office.

### **Observation No. 9: Revenues Should Be Deposited Into Statutorily Designated Accounts**

*Observation:*

During the ten months ended April 30, 2007, the Department did not deposit certain revenues into the accounts designated by statute.

During this period, approximately \$157,000 of revenue that should have been deposited into the Vital Records Improvement Fund, pursuant to RSA 5-C:10, II, RSA 5-C:11, III, and RSA 5-C:34, I, was instead deposited into the General Fund.

The misallocation of revenue resulted from an error in programming a report in the New Hampshire Vital Records Information Network (NHVRIN) system that generates the *Record of Daily Receipts*. This report allocates the revenues collected by the Office of Vital Records into revenue source accounts.

*Recommendation:*

The Department should correct the component of the NHVRIN system that generates the *Record of Daily Receipts* to ensure that revenues collected by the Office of Vital Records are allocated into the statutorily designated accounts.

*Auditee Response:*

The Office of Information Technology has corrected the programming error in the NHVRIN system, and the appropriate funds are being deposited into the Vital Records Improvement Fund.

### **Observation No. 10: Federal Participation In Program Expenditures Should Be Collected Timely**

*Observation:*

The Department does not have policies and procedures in place for the timely collection of the federal share of program expenditures.

During fiscal years 2004 through 2007, the Department was awarded a total of \$400,000 of federal Voting Access For Individuals With Disabilities – Grants to States funds. During fiscal years 2004 through 2006, the Department incurred \$14,329 of federally reimbursable expenditures, only \$5,120 of which it had requested and collected prior to July 1, 2006. During

the ten months ended April 30, 2007, the Department incurred an additional \$220,650 of federally reimbursable expenditures. The Department did not draw the federal funds to cover these expenditures until the end of September 2007, subsequent to our inquiry into the status of these funds.

*Recommendation:*

The Department should establish policies and procedures for the timely collection of federal participation in program expenditures. Policies and procedures should include the regular monitoring of program expenditures and the drawing of federal reimbursement as soon as provided for in the program.

*Auditee Response:*

The lack of familiarity with federal payment programs on the part of the U.S. Department of Health and Human Services (USDHHS) has been a contributing factor in what has been viewed as a delay in drawing down those funds. It is the Department's attempt to accommodate the USDHHS by complying with their grant-related reporting requirements that has required additional time and has inhibited New Hampshire's ability to draw down funds.

Unlike other HAVA funding, these awards are administered by the USDHHS Administration on Developmental Disabilities. These awards were received in four annual amounts of \$100,000.

New Hampshire's response to HAVA included the establishment of a Disabilities Access and Voting Systems Task Force (Task Force) comprised of members of the general court, state officials, local officials, and members of the disabilities community and their advocates. The Task Force gave both specific and general direction for all of the work, purchases and reimbursements. This was an interactive and iterative process that took considerable time over a four year period.

By June 30, 2005, only approximately \$14,000 of the available \$400,000 had been spent and was available for reimbursement. Previously, \$5,120 had been successfully drawn down leaving a balance of less than \$10,000 unreimbursed. During the summer of 2006 through the end of fiscal year 2007, authorized expenditures included reimbursement to local communities for polling place accessibility improvements, outreach to the disabilities community, local election official training, and the purchase of items specifically designed to assist voters with disabilities, resulting in about \$220,000 available for reimbursement.

Draw downs for the expenditures are required to be detailed in each of four categories in accordance with a pre-approved state plan. The federal reporting requirements are extensive, initially unstated, and relatively unclear. This is a payment program which is being administered as a grant. (See 42 USC 15421, Section 261.) The USDHHS is apparently unfamiliar with overseeing a payment program, and the Department has attempted to accommodate their administrative limitations. This situation has interfered with what would otherwise have been considered timely draw downs of federal funds. In every case, the Department initiated requests for timely reimbursement but was met with repeated resistance due to alleged errors in or lack of required reporting. In each case, the Department undertook to redress the deficiencies so that the federal funding could be secured for reimbursement to the State Election Fund.

Timely collection of the federal share of program expenditures is an important function that the Department recognizes. Without this extra effort, no funds would be forthcoming. During the summer of 2007, staff was dedicated to the payment program to establish federal contacts, to develop a knowledge base of grant-related reporting policies and procedures, and to ensure that all grant-related reports were properly and timely filed so that the funds due to the Department would be released by the federal authorities. The issue has been addressed from a management and procedural perspective.

### **Observation No. 11: Controls Should Be Improved Over Collection Of Miscellaneous Fee Revenues**

*Observation:*

The Division of Vital Records Administration (Division) has weaknesses in its procedures for collecting miscellaneous fees at its Concord office.

- Pursuant to RSA 5-C:11, the Division sells decorative heirloom birth certificates for a \$25 fee. The Division has not established control procedures to ensure that the number of certificates issued/sold correlates to the revenue collected from the sales.
- The Division charges customers fifty cents per page as a photocopy fee for copying genealogical records. The administrative rule that established the fifty-cent fee was repealed in 2003. The Division has not performed any analysis to establish its actual per-page photocopy costs and continues to charge the fifty cents per page fee.
- The Division has not instituted control procedures to ensure that all copying fees are accounted for and deposited in the timeframe provided in RSA 6:11.

*Recommendation:*

The Division should improve controls over its collection of revenues from miscellaneous fees.

- The Division should establish controls that correlate the number of heirloom certificates issued/sold and the resulting revenue collected.
- The Division should establish reasonable controls over photocopy revenues including determining whether it has authority to charge a photocopy fee in excess of the actual copying costs.
- Revenues collected by the Division, including miscellaneous copying fees, should be deposited daily, unless the State Treasurer sets an alternative deposit threshold as provided in RSA 6:11.

*Auditee Response:*

These practices existed when the Division was transferred to the Department of State. Actions, which are still in process, had been taken by the Department prior to the audit to make the Division more accountable. These actions have included the adaptation of SOSKB financial management software to the Vital Records front desk revenue handling procedures. The sale of

heirloom birth certificates will be included in this process. Heirloom certificates are not certified birth documents and cannot be used for legal purposes. The Division sells approximately 100 heirloom certificates per year.

The scope of the audit period was the 10 months that ended April 30, 2007. The following month, in May, 2007, the Division moved to the Archives Building from Hazen Drive thereby consolidating it with other Department of State Divisions and allowing for more direct supervision.

All of the Division expenditures associated with photocopying (collection of monies, equipment and maintenance, supplying toner and paper) are now being attributed to a different coin operated copy machine that charges a customer \$.25 per page. Change from the coin operated copy machine is now being deposited weekly, and amounts to approximately \$75 per week. It is our understanding this is consistent with Treasury guidelines.

### **Observation No. 12: Effective Reconciliation Procedures Should Be Incorporated Into Online Returns Filing System**

#### *Observation:*

The Department has not incorporated effective reconciliation procedures into its online business reports filing system to ensure the ability to identify and resolve differences in reported information.

During the fiscal year 2007 annual report filing period, the Department collected \$2,367 of credit card revenue for report filings that were either not successfully filed/accepted by the online system or where a credit card was charged multiple times for a return. According to the Department, there are no procedures in place to reconcile and resolve differences in transactions recorded in the Secretary of State Knowledge Base (SOSKB) information system with those processed by the credit card payment agent. The Department is unclear as to how to resolve the issues related to the payments collected without a record of corresponding reports having been filed.

#### *Recommendation:*

The Department should incorporate effective reconciliation procedures into its online business reports filing system to allow for recognition and resolution of differences in reported information.

#### *Auditee Response:*

The Corporations Division of the Department of State is a repository of business filing information. Over the past few years the Corporations Division has implemented an on-line filing system for the general public resulting in many efficiencies, including the elimination of lengthy backlogs in the turn around time of certain filings. Citizen satisfaction has improved dramatically over the past 5 years, and complaints are now very rare.

During the 10 month period that this audit covered, \$4,860,080 was received through the on-line filing system. If the credit card revenue identified was for report filings that were either not successfully filed/accepted by the on-line system or where a credit card was charged multiple times for a return, then \$2,367 represents a 99.95% success rate for the on-line filing application. This is a huge success for the citizens of this State to have a system that enables them to have up-to-date corporate business information instead of one month of lag time, all without additional personnel.

Procedures are and have been in place to reconcile daily deposits with the SOSKB receivables system. These procedures are not documented in writing. A standard, common sense approach is used where all revenues received should have a corresponding entry in the SOSKB system. The Department does reconcile all anomalies that may occur and ultimately always reconciles.

**Observation No. 13: Input Edit Controls Should Be Improved In The Secretary Of State Knowledge Base System**

*Observation:*

A limitation in the Department's Secretary of State Knowledge Base (SOSKB) system allows errors in data entry to go uncorrected, affecting the accuracy of the data captured by the SOSKB system and the return of revenues to cities and towns in the State.

Per Uniform Commercial Code (UCC) RSA 382-A:9-525(i),(2), "\$15 of each fee collected ... for any filing associated with an initial financing statement that shows a mailing address in this state for the first-listed debtor, [shall go] to the clerk of the town or city shown in such mailing address."

To comply with statute, the Department's SOSKB system calculates the amount due to towns and cities generated from financing-statement filing fees collected by the Department. The allocation is calculated on a quarterly basis based on the transactions recorded by the SOSKB system during the quarter. A quarterly payment was selected as an item in the audit's random test sample of general expenditures.

Three out of 10 (30%) financing statements supporting the tested payment had a first-listed debtor with a New Hampshire mailing address, which the SOSKB system did not validate as a New Hampshire town or city. These items did not generate a payment to the respective New Hampshire town or city. According to the Department, the validation and payment did not occur in these noted circumstances due to a misspelling or other error in the recording of the town or city name. The errors included the town of Milford having a comma included in the town field on the form and the towns of Allenstown and Belmont being misspelled. In each instance the correct zip code was included on the financing statement. The SOSKB system did not recognize a comma as being associated with a New Hampshire town or city name or the misspelled town names and categorized the locations as out of state. All funds related to filings with out of state first-listed debtors are deposited in the General Fund. The Department stated the system was programmed with New Hampshire town and city names and the SOSKB matches the entered location to the list to recognize valid New Hampshire local governments. While testing the town



and city name to a list of New Hampshire locals is a valid system control, because it is a single step edit check and not a multiple step check (which might also agree the state name and zip code as well as the town or city name) the SOSKB system does not recognize evident errors and prompt corrections that would promote the accurate collection of data and payment of fees.

During the ten months ended April 30, 2007, approximately \$27,000 of revenue was deposited in the General Fund representing the \$15 portion of the filing fee for filings with recorded primary debtors that did not match the SOSKB listing of New Hampshire towns and cities.

*Recommendation:*

The Department should develop the controls within the SOSKB system to provide for a multi-step location edit check to ensure the accurate recording and reporting of filed information. This would also help to ensure revenues are distributed as provided in statute.

*Auditee Response:*

RSA 382-A:9-526 and Section 401 of the International Association of Commercial Administrators Uniform Commercial Code, Article 9, states that data from filings is to be entered in the information management system (SOSKB) **exactly** as recorded on the paper or electronic filing presented by the filer. In short, the statute and accepted uniform practice does not permit the corrections suggested by the auditors. Additionally, the UCC system includes a double-blind data entry system to ensure that the required information submitted in paper form is keyed exactly as submitted by the filer.

The auditors are critical of the fact that not all of the filing fees designated to the cities and towns is returned to them. This is despite the fact the division is following its statutory obligation. The statutory filing fee to be disbursed to the towns is sent to the general fund if the first named debtor is not located in a New Hampshire town or the town location cannot be determined by the name used or any misspelling. The example cited in the audit is an extremely rare example.

**Observation No. 14: Effective Controls Over The Expenditure Process Must Be Established**

*Observation:*

<p>The Department has not established an effective control system over its expenditure process. The expenditure process used by the Department during the ten months ended April 30, 2007 suffers from deficiencies in essentially all five of the generally accepted components of internal control including control environment, risk assessment, control activities, information and communication, and monitoring.</p>
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The Department, pursuant to RSA 21-I:18, I(c), is not required to comply with the general State control policies and procedures applicable to most Executive Branch agencies. The Department has used this exemption in its normal expenditure process and does not consistently utilize purchase orders and inspection and receiving documents to support payment vouchers. In addition, the Department does not consistently use State centralized procurement services or

submit contracts to Governor and Council for approval. The combination of the Department not adopting controls to compensate for the inconsistent application of normal State expenditure controls as well as inadequate segregation of duties and other procedural weaknesses in the Department's expenditure processes increases the risk over Department expenditures.

For example:

- For the past 20 years, the Department has used one vendor for the printing of election ballots. During the ten months ended April 30, 2007, the Department paid this vendor \$230,000 for printed ballots. The vendor invoices the Department a lump sum amount for ballots printed. There is no detail on the invoice to allow for an understanding of relative costs of services provided. According to the Department, the Department has not submitted the ballot printing service to a request for proposals or bid process to determine whether it is purchasing ballots in an efficient and economic manner.
- Twenty-six of 50 expenditure items reviewed (52%<sup>2</sup>) during audit testing did not display evidence of having been reviewed and approved prior to payment. The processing of many of these expenditures illustrated a significant segregation of duties weakness, as the same individual who processed the payments also was responsible for ordering and receiving the merchandise.
- Receiving and inspection reports are not consistently prepared and forwarded for comparison to the vendor invoice prior to payment. Receiving and inspection reports for information technology (IT) equipment are not provided to the Business Office. The Department IT manager prepares and retains the receiving and inspection reports and only provides verbal assurance to the Business Office that the delivery is complete and the invoice should be paid.
- The Department does not perform a reconciliation of the payment voucher documents to the State accounting system (NHIFS) reports to ensure that all expenditures have been accurately recorded and reported.
- Six of the invoices tested provided for prompt payment discounts. The Department did not take advantage of the discounts offered on three of the payments made (50%) which resulted in approximately \$500 in unnecessary payments. The Department indicated that the failure to take advantage of the discounts was an oversight.

*Recommendation:*

The Department must improve its controls over its expenditure process. The Department should ensure that all five components of internal control are adequately addressed in its expenditure control process. Management must demonstrate the importance of controls in establishing the appropriate control environment. Significant procurements must be supported by evidence of management's concern for efficient and economic purchasing. Risks associated with payment activity must be regularly reviewed with appropriate responsive actions taken. The system of control activities must provide for reasonable assurance of detecting and correcting erroneous payments, including, but not limited to, segregating incompatible functions. Employees must be provided with accurate and timely information and direction to provide for their effective participation in the control process, and the entire process has to be monitored to ensure

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<sup>2</sup> The sample included both items selected randomly and items selected judgmentally. Therefore the noted error rate may not accurately represent the entire population of Department expenditures.

continued operation and effectiveness. The exemption provided to the Department by RSA 21-I:18, I(c) presents an increased obligation upon the Department to enact an effective Department-based control structure in its stead.

*Auditee Response:*

Generally, the Department is unique in state government because it answers to both the legislative and executive branches of government. The Secretary of State is elected by the Legislature, and is not appointed by the Governor and Council. The Department of State has exemptions from policies and procedures under RSA 21-I to keep it independent from politics and political pressure, especially in the area of elections. The Department of State takes appropriate control systems seriously.

The Department has absorbed tremendous growth within the past 6 years with a limited increase in additional resources. While we believe that controls can be improved over the expenditure process, we also believe that we have struck a balance between maintaining a minimal staff and proper expenditure controls.

To specifically address some of the examples cited in this observation:

The Department utilizes statutory exemptions in RSA 5:6-c and RSA 21-I:18, I (c) when dealing with elections to maintain the necessary expertise and flexibility required to conduct fair and accurate elections without the potential for undue, outside, political influence over the process. These exemptions have been in place in some form since the early 1960's. The vendor utilized to print ballots has the capability, experience and specialized equipment necessary to produce ballots accurately, efficiently and economically. The \$230,000 spent to print ballots for the 2006 election cycle included two elections and amounted to 14 cents per registered voter for each election. Nationwide per ballot costs range from around 20 cents to one dollar.

This observation also cited an example of expenditure items not being properly reviewed. The 26 items cited as not having been reviewed and approved prior to payment were from the Administrative and Elections Division. These items had been reviewed and verbally approved by senior staff working in the same office in which the subject items were processed. To the best of our knowledge all items from the other Divisions within the Department were properly signed off.

In order to mitigate any appearance that there are no segregation of duties between individuals who order, receive, prepare, and approve the payment of goods and services (where in fact there have been), the Department will implement a procedure where all goods and services received must have signed evidence that those goods or services were indeed received prior to processing payment. As the auditors noted, evidence for the payment for IT purchases had been prepared but kept with the IT manager. Copies of those receiving tickets will be attached to the department's copy of the invoice. Although already in place, it has been reiterated that any person who orders goods or services cannot be the individual who approves the payment for those goods or services. The department has used and will continue to use purchasing options available through Administrative Services purchase and property division.

The auditors cited prompt payment discounts not being taken in six instances. At least 3 of the 6 were invoices that were during the time of the State Primary Election when the office had higher priorities. The department will continue to make every effort to review invoices when presented to recognize if a discount is offered.

**Observation No. 15: The Corporate Administration Account Should Only Be Used For The Statutory Purpose Of The Account**

*Observation:*

The Department charged some costs related to renovations of the Leon W. Anderson Building (Building) to the Corporate Administration Account, which do not appear related to the Department's operations funded by the Account.

The Corporate Administration Account (Account), was established in response to RSA 293-A:1.37(b) to fund expenditures of administering the New Hampshire Business Corporation Act, Uniform Commercial Code - Secured Transactions, and other information technology costs of the Department out of fees collected under RSA 293-A:1.22(a) and RSA 382-A:9-411(d).

The State's Capital Budgets in 2003 and 2005 provided \$3.7 million for capital improvements to build and improve the Building also known as the Records and Archives Building. The contract for this work was submitted to and approved by the Governor and Council. Subsequent to the original contract, an additional, related contract was established. This contract, dated August 2005, provided for a \$200,000 renovation to the West Wing of the Building to provide for the future relocation of the Department's Uniform Commercial Code (UCC) operations. The planned funding for this contract was the Account. The Department did not submit this contract to Governor and Council for approval, as the Department did not consider Governor and Council approval necessary for contracts funded by the Account.

As of April 30, 2007, a total of \$267,700 had been paid from the Account for construction work on the Building since the inception of the second contract during fiscal year 2006. Some of the costs charged to the Account do not appear related or primarily related to the UCC's future use of the building. For example during fiscal year 2007, \$108,000 was expended on contract change orders 3 and 4 including: \$14,000 for a bulletproof reception booth for the Vital Records operation, \$60,000 for a granite entrance on the Building's main entrance, \$1,600 for sprinklers for the Vital Records vault, \$7,000 for carpet upgrades, and \$3,300 for staining oak trim and millwork in the research room. Approximately \$67,000 of the costs for change orders 3 and 4 were charged to the Account. The Department did not provide any documentation to support that the construction paid for by the Account was primarily related to the UCC's future use of the building.

As of April 30, 2007, the Department was not utilizing the space funded by the Account and there were no scheduled plans for the UCC to move into the Building.

*Recommendation:*

The Department should only charge the costs of administering the New Hampshire Business Corporation Act, Uniform Commercial Code - Secured Transactions, and other information technology costs of the Department to the Corporate Administration Account. The Department should not charge the Account for operations of the Department that are unrelated to the statutory purpose of the Account.

*Auditee Response:*

The construction of the Archives addition was a design-build project at the request of the Governor at that time who felt it would provide flexibility and cost savings. This project involved ongoing decision making and several significant design changes during the physical construction. The Department relied on the expertise of another state department for guidance during the process. The capital budget appropriations contained funds for both the actual construction of the Archives addition, and the purchase of furniture and equipment for the new sections of the building. During the design-build a necessary structural change reduced the height of the building and created a larger footprint. This presented an opportunity to add some additional space allowing the Department to address a looming space shortage within the Corporations Division at the State House Annex. A second contract was created with the same vendor on site utilizing Corporations funds to construct space for their future needs. Additionally, the second contract was used to pay for change orders during the project, furniture and equipment from funds available for the project other than Corporations funds. The new space was being used at the time of the audit to store many volumes of Corporations records, and the project was still in the final stages of completion during the audit.

The Department agrees that approximately \$50,000 in change orders was not properly charged to the Corporations account, and should have been charged to Vital Records. These items include bullet proof glass in the Vital Records reception area, fire suppression sprinklers in the Vital Records vault and pre-action fire suppression in the Research Room. Some of these improvements were made in anticipation of new Homeland Security guidelines resulting from 9/11. The Department has reimbursed Corporations from Vital Records funds. The \$17,000 balance was used to help pay for a portion of unanticipated costs in excess of \$100,000 resulting from additional requirements of the Concord Fire Department and the State Fire Marshal's office.

**Observation No. 16: The General Fund Should Not Be Used To Supplant The Election Fund In The Funding Of Help America Vote Act Expenditures**

*Observation:*

During fiscal years 2005 through 2007, the Corporate Administration Account (Account) lapses to the General Fund were reduced by a total of \$2.9 million due to the Department charging Help America Vote Act (HAVA) information technology (IT) expenditures to the Account. These HAVA IT expenditures should have been charged to the Department's federal HAVA program, funded primarily by federal funds.

It appears the HAVA IT expenditures were charged to the Account to protect the balance in the HAVA program, to the detriment of the State's General Fund.

During fiscal years 2005, 2006, and 2007, the Department transferred \$0.8, \$1.1 and \$1.0 million, respectively, of HAVA related expenditures out of the mostly federally funded Election Fund and into the Corporate Administration Account funded primarily by corporate filing fees. While RSA 293-A:1.37(b) provides that the Department can charge all Department information technology costs to the Corporate Administration Account, it is apparent that these expenditures were directly related to the purpose and operation of the HAVA program and would more appropriately be charged to that account. As amounts remaining in the Corporate Administration Account lapse to the General Fund at year end, these fiscal year 2005, 2006, and 2007 transfers reduced funds that otherwise would be available to the General Fund by a total of \$2.9 million. In addition, had those expenditures remained recorded in the Election Fund, it is not clear that the Department could comply with the RSA 5:6-d, III, Election Fund balance requirement going forward.

*Recommendation:*

The Department should reverse the HAVA related expenditure transfers for fiscal years 2005, 2006, and 2007 totaling \$2.9 million.

The Department should establish policies and procedures for determining, reviewing, and maintaining the required balance in the Election Fund.

In order to assist in determining the required balance, the Department will need to plan for the programs that are to be funded from the Election Fund. The Department should develop a business-type plan that considers both initial and ongoing costs that will be charged to the Fund as well as other foreseeable resources that will accrue to the Fund. Only by effectively planning for the use of the Fund can the Department be reasonably assured to effectively meet and manage the 20 times estimated annual cost provision of the law, and also have the greatest opportunity to leverage the balance in the Fund for the purpose of the Fund.

If the Department determines that the 20 times estimated annual cost provision of the law is no longer a benefit to the program and the State, the Department should request that the statute be revised.

*Auditee Response:*

The Legislature adopted RSA 293-A:1.37(b) which provides that the Department can charge all Department IT costs to the Corporate Administration Account. The Legislature also made it clear when they created the Election Fund that the Department was to have sufficient funds to maintain HAVA initiatives for two decades without additional general funds beyond the initial 5% required match.

In 2004, we created a spreadsheet in which we record the revenue and expenditures of the Election Fund. This spreadsheet has been kept current and is used to manage the balance in the Fund. Because we contracted maintenance costs for twenty years, there is little variation expected in annual expenditures. Each quarter, or when we contemplate a new purchase, we

adjust the forecasted revenue and expenditures for the next two years and compare the net use of funds times twenty against the balance in the fund.

This has been a very clear and concise method to ascertain whether the current balance in the Fund can be sustained over twenty years. We feel this is a valid method of determining adequacy as we have shown this method to be both effective and viable.

After a recent review of the balance in the fund, it was determined that there were sufficient funds available to maintain the required balance and a reversal of the 2007 transfer was recorded. This resulted in an additional million dollars lapsing to the general fund through the Corporate Administration Account in fiscal year 2008. A more detailed review of the long-term needs of HAVA will be done in the near future to determine if additional Election Funds could be transferred back to the Corporate Administration Account and subsequently lapsed to the general fund.

The twenty-times requirement has resulted in the hiring of minimal staff. This staff has kept pace with all federal requirements and we are among a dwindling number of States that have neither been sued by nor had to sign a consent order by the U.S. Department of Justice over HAVA.

#### **Observation No. 17: Effective Accounting Procedures For The Help America Vote Act Programs Should Be Established**

*Observation:*

At April 30, 2007, the Department did not have accounting procedures in place to efficiently record, report, and monitor financial activity and ensure compliance with provisions of the Help America Vote Act of 2002 (HAVA).

HAVA section 902 requires each recipient of HAVA funds to keep records consistent with sound accounting principles to facilitate an effective audit.

Federal Election Assistance Commission (EAC) guidance provides:

- Fiscal control and accounting procedures must be sufficient to:
  - Permit preparation of reports required by the Election Assistance Commission.
  - Permit the tracing of funds to a level of expenditures adequate to determine that funds have not been used in violation of Federal restrictions (HAVA and federal Office of Management and Budget) and that they comply with the State plan.
- Accounting records must be supported by source documents.

Prior to fiscal year 2007, the Department had received \$16,596,803 under the *Requirement Payments To States Program* and the *Election Reform Payments Program*. Much of this federal program revenue remained unspent in Department accounts as of April 30, 2007. Also, the Department has been eligible to receive \$100,000 annually under the *Voting Access For Individuals With Disabilities - Grants To States Program*. Each of these HAVA programs has

different requirements and, therefore, revenues and expenditures must be recorded separately to ensure adequate audit trails and accounting records to satisfy program requirements.

- During the ten months ended April 30, 2007, the Department recorded expenditures for two HAVA programs (*Requirement Payments To States Program* and *Voting Access For Individuals With Disabilities - Grants To States Program*) in one account in the State's accounting system (NHIFS). At the end of the State's fiscal year, the Department segregated the expenditures for the two programs and decided which were funded with federal funds. This subsequent review and allocation of expenditures to programs is inefficient and subject to error as illustrated by the next bulleted item.
- The Department's inefficient accounting procedures for the HAVA programs resulted in errors requiring a \$344,803 restatement of the State's fiscal year 2006 Schedule of Expenditures of Federal Awards (Schedule) in August of 2007. This Schedule is included in the State's Single Audit of Federal Financial Assistance Programs report. As noted in Observation No. 18, the Department charged the HAVA account for the salary expense of an employee who performed work outside the HAVA programs. Department personnel confirmed the allocation of this employee's salary to the HAVA program was in error when the auditor brought it to their attention. The Department's accounting procedures did not require the preparation of a timesheet or other payroll certification to support the allocation of the employee's salary to the HAVA program.
- HAVA section 104(d) and 254(b)(1)(D) requires the Department to deposit all interest earned on the Election Fund (balance of federal funds on hand) in the Election Fund. The Department reports the interest earned on Title I and Title II funds in one revenue source account hampering the breakout and audit of these amounts under the categories of Title I and II funds.
- As part of the maintenance of effort calculation, \$30,000 reported for salaries and benefits was not adequately supported. While Department personnel reported the amount represented that 12% of the Secretary of State's time, 18% of an Assistant Secretary of State's time, and 14% of the Business Administrator's time was spent on election activities during fiscal year 2000, the Department was unable to describe the basis for and support the accuracy of those percentages.
- The maintenance of effort amount included expenditures incurred by the Department of Justice for elections law enforcement related activities. An average of 538 hours per year for fiscal years 2000 and 2001 was used for the maintenance of effort calculation. This calculation was not in compliance with program requirements, which require direct expenditures be limited to those made in the state fiscal year that ended prior to November of 2000 (State fiscal year 2000). The Department of Justice reported actual hours attributed to elections in fiscal year 2000 were 883.65. When this discrepancy was brought to the Department of State's attention, the calculation of the maintenance of effort was revised to correct for the actual hours for the Department of Justice. However, the effect of the increase in the hours was offset in the calculation by a downward revision of the percentages used leaving the total calculated amount unchanged. There was no support given for the propriety to revise down the percentages used and this change appeared to be made simply to keep the total amount unchanged.



Not properly determining the maintenance of effort amount could prevent the State from meeting the annual requirement of maintaining at least the expenditures incurred prior to November of 2000.

*Recommendation:*

The Department should establish effective accounting procedures over its HAVA programs. As a primary step in that effort, the Department will need to ensure that employees responsible for the operation and oversight of the Department's HAVA activities are sufficiently trained in both the general financial and operational requirements of federal programs and the specific requirements of the HAVA programs.

In addition, the Department should improve its specific accounting procedures, including accounting records and documentation procedures, to ensure that accurate, consistent, and timely management information, including federal financial reporting is regularly generated. A suitable account structure should be established to provide for the contemporaneous and accurate accounting and reporting and the controlled and effective operation of the HAVA programs.

*Auditee Response:*

This Department has used the State's financial accounting system (NHIFS and GHRS) for all Department revenues and expenditures including those for the Election Fund, which includes HAVA and other funding. Since NHIFS and GHRS are used by every agency of the State, including the Legislature, it was expected to be an acceptable basis for sound accounting principles, in compliance with HAVA, Section 902.

In May of 2003, the State received \$5,000,000 in the category of "Title I - Payments to States for Election Administration Improvements..." In July of 2004, the state received \$11,596,803 as a Title II Requirements Payment. Because of New Hampshire's accompanying law, RSA 5:6-d, which created the Election Fund, the balance in the fund must support implemented programs for 20 years.

The Election Fund contains not only HAVA funding but also other funding directed by the legislature. Even though expenses for a particular employee were intended to be expended from a different election account, yet were charged to the Election Fund and inadvertently included in the single audit report for that period, the single audit information has since been amended. The work that was done by this employee during the audit period was primarily election-related and permitted under state law to be paid from the Election Fund.

The Department periodically sends an Election Fund monthly balance report to the Treasury Department. Treasury uses these monthly balances to post interest to the Election Fund using the separate and specific revenue account set up for this purpose.

HAVA, adopted in 2002, demands a retroactive accounting of election costs incurred in state fiscal year 2000. In PL 107-252, Section 254(7) [see 42 U.S.C. 15404(7)], under the title "State Plan" the Maintenance of Effort (MOE) requirement states: "How the State, in using the requirements payment, will maintain the expenditures of the State for activities funded by the

payment at a level that is not less than the level of such expenditures maintained by the State for the fiscal year ending prior to November 2000.”

The result of this retroactive accounting calculation is known as Maintenance of Effort (MOE.) This planning directive was to ensure that states would maintain baseline election expenditures using state funds and would not use HAVA money to fund baseline operations. The legislature has wisely planned for elections by budgeting this MOE outside the Election Fund.

In order to follow federal law, we have made our best efforts to calculate, keep and maintain the necessary supporting material for the MOE calculation. Most states could not have obtained detailed Maintenance of Effort (MOE) figures for the baseline year of 2000 when they never knew they had to collect detailed figures at the time. In light of this retrospective unknown, we used our most informed estimate to determine the state/local time allocations for both the Department of Justice and our office. All other numbers were based on actuals. New Hampshire will shortly be joining a number of other states in submitting comments to the EAC questioning the practicality of obtaining detailed information from past years records that did not contain sufficient detail to answer questions now being asked.

Due to the variability of election costs, the legislature has budgeted for elections on a biennial basis. Unused funds from year one carry forward to year two. In a small state such as New Hampshire, contentious subjects and cases may drive up costs for the Attorney General in one year and not in the next year, irrespective of election timing. In the Attorney General’s portion of this analysis, the Department relied on the state’s two-year figures, divided by two, and applied a reasonable estimate of the state/local ratio. This method incorporated three elections - the Presidential Primary, the State Primary and the General Election – into the cycle, so the reported costs would more closely reflect a complete election cycle. Based on the HAVA State Plan, we believe this approach best achieves the purpose of the federal planning directive in this instance. From a financial management perspective, this approach provides an appropriate basis for the baseline.

Taken singly or together, the above errors have profound implications for New Hampshire’s presidential primary. If the Federal government is allowed to use a back-door method to impose regulatory requirements on the states, and New Hampshire elects to conduct elections without compliance with such standards, this could affect New Hampshire’s ability to retain its first-in-the-nation presidential primary.

In the spirit of transparency, we have already begun work on a comprehensive database that will detail in multiple formats the expenditures from the Election Fund. The database will then be used to print reports for the various needs of the department. Because of the minimal staff and the continued work to be done complying with HAVA, this database is not expected to be fully operational until after the 2008 state primary and general elections.

## **Observation No. 18: Only Allowable Costs Should Be Charged To Help America Vote Act Program**

### *Observation:*

During the ten months ended April 30, 2007, the salary and benefits of one employee was charged to the Help America Vote Act (HAVA) program, even though this employee's responsibilities were generally not related to this federal-State program.

This employee's responsibilities were described as including a variety of Archives-related activities such as pulling records for researchers and State agencies, supervising the research reading room, coding new boxes of records in a system, data entry for archival records, coordinating the maintenance of State vehicles, and other responsibilities. During fiscal year 2007, the Department reported that this employee also managed the printing and distribution of the ballots for the State primary and general election.

- While the cost for this employee's work related to the election ballots may be an appropriate charge to the HAVA account, the payroll costs related to the majority of this employee's work at the Archives are not allowable charges to the HAVA program and should not be charged to the account.

The Department, when first asked indicated the employee was appropriately charged to the HAVA program, as his responsibilities were elections related. Upon further inquiry, the Department revised its statement and indicated charging the HAVA account was an error.

*Questioned Costs:* \$37,500 for fiscal year 2007.

### *Recommendation:*

Only the costs for allowable activities should be charged to the HAVA program. All costs charged to the program should be supported by documentation, including timesheets or other payroll certification to support the allowability of payroll charges.

### *Auditee Response:*

Although the mentioned employee's responsibilities were described as including a variety of Archives related activities, they worked primarily for elections during the audit period. The Department of State has not intentionally charged any salaries or benefits of any employees to the HAVA program who did not work on the HAVA program. In an email to one of the auditors dated September 25, 2007, it was explained that the charge to appropriation code 1064, the elections fund, which houses not only HAVA funds but other election related funding, should have been made to appropriation code 1061 and was purely and simply a keypunch error. Even though the end of the fiscal year had passed and a transfer of expense was not practical, the expense against the Election Fund was not an inappropriate charge. The end result was a return of those funds to the general fund.

## **Observation No. 19: Written Procurement Policies And Procedures Should Be Established For Federal Program Expenditures**

### *Observation:*

The Department does not currently have written policies and procedures for certain procurements funded with federal payments.

The federal administrative law 41 CFR 105-71.136, Procurement, states in part, “When procuring property and services under a grant, a State will allow the same policies and procedures it uses for procurements from its non-Federal funds.”

State agencies often satisfy this requirement by using the State’s documented procurement system and control process. However, per RSA 21-I:18, I(c) the Department is not required to, and does not, use much of the State’s normal procurement and expenditure control process. While the Department is subject to RSAs 21-I:22-a through d, as they relate to procurements greater than \$35,000, including contracting for consultants and consulting services greater than \$35,000, the Department does not consistently adhere to the requirements of the statute.

During the ten months ended April 30, 2007, the Department expended approximately \$2 million of federal program funds using its authority to make purchases outside the State’s normal procurement and expenditure control process. As noted in Observation No. 16, approximately half of this amount was subsequently transferred out of the HAVA account and into the Corporate Administration account.

The Department contends that in its reading of the federal HAVA law (Public Law 107-252), the State is not required, in its administration of the HAVA program, to comply with 41 CFR 105-71.136 and other federal administrative laws and regulations commonly applicable to federal-state programs. To support its argument, the Department cites testimony from representatives of other Secretaries of State before the federal Election Assistance Commission (EAC). The EAC and the General Services Administration, federal agencies that currently and previously administered the federal HAVA payments to the states, and the general counsel for the federal Government Accountability Office (GAO) report these common federal administrative laws and regulations apply to HAVA program activity.

### *Recommendation:*

The Department should establish written procurement policies and procedures for all significant Department expenditures, including expenditures funded from federal HAVA payments.

The Department should continue to work with the respective federal agencies and others to resolve the differences in opinion as to the applicability of the common federal administrative law and regulations to HAVA program activity. This is especially important since all funds provided under HAVA are subject to mandatory audit by the Comptroller General once during the lifetime of the program. Any State expenditures of HAVA funds that are ultimately determined to be outside program guidelines may be subject to repayment by the State.

*Auditee Response:*

The Department has some fundamental differences of opinion with the Election Assistance Commission (EAC) on the oversight and authority they are attempting to exert upon the states relative to the use of Help America Vote Act (HAVA) funds. New Hampshire is not alone among the states in holding this position. The Department has documented and thoroughly researched its position that the EAC was given a very limited role by Congress which did not include rulemaking authority. It is the position of the Department this federal agency has aggressively attempted to expand its role and exercise authority in a way not contemplated by Congress.

With the help of the State Legislature, and Governors in office since the implementation of HAVA, the Department has complied with the federal law in a manner that has been economical, efficient and in a way that will allow us to sustain the program into the future without burdening New Hampshire taxpayers. The Department is not willing to cede any authority over state elections to the federal government.

The Department is unaware of any non-compliance with the provisions of RSA 21-I:22-a through d as they relate to procurements for HAVA federal program expenditures.

The Department has requested clarification of the U.S. Election Assistance Commission staff interpretation regarding the applicability of OMB circulars on HAVA program payments. In a June, 2008 public meeting of the National Association of State Election Directors, both the U.S. Election Assistance Commission and the U.S. Inspector General said that their initial decision to rely on OMB circulars is being reexamined.

**Observation No. 20: Controls Over Payroll Must Be Improved**

*Observation:*

Payroll control activities described as in place by the Department during the ten months ended April 30, 2007 were not consistently and effectively applied. Related control monitoring activities were also not consistently applied as management did not recognize and take corrective action when control procedures became less than effective.

For example:

- In three out of the 23 (13%) items tested, wages paid were allocated to improper accounts. In extended testing, we noted the salaries and benefits for an additional seven employees were charged to accounts that were not in the areas that the employees worked. According to the Department, some of these positions were incorrectly budgeted and some of the positions were correctly budgeted; however, the salaries and benefits were erroneously charged to the incorrect account.
- In five out of the 23 (22%) items tested, payroll changes were made based on Personnel Action Forms that were not subject to a review and approval process as one employee

prepared the form, signed the form as the approver, and input the payroll change data into the State payroll system, GHRIS, without other formal Department review or oversight.

- In three out of 23 (13%) items tested, either a part-time employee had not submitted a required timesheet or a required supervisory approval was not present on a completed timesheet.
- In three out of the 23 (13%) items tested, leave time taken by employees was either not entered or not entered correctly into GHRIS.
- The Department's approval of the Agency Payroll Certification did not appear to be an effective control procedure during the ten months ended April 30, 2007 as the certifications were often not approved timely. In one instance noted the approved certification was in error and in another instance the cover sheet of the approved certification was for and reported payroll information of an agency other than the Department.
- Department payroll costs totaling \$9,914 were paid by other State agencies due to untimely payroll record updates. The Department's payroll personnel did not detect that Department payroll was being charged to other State agencies.

*Recommendation:*

As recommended in Observation No. 14, the Department must improve its controls over its expenditure process, including payroll.

The Department should ensure that all five components of internal control are adequately addressed in its payroll expenditure control process. Management must demonstrate the importance of controls in establishing the appropriate control environment. Risks associated with payroll activity must be regularly reviewed with appropriate responsive actions taken. The system of control activities must provide for reasonable assurance of detecting and correcting erroneous payments including, but not limited to, segregating incompatible functions. Employees must be provided with accurate and timely information and direction to provide for their effective participation in the control process, and the entire process has to be monitored to ensure continued operation and effectiveness.

*Auditee Response:*

The Department of State has controls in place for the payroll process.

At the end of the 2007 session, the legislature passed the budget bill from which we are currently expending funds. The department assigns personnel to the areas needed to fulfill its obligations under the constitution and law. Sometimes the areas where these individuals are working are different than where their salaries were budgeted. Since the budgeting process is not flexible enough to allow a single position to be assigned to more than one division, the appropriation to charge the salaries for these positions can only be in one place. Given this restraint, the department has little alternative than to have the entire salary of each employee charged to one account.

Leave records are reconciled every six months and any necessary corrections are made at that time.

The Department prepares Agency Payroll Certifications. In one instance a payroll number very similar to ours from a different department was accidentally used to print the cover sheet. However, all of the backup information was for our Department and was properly paid. Payroll costs paid by another agency were a direct result of an employee of that other agency being transferred to our department in the middle of a pay period. We will make every effort to ensure that the payroll certifications are signed in a timely manner.

By being flexible in assigning responsibilities, this department has been able to utilize individual management skills allowing it to be more efficient and effective. IFS/GHRS is not flexible in the same manner as the department operates for budgeting purposes. The department is hopeful that the new accounting system will solve some of these issues.

**Observation No. 21: Risk To Operations Resulting From Employing Relatives Should Be Addressed**

*Observation:*

The Department employed a spouse and dependent and nondependent children of various senior management officials during the ten months ended April 30, 2007. Five family members were employed on a part-time basis, primarily summer employment, and one family member was employed on a full-time basis.

Employing relatives of management employees, in addition to raising the possible appearance of impropriety or a conflict of interest, can limit the effectiveness of supervisory controls when the dynamics of familial and supervisor/subordinate relationships commingle.

During the audit period, there were no State statutes or statewide rules or policies that specifically addressed the employment of family members.

*Recommendation:*

The Department should consider the effect of the appearance of conflicts of interests that results from the practice of hiring family members of management employees to determine whether it should continue the practice in new hiring decisions going forward.

If the Department is to continue to employ family members of management employees, the Department should ensure appropriate actions are taken to provide for recusal of the management employee from the hiring process and any supervisory decisions regarding the family member, as required by Executive Branch Ethics Committee Advisory Opinion 2008-001, issued April 2, 2008.

*Auditee Response:*

The Department employed 160 full-time and part-time individuals during the time of the audit. No one with hiring authority within the Department has hired or participated in the hiring of a related person, and no employee has a direct supervisory position over a relative. The recent

Executive Branch Ethics Committee Advisory Opinion 2008-001 has been fully complied with in spirit and fact, before, during, and after the audit, as have all state statutes, policies or rules in this regard. The positions cited in this observation collectively amounted to one percent of the entire Department payroll.

**Observation No. 22: Controls For Documenting Leave Accounting For Other Than Classified Workers Should Be Improved**

*Observation:*

The Department does not document certain aspects of its accounting for leave time for other than classified workers.

Typically, unclassified and non-classified State employees do not accrue annual and sick leave benefits. However, pursuant to RSA 5:6-b, “[a]ll full-time employees and officials in this department shall be eligible for annual and sick leave.”

- All but four of the Department’s 12 unclassified and non-classified employees eligible for annual and sick leave accrue annual and sick leave time. The Department does not maintain documentation of the employee’s determination of whether or not to accrue leave in the employee’s personnel file or elsewhere in the Department’s payroll records.
- During the ten months ended April 30, 2007, the Department did not record the accruals and usage of leave time for these unclassified and non-classified Department employees in the State’s payroll system (GHRIS). The Department indicated it was unaware of the GHRIS’ capacity to do so. The Department manually tracked these employees’ leave accruals and usage on a separate spreadsheet.

Incomplete payroll documentation increases the risk of disagreements arising from incomplete or misunderstood information and repudiated decisions. In addition, recording and reporting all leave in GHRIS allows for central State system controls over the leave accounting process and also provides the State with the ability to accurately and fully account for and report accrued leave liabilities in its annual financial reports.

*Recommendation:*

The Department should improve its controls for documenting leave accounting for other than classified workers.

- All employee decisions regarding the accrual of leave time should be documented as part of the Department’s payroll records.
- All accruals and usage of leave time should be accounted for in GHRIS. The Department should ensure that its payroll officials are appropriately trained in accounting and reporting leave time for other than classified employees.



*Auditee Response:*

The Department does document its accounting for leave time for other than classified workers. The Department maintains a manual record of the participating employees accrued annual and sick time. The documentation procedure is no different than what was being done at the time of our previous LBA audit where no finding or observation was mentioned even though the GHRS system was available at that time as well.

RSA 5:6-b authorizes full-time employees and officials of the Department of State to be eligible for and use annual and sick leave. During the period of the audit there were ten (10) unclassified and two (2) non-classified employees who were eligible to participate. Two of the four that did not elect to participate have since left the Department. While an actual determination of participation statement has not been kept in the employees file, history shows this has not been a problem. The Department will request such a statement from eligible employees in the future.

One reason leave time is recorded in GHRS and reported on the payroll stubs is a requirement of the bargaining agreement. Sections 10.7 and 11.8 require that accrued annual and sick leave be “reported to each employee twice a year.” Unclassified and non-classified employees are not part of the bargaining agreement and thus are unaffected by this. Although there is no requirement to record this information in GHRS, we will take the additional time to record this information in GHRS for all employees.

**Observation No. 23: Relationship With Independent Contractors Should Be Documented**

*Observation:*

The Department has not documented its contract agreements with independent contractors providing service to the Department.

The Department has employed an independent contractor since 2003 to assist with the development and implementation of the Secretary of State Knowledge Base System (SOSKB), the primary Department information system. However, the Department has not documented the working relationship with this contractor through a contract, memorandum of understanding, or other written agreement.

Common contracting practice requires the particulars of the agreement, including services to be performed, the expected duration of service, conduct of work, metrics for measuring progress, specifics for payment, and dispute resolution, etc., are understood and documented prior to the start of service. The lack of any documented work-plan and performance criteria for this relationship gives it the appearance of an employer-employee and not a principal-independent contractor relationship. Without the documented criteria, the Department does not have the protection provided by a contract document to measure and demand performance from the contractor.

According to the Department, the original procurement of the contractor’s service in 2003 was not subject to a formal request for consultant service or bid process.

During the ten months ended April 30, 2007, the Department paid this contractor \$41,300 for services provided.

The Department also employs a contractor as a Division of Securities Regulation compliance consultant. During the ten months ended April 30, 2007, the Department paid this consultant \$20,392. The business arrangement between the Department and this consultant is also not documented.

*Recommendation:*

The Department should review its relationship with these independent contractors to determine whether engaging independent contractors is the most efficient and effective manner to obtain these needed services.

The Department should especially consider whether obtaining contractor services for the SOSKB project places the Department at a risk of dependence on this contractor for information and expertise that should be developed and resident in the Department and its employees.

If the Department determines that the current contractor model continues to be the best option for the Department and the State, the Department should fully document the relationship in contract documents that describe the scope, duration, and deliverables of the work to be provided and payment and other agreed-to particulars that will protect the interests of both the Department and the contractors.

*Auditee Response:*

The Department now has a current contract in place with the two vendors cited in the observation.

The Bureau of Securities secured the services of a local and recently retired securities compliance executive to assist with field audit matters as well as investor education initiatives. The consultant immediately and properly registered as a vendor with the State of New Hampshire at the outset of this arrangement.

**Observation No. 24: Controls Over Contracts, Including Changes To Contract Provisions, Should Be Improved**

*Observation:*

During the ten months ended April 30, 2007, the Department negotiated significant changes to a contract with a vendor engaged to implement and operate the Secretary of State Knowledge Base (SOSKB) system without documenting the changes in the manner specified in the contract.

According to Section 17 of Exhibit C to the contract, "This agreement may be amended, waived, or discharged only by an instrument in writing signed by the Secretary of State, Deputy Secretary of State, or Assistant Secretary of State."

During fiscal year 2003, the Department entered into a seven-year \$1.028 million contract for the implementation and ongoing operation of the SOSKB system. The Department uses the SOSKB system to process transactions in its Corporate and Uniform Commercial Code (UCC) Divisions, as well as to process other Department cash receipts, and to upload the transactions into the State's accounting system (NHIFS). As part of the contract, the Department contracted for ongoing vendor support and maintenance of the SOSKB system, referred to as a service level agreement (SLA). The cost for the SLA was \$68,000 per year.

The Department reported that at the beginning of fiscal year 2007, the vendor requested an increase in the SLA price from \$68,000 to \$202,500. The Department countered with an offer of \$165,000 for unlimited standard support calls and with payments to be made on a quarterly basis, rather than a lump sum. According to the Department, the quarterly payment provision was added to monitor for and encourage good vendor performance. These negotiations with the vendor were transacted via email between the Department's project manager and the vendor. Contrary to the conditions in the original contract, these changes in the SLA were not formally documented and executed.

During detail testing of expenditures we noted the vendor was paid on August 22, 2006, prior to the end of the first quarter, in apparent noncompliance with the conditions negotiated with the vendor via email. It is unclear from the records whether the Department recognized it had not acted in accordance with the prior negotiations and had paid the vendor prior to evaluating the vendor's first quarter performance.

The Department reported a monthly payment schedule was adopted after the first two payments were made during fiscal year 2007 to allow for even closer monitoring of vendor performance. Again, there was no formal written documentation of the change to the provisions of the SLA.

The Department agreed negotiations should have been in writing in accordance with the provisions of the original contract. However, the Department also reported that because they considered the contract discussions to be incomplete during the ten months ended April 30, 2007, formalizing the agreement would be premature.

*Recommendation:*

Responsible Department and contractor officials should execute contract provisions and all changes to contract provisions. All contract provisions, including changes to the SLA, should be documented according to the contract requirements to establish and support required Department and contractor performance. The Department should consider the risk to its controlled operations of having an independent contractor negotiate significant changes to Department contracts on behalf of the Department.

The Department should improve its information and communication controls to ensure that all appropriate Department employees are made aware of contract provisions and changes to contract provisions to ensure that the provisions are incorporated into the Department's control structure and procedures, including authorizing and making payment on contractor invoices.

*Auditee Response:*

Contract amendments were signed by the deputy secretary of state on May 10, 2004, May 25, 2004, December 1, 2005, January 8, 2006 and October 2, 2007. During the audit period, and leading up to the Service Level Agreement signed on October 2, 2007, the Department was negotiating through some extenuating circumstances. The vendor was requesting additional funds to cover an increase in services required by the SOSKB system, concerns over vendor performance were being addressed, the consortium of other states with which we were partnered on the SOSKB system was falling apart, and the Department was reviewing other options relative to the support of the SOSKB system. The Department intentionally chose not to enter into a formal agreement with the vendor until the concerns over the critical issues described above were resolved. We believe this approach was in the best interest of the state, and in retrospect turned out to be true.

We believe the use of extensive e-mails exchanged internally and with the vendor, fully document in writing the decisions relative to changing the level and frequency of payments now incorporated in the Service Level Agreement. Additionally, the negotiation team from the Department included the deputy secretary of state, the entire SOS IT division, an in-house attorney, the top two Corporations Division managers and our contracted project manager.

**Observation No. 25: Equipment Accountability And Reporting Controls Should Be Established**

*Observation:*

The Department has not established equipment accountability and reporting controls.
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As of April 30, 2007, the Department did not have a comprehensive listing of its equipment and could not provide information related to its equipment such as the total balance, specific items owned, identifying characteristics, cost, location, and who was responsible for the custody of the equipment. Records available at the Department were missing, incomplete, not current, and did not support information reported to the Department of Administrative Services (DAS) for inclusion in the State's annual financial statements.

Pursuant to RSA 21-I:18, I(c), the Department of State is not required to adhere to most common State administrative controls, including the DAS requirements for equipment controls and reporting. The Department of State has not established alternative controls to ensure that it is and remains accountable for the State equipment it owns and that it is able to accurately report equipment information for management's purposes, including maintaining accountability for the equipment.

As of April 30, 2007, the Department was in the beginning stages of creating (and recreating) equipment accounting and control records.

*Recommendation:*

The Department should establish equipment accountability and reporting controls sufficient for the Department's and the State's needs. The Department should look to the DAS equipment controls as a reasonable baseline framework for equipment accounting and reporting requirements. The Department should ensure that the controls it implements are at least as vigorous as the DAS controls.

*Auditee Response:*

The Department has information on all items purchased by the Department since the last audit in 1996, and inventory lists existed at the time of the audit, but were not up to date. The Department currently has a comprehensive equipment database that is being kept up-to-date as we move forward. The inventory control number, item description, purchase value, location, referenced payment document, date of purchase and other comments are part of that database. Our IT equipment inventory is extremely accurate and detailed. We are currently working on completing the details of our non-IT equipment.

We intend to provide an updated inventory list annually to the Department of Administrative Services.

## Federal Compliance

### **Observation No. 26: Federal Approval Should Be Requested Prior To The Expenditure Of Help America Vote Act Funds For Capital Assets**

*Observation:*

The Department has constructed an addition to the Records and Archives Building that was budgeted in part with federal Help America Vote Act (HAVA) funds. The Department had not requested pre-approval from the federal Election Assistance Commission (EAC) for the use of HAVA funds for the capital expenditure and does not recognize a requirement for a federal pre-approval for this purpose.

OMB Circular A-87 - *Cost Principles for State, Local, and Indian Tribal Governments*, Attachment B, Section 15, defines other capital assets as buildings, land, and improvements to buildings or land that materially increase their value or useful life. It further states, “Capital expenditures for general purpose equipment, buildings, and land are unallowable as direct charges, except where approved in advance by the awarding agency.” Federal awarding agencies are authorized to waive or delegate the prior approval requirement.

In the federal Election Assistance Commission (EAC) *Report To Congress On State Governments’ Expenditures Of Help America Vote Act Funds* dated July 2007, Appendix C of the report contains frequently asked questions and states that, “[t]he cognizant agency [EAC]... has the authority to pre-approve or waive the right to pre-approve the purchase of any capital equipment ... or capital improvement with grant funds. EAC has waived its right to pre-approve **ONLY** [emphasis original] the purchase of voting equipment that complies with Section 301 of HAVA and any computer equipment used solely for the purpose of developing or operating the statewide voter registration list. Conversely, the EAC has not waived its right to pre-approve the use of HAVA funds for other items that may be required to meet the requirements of Title III or that may be used to improve the administration of elections for Federal office.”

Chapter 240:1, X, Laws of 2003, included a \$2.5 million capital improvement appropriation for an addition to the Records and Archives building located on Fruit Street in Concord. The funding for this project included \$1 million in HAVA funds for a 4,145 square-foot HAVA facility on the second floor of the building. The addition was completed and HAVA personnel occupied the space during the spring of 2007. The Department, in noncompliance with OMB Circular A-87, Attachment B, Section 15, did not request federal pre-approval to use HAVA funds for the capital expenditure.

In May 2008, the Department charged the HAVA account \$1,000,000 for the HAVA program’s intended share of the construction costs. This amount was credited to the State’s Capital Fund.

The Department contends that in its reading of the federal HAVA law (Public Law 107-252), the State is not required, in its administration of the HAVA program, to comply with OMB Circular A-87 and other federal administrative laws and regulations commonly applicable to federal-state programs. To support its argument, the Department cites testimony from other Secretaries of State before the federal Election Assistance Commission (EAC). The EAC and the General

Services Administration, federal agencies that currently and previously administered the federal payments to the states, and the general counsel for the federal Government Accountability Office (GAO) report these common federal administrative laws and regulations apply to HAVA program activity.

*Recommendation:*

The Department should immediately contact the federal Election Assistance Commission (EAC) to request approval for the expenditure of HAVA funds for the capital construction project.

If the Commission does not allow the expenditure of HAVA funds for the construction of capital assets, the Department should request direction from the Legislature as to how to resolve any resulting negative available balance in the Department's Capital Projects Fund appropriation.

The Department should review the HAVA program guidance and other federal regulations to ensure that it is cognizant of all program requirements.

The Department should continue to work with the respective federal agencies and others to resolve the differences in opinion as to the applicability of the common federal administrative laws and regulations to HAVA program activity. This is especially important since all funds provided under HAVA are "subject to mandatory audit by the Comptroller General once during the lifetime of the program." Any State expenditures of HAVA funds that are ultimately determined to be outside program guidelines may be subject to repayment by the State.

*Auditee Response:*

The Department has some fundamental differences of opinion with the Election Assistance Commission (EAC) on the oversight and authority they are attempting to exert upon the states relative to the use of Help America Vote Act (HAVA) funds. New Hampshire is not alone among the states in holding this position. The Department has documented and thoroughly researched its position that the EAC was given a very limited role by Congress which did not include rulemaking authority. It is the position of the Department this federal agency has aggressively attempted to expand its role and exercise authority in a way not contemplated by Congress.

With the help of the State Legislature, and Governors in office since the implementation of HAVA, the Department has complied with the federal law in a manner that has been economical, efficient and in a way that will allow us to sustain the program into the future without burdening New Hampshire taxpayers. The Department is not willing to cede any authority over state elections to the federal government.

Public Law 107-252, Section 253(c) provides that, "The specific choices on the methods of complying with the elements of a State plan shall be left to the discretion of the State". There is similar wording in Section 305. The Department has, after consultation with the NH Attorney General's Office, along with other states continues to correspond with EAC officials, the US Inspector General, and other federal agencies to resolve the differences in opinion as to the applicability of the common federal administrative law and regulations to HAVA program activity.

## Observation No. 27: Federal Program Reports Should Be Completed And Filed

### Observation:

The Department has not met the Help America Vote Act of 2002 (HAVA) reporting requirements established in HAVA, a House Resolution, and other supporting federal guidance for HAVA.

- Public Law 107-252, Help America Vote Act of 2002, Title II, section 258 states “Not later than 6 months after the end of each fiscal year for which the State received a requirements payment under this part, the State shall submit a report to the Commission on the activities conducted with the funds provided during the year...”
- *House Resolution - 3295 Help America Vote Act of 2002, Joint Explanatory Statement*, dated October 2002, directs States to submit reports to the Election Assistance Commission on an annual basis.
- The federal *Catalog of Federal Domestic Assistance*, a document that summarizes the requirements for federal programs, indicates in Section 90.401, *Help America Vote Act Requirements Payments, Reports*, States should submit the *Standard Form 269* to the Election Assistance Commission no later than six months after the end of each fiscal year.

The reports filed in December 2003 and March 2005 by the Department to report the receipt of the Title I and Title II funds were not complete and contained inaccuracies. The Department has issued no further program reports to the federal grantor organization.

The Department indicated it does not agree that any reporting to the federal grantor organization is required after the initial reporting in the year of receipt and has accepted a lack of a response to an emailed request for clarification of reporting requirements as confirmation of its position.

The Department contends that in its reading of the federal HAVA law (Public Law 107-252), the State is not required, in its administration of the HAVA program, to comply with federal administrative laws and regulations commonly applicable to federal-state programs as reported in the *Catalog of Federal Domestic Assistance*. To support its argument, the Department cites testimony from other Secretaries of State before the federal Election Assistance Commission (EAC). The EAC and the General Services Administration, federal agencies that currently and previously administered the federal payments to the states, and the general counsel for the federal Government Accountability Office (GAO) report these common federal administrative laws and regulations apply to HAVA program activity.

### Recommendation:

The Department should annually report program activity to the Election Assistance Commission.

The Department should continue to work with the respective federal agencies and others to resolve the differences in opinion as to the applicability of the common federal administrative laws and regulations reported in the *Catalog of Federal Domestic Assistance* to HAVA program activity. This is especially important since all funds provided under HAVA are “subject to mandatory audit by the Comptroller General once during the lifetime of the program.” Any State



expenditures of HAVA funds that are ultimately determined to be outside program guidelines may be subject to repayment by the State.

*Auditee Response:*

The Department has some fundamental differences of opinion with the Election Assistance Commission (EAC) on the oversight and authority they are attempting to exert upon the states relative to the use of Help America Vote Act (HAVA) funds. New Hampshire is not alone among the states in holding this position. The Department has documented and thoroughly researched its position that the EAC was given a very limited role by Congress which did not include rulemaking authority. It is the position of the Department this federal agency has aggressively attempted to expand its role and exercise authority in a way not contemplated by Congress.

With the help of the State Legislature, and Governors in office since the implementation of HAVA, the Department has complied with the federal law in a manner that has been economical, efficient and in a way that will allow us to sustain the program into the future without burdening New Hampshire taxpayers. The Department is not willing to cede any authority over state elections to the federal government.

The first report covering the receipt of Title I funds was submitted to the General Services Administration in December of 2003. (The Election Assistance Commission had not been organized by that date.) The first report required by HAVA 2002, Public Law 107-252, Title II, Section 258 covering the receipt of Title II funds was submitted to the U.S. Election Assistance Commission (EAC) in March of 2005. Although the EAC has posted amounts to their web site that differ from one of these reports, we believe the reports that were submitted are complete and do not contain inaccuracies.

Some of the persons most effective in reporting are also the same persons implementing HAVA. Hiring extra persons in this management category would have caused the department to potentially violate the state legislature's 20 times maintenance requirement in RSA 5:6-d. Given the department's plain reading of federal law and the fact that we can readily provide this information when time permits, it seems a better decision to comply with the clearly mandatory aspects of federal law. We do intend to file reports with the EAC.

## State Compliance

### **Observation No. 28: Capital Budget Status Reports Should Be Filed**

*Observation:*

The Department has not filed Capital Budget Status Reports for the addition to and renovation of the Records and Archives Building.

Per RSA 17-J:4, “[t]he capital budget overview committee shall review the status of capital budget projects both during and between legislative sessions. Each state agency with capital budget projects shall submit to the committee a status report on the projects every 60 days.”

The Department is near completion of a \$3.7 million addition and renovation of the Records and Archives Building. Expenditures for this project began in fiscal year 2005 and continued through and beyond the ten months ended April 30, 2007. The Department has not completed or filed any of the required status reports. The Department indicated it was unaware of the requirement to file the reports.

*Recommendation:*

The Department should complete and file the capital budget status reports required by statute.

*Auditee Response:*

This project is now complete. Had the Department been aware of this statute, it would have filed 60 day reports. The Department relied on another state agency to guide it through the design/build capital project. A final report will be filed with the capital budget overview committee.

### **Observation No. 29: Archive Inventory And Procedures Manual Should Be Prepared**

*Observation:*

The Department has not prepared and maintained a statutorily required descriptive inventory and photographic reproduction collection of all portraits and artifacts belonging to the State nor has it prepared and maintained a procedures manual for the State’s archives and records management.

- Per RSA 5:30, X, effective July 24, 1987, the Director of the Department’s Division of Archives and Records Management (Division) shall “[m]aintain a descriptive inventory and photographic reproduction collection of all portraits and artifacts that belong to the state.”
- Per RSA 5:40, effective July 24, 1987, “[t]he director under the supervision of the secretary of state, shall establish a manual of uniform procedures necessary and proper to effectuate the purpose of this subdivision. Such procedures and any subsequent revisions, when approved by the governor and council, shall be binding upon all officers and employees of the state.”

The Division reported on August 31, 2007 that, while it had initiated work on a procedures manual intended to comply with RSA 5:40, it had little time to work on the project. The Division also indicated that it assumed that another State agency had taken on the responsibility for the descriptive inventory and photographic reproduction collection for all portraits and artifacts belonging to the State. According to that agency, it had not.

*Recommendation:*

In compliance with statute:

- The Department should establish and maintain a descriptive inventory and photographic reproduction collection of all portraits and artifacts that belong to the State.
- The Department should establish and maintain a manual of uniform procedures necessary and proper to effectuate the purpose of the referred to subdivision. Such procedures manual, when complete, should be submitted to the Governor and Council for their approval.

If the Department determines that its compliance with the statute is no longer necessary, the Department should request an appropriate revision to the statute.

*Auditee Response:*

RSA 5:30, X directs the Archivist to “maintain a descriptive and photographic inventory of all portraits and artifacts that belong to the state.” The Archives has a photographic inventory of all of the gubernatorial portraits in the state house. Additionally, a more comprehensive inventory has been done by the NH Division of Historical Resources under RSA 227-C:4, I. The photographic inventory can be viewed on the state web site at the following address <http://www.nh.gov/nhdhr/publications/>. We agree the relationship between the two departments should be clarified in the statute as it relates to the responsibility of maintaining the inventory.

The Division of Archives has drafted the Manual of Uniform Procedures as directed by legislation effective June 15, 2006. The Manual of Uniform Procedures will become effective when approved by Governor and Council.

**Observation No. 30: Resolution Of Inconsistency In Statutes For The Director Of Vital Records Position Should Be Requested**

*Observation:*

A salary has not been established in RSA 94:1-a for the position of the Director of Vital Records Administration and the position has not been filled in the manner provided for in statute.
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RSA 5-C:2 states, “[t]he secretary of state, with the approval of the governor and council, shall appoint the director of vital records administration. In addition to the title of director, the director shall also be known as the state registrar.” The manner of appointment of the Director of Vital Records Administration implies that the Director is an unclassified position, however there is no salary for the position provided for in RSA 94:1-a.

Currently, the Division of Vital Records is headed by a classified employee who has headed the organization since 1999, prior to its transfer to the Department of State from the Department of Health and Human Services during fiscal year 2004.

While the Department has been aware of the inconsistency between the two statutes, the Department has not requested legislative clarification.

*Recommendation:*

The Department should request a legislative resolution to the current inconsistency in the statutes that apparently provide for an unclassified Director of Vital Records but do not provide a salary for the position.

*Auditee Response:*

The Department has been aware of this issue since the statute was recodified in 2005. During the 2007 session of the legislature, HB 362 attempted to address this situation, but was unsuccessful. Currently the Department is undergoing a comprehensive review of staff responsibilities within the Division of Vital Records. This exercise will help determine the appropriate way to address the conflict in the statute. The legislature will be approached by the Department during the next session to clarify the statute.

## **Independent Auditor's Report**

*To The Fiscal Committee Of The General Court:*

We have audited the accompanying Statement Of Revenues Deposited And Expenditures Paid – General Fund and Capital Projects Fund of the New Hampshire Department of State for the ten months ended April 30, 2007. This financial statement is the responsibility of the Department of State’s management. Our responsibility is to express opinions 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 of State’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 opinions.

As discussed in Note 1, the financial statement only presents the revenues deposited and expenditures paid by the Department of State. Accordingly, this financial statement does not purport to, and does not, constitute a complete financial presentation of either the Department of State or the State of New Hampshire in conformity with accounting principles generally accepted in the United States of America.

As discussed in Note 1, this financial statement is prepared on the cash basis, which is a comprehensive basis of accounting other than accounting principles generally accepted in the United States of America.

In our opinion, the financial statement referred to above presents fairly, in all material respects, the revenues deposited and expenditures paid – General Fund and Capital Projects Fund by the Department of State for the ten months ended April 30, 2007 on the basis of accounting described in Note 1.

Our audit was conducted for the purpose of forming opinions on the Statement Of Revenues Deposited And Expenditures Paid – General Fund and Capital Projects Fund of the New Hampshire Department of State. 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, except for the Prior Period Expenditures Paid, Total Expenditures Paid, and Unexpended amounts as listed in the Schedule Of Budget And Expenditures Paid – Capital Projects Fund. The Prior Period Expenditures Paid, Total Expenditures Paid, and Unexpended amounts have not been subjected to the auditing procedures applied in the audit of the financial statement and accordingly we express no opinion on them. In our opinion, except for the financial information described in the preceding sentence, the supplementary schedules are 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 our report dated July 18, 2008 on our consideration of the Department of State’s internal control over financial reporting and on our tests of its compliance with certain provisions of laws, rules, regulations, and 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

July 18, 2008

**STATE OF NEW HAMPSHIRE  
DEPARTMENT OF STATE  
STATEMENT OF REVENUES DEPOSITED AND EXPENDITURES PAID  
GENERAL FUND AND CAPITAL PROJECTS FUND  
FOR THE TEN MONTHS ENDED APRIL 30, 2007**

<u>Revenues Deposited</u>	<u>General Fund</u>	<u>Capital Projects Fund</u>	<u>Total</u>
<b>Unrestricted Revenues</b>			
Securities Registrations	\$ 18,159,882	\$ -0-	\$ 18,159,882
Securities Licensing	10,886,820	-0-	10,886,820
Annual Returns	3,176,465	-0-	3,176,465
Corporate Fees	1,034,384	-0-	1,034,384
Uniform Commercial Code	392,723	-0-	392,723
Notaries Public	249,950	-0-	249,950
Other	344,204	-0-	344,204
<b>Total Unrestricted Revenues</b>	<u>34,244,428</u>	<u>-0-</u>	<u>34,244,428</u>
<b>Restricted Revenues</b>			
Corporate Administration	5,285,319	-0-	5,285,319
Securities Administrative Fines	1,127,642	-0-	1,127,642
Vital Records Improvement Fund	803,013	-0-	803,013
Election Fund	635,472	-0-	635,472
Town Portion Of UCC Filing	320,400	-0-	320,400
Birth Certificates	156,917	-0-	156,917
Vital Records Federal Funds	158,837	-0-	158,837
Other	159,935	-0-	159,935
<b>Total Restricted Revenues</b>	<u>8,647,535</u>	<u>-0-</u>	<u>8,647,535</u>
<b>Total Revenues Deposited</b>	<u><b>42,891,963</b></u>	<u><b>-0-</b></u>	<u><b>42,891,963</b></u>
<b>Expenditures Paid</b>			
Salaries And Benefits	3,530,916	-0-	3,530,916
Election Fund	2,430,338	-0-	2,430,338
Vital Records Improvement Fund	699,703	-0-	699,703
Current Expenses	519,082	-0-	519,082
Corporate Computer Conversion	387,083	-0-	387,083
UCC Payments To Towns	300,555	-0-	300,555
Other Expenditures	140,043	-0-	140,043
Equipment	69,712	-0-	69,712
Consultants	40,393	-0-	40,393
Archives Building	-0-	519,436	519,436
<b>Total Expenditures Paid</b>	<u><b>8,117,825</b></u>	<u><b>519,436</b></u>	<u><b>8,637,261</b></u>
<b>Excess (Deficiency) Of Revenues Deposited</b>			
<b>Over (Under) Expenditures Paid</b>	<u><b>\$ 34,774,138</b></u>	<u><b>\$ (519,436)</b></u>	<u><b>\$ 34,254,702</b></u>

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

**STATE OF NEW HAMPSHIRE  
DEPARTMENT OF STATE  
REVENUES DEPOSITED AND EXPENDITURES PAID**

**NOTES TO THE FINANCIAL STATEMENT  
FOR THE TEN MONTHS ENDED APRIL 30, 2007**

**NOTE 1 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES**

**A. Financial Reporting Entity**

The Department of State (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 revenues and expenditures of the Department of State are accounted for and reported in the General and Capital Projects Funds in the State of New Hampshire's Comprehensive Annual Financial Report (CAFR).

**B. Basis Of Presentation – Fund Accounting**

The State of New Hampshire and the Department of State use funds to report on their financial position and the results of their operations. A fund is a separate accounting entity with a self-balancing set of accounts. Fund accounting is designed to demonstrate legal compliance and to aid financial management by segregating transactions related to certain government functions or activities.

*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.

Capital Projects Fund

The Capital Projects Fund is used to account for certain capital improvement appropriations which are or will be primarily funded by the issuance of state bonds or notes, other than bonds and notes for highway or turnpike purposes, or by the application of certain federal matching grants.

**C. Measurement Focus And Basis Of Accounting**

The accompanying Statement Of Revenues Deposited And Expenditures Paid for the ten months ended April 30, 2007 was prepared using the cash basis of accounting and includes only those revenues collected and deposited in the bank accounts maintained by the State Treasurer.



Financial statements prepared on the cash basis, which is a comprehensive basis of accounting other than accounting principles generally accepted in the United States of America, may differ from presentation under accounting principles generally accepted in the United States of America since certain revenues are recognized when received rather than when earned, and certain expenses are recognized when paid rather than when the obligations are incurred. Accordingly, the accompanying financial statement is not intended to present the Department's results of operations in conformity with accounting principles generally accepted in the United States of America.

**STATE OF NEW HAMPSHIRE  
DEPARTMENT OF STATE  
REVENUES DEPOSITED AND EXPENDITURES PAID - GENERAL FUND  
BUDGET TO ACTUAL SCHEDULE - CASH BASIS  
FOR THE TEN MONTHS ENDED APRIL 30, 2007**

<b>Revenues Deposited</b>	<b>Original Operating Budget</b>	<b>Modified Budget</b>	<b>Actual</b>	<b>Favorable/ (Unfavorable) Variance</b>
<b>Unrestricted Revenues</b>				
Securities Registrations	\$ 19,991,000	\$ 19,991,000	\$ 18,159,882	\$ (1,831,118)
Securities Licensing	11,500,000	11,500,000	10,886,820	(613,180)
Annual Returns	4,000,000	4,000,000	3,176,465	(823,535)
Corporate Fees	1,455,000	1,455,000	1,034,384	(420,616)
Uniform Commercial Code	600,000	600,000	392,723	(207,277)
Notaries Public	270,000	270,000	249,950	(20,050)
Other	430,500	430,500	344,204	(86,296)
<b>Total Unrestricted Revenues</b>	<b>38,246,500</b>	<b>38,246,500</b>	<b>34,244,428</b>	<b>(4,002,072)</b>
<b>Restricted Revenues</b>				
Corporate Administration	1,781,811	2,013,020	5,285,319	3,272,299
Securities Administrative Fines	1,017,512	1,059,543	1,127,642	68,099
Vital Records Improvement Fund	1,140,228	1,141,642	803,013	(338,629)
Election Fund	1,576,705	1,579,450	635,472	(943,978)
Town Portion Of UCC Filing	400,000	412,617	320,400	(92,217)
Birth Certificates	170,000	174,358	156,917	(17,441)
Vital Records Federal Funds	198,830	204,153	158,837	(45,316)
Other	-0-	-0-	159,935	159,935
<b>Total Restricted Revenues</b>	<b>6,285,086</b>	<b>6,584,783</b>	<b>8,647,535</b>	<b>2,062,752</b>
<b>Total Revenues Deposited</b>	<b>44,531,586</b>	<b>44,831,283</b>	<b>42,891,963</b>	<b>(1,939,320)</b>
<b>Expenditures Paid</b>				
Salaries And Benefits	4,266,601	4,344,809	3,530,916	813,893
Election Fund (Note 2)	1,700,705	23,056,779	2,430,338	20,626,441
Vital Records Improvement Fund	1,140,228	4,184,407	699,703	3,484,704
Current Expenses	380,220	569,278	519,082	50,196
Corporate Computer Conversion	100,000	429,863	387,083	42,780
UCC Payments To Towns	400,000	400,000	300,555	99,445
Other Expenditures	244,649	5,436,247	140,043	5,296,204
Equipment	17,635	99,045	69,712	29,333
Consultants	5,000	45,000	40,393	4,607
<b>Total Expenditures Paid</b>	<b>8,255,038</b>	<b>38,565,428</b>	<b>8,117,825</b>	<b>30,447,603</b>
<b>Excess (Deficiency) Of Revenues</b>				
<b>Deposited Over (Under)</b>				
<b>Expenditures Paid</b>	<b>\$ 36,276,548</b>	<b>\$ 6,265,855</b>	<b>\$34,774,138</b>	<b>\$ 28,508,283</b>

The accompanying notes are integral part of this financial schedule.

## **Notes To The Budget To Actual Schedule – General Fund For The Ten Months Ended April 30, 2007**

### **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 2007 as passed by the Legislature in Chapter 176, Laws of 2005, consisting of the operating budgets for the fiscal years ending June 30, 2006 and June 30, 2007, and a budget which has been modified due to additional appropriations, transfers, and balances brought forward from prior years.

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 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 – Cash Basis highlights differences between the modified operating budget for fiscal year 2007 and the actual revenues deposited and expenditures paid through the ten months ended April 30, 2007. 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. Unfavorable variances are expected for revenues and favorable variances are expected for expenditures when comparing ten months of actual revenues deposited and expenditures paid to an annual budget.

## **Note 2 – Election Fund**

The Modified Budget amount reported in the Election Fund expenditure line includes appropriations related to federal Help America Vote Act program funds paid in advance to the State. The Department received \$5,000,000 from the United States General Services Administration in fiscal year 2003 and an additional \$11,596,000 in July 2004 as part of the Help America Vote Act of 2002. The funds are to be used for establishing minimum election administration standards for states and local governments with their responsibility for the administration of federal elections.

The Election Fund also includes appropriations associated with revenue deposited into the Fund in accordance with statute, including elections filing fees and registrations of political committees.

RSA 5:6-d, III authorizes the Secretary of State to accept, budget, and, subject to the limitations set forth in RSA 5:6-d, III, expend monies in the Election Fund received from any party for the purposes of conducting elections, voter and election official education, the purchase or lease of voting equipment which complies with the Help America Vote Act of 2002, election law enforcement, and improvements to related information technology. The Modified Budget amount represents amounts available to expend for these purposes.

**STATE OF NEW HAMPSHIRE  
DEPARTMENT OF STATE  
REVENUES DEPOSITED AND EXPENDITURES PAID**

**SCHEDULE OF BUDGET AND EXPENDITURES PAID – CASH BASIS  
CAPITAL PROJECTS FUND  
FOR THE TEN MONTHS ENDED APRIL 30, 2007**

	<u>Budget</u>	<u>Audit Period Expenditures Paid</u>	<u>Prior Period Expenditures Paid</u>	<u>Unaudited</u>	
				<u>Total Expenditures Paid</u>	<u>Unexpended</u>
<b><u>Chapter Law, Program</u></b>					
Chapter 240:1, X, A, Laws 2003					
Archives Addition - Design and Building <i>Federal Participation 39%</i>	\$ 2,549,330	\$ 423,322	\$ 1,984,879	\$ 2,408,201	\$ 141,129
Chapter 259:1, XI, A, Laws 2005					
Renovation to Archives Building <i>No Federal Participation</i>	<u>1,150,000</u>	<u>96,114</u>	<u>958,889</u>	<u>1,055,003</u>	<u>94,997</u>
<b>Total</b>	<b><u>\$ 3,699,330</u></b>	<b><u>\$ 519,436</u></b>	<b><u>\$ 2,943,768</u></b>	<b><u>\$ 3,463,204</u></b>	<b><u>\$ 236,126</u></b>

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

**Notes To The Schedule Of Budget And Expenditures Paid - Capital Projects Fund  
For The Ten Months Ended April 30, 2007**

**Note 1 - Archives Addition – Design And Building**

This project was established by Chapter 240:1, X, A, Laws of 2003 with an appropriation of \$2,549,330 for an addition to the Records and Archives building.

**Note 2 - Renovation To Archives Building**

This project was established by Chapter 259:1, XI, A, Laws of 2005 with an appropriation of \$1,150,000. for the renovation of the Records and Archives building.

**Note 3 - Capital Budget**

Prior to May 2004, capital projects appropriations lapsed at the end of the biennium unless extended in the subsequent capital budget. Chapter 138, Laws of 2004 changed the two-year capital budget, by establishing a six-year capital budget, and amending sections of RSA 9. RSA 9:18 provides that all unexpended portions of capital appropriations made by the six-year capital budget are to lapse at the end of six-years from the date the appropriation took effect. However, legislative practice has been to continue extending the lapse dates for all approved projects through the subsequent biennium. During the 2005 legislative session, each of the projects initially budgeted in a previous biennium was extended through June 30, 2007.

## APPENDIX A - CURRENT STATUS OF PRIOR AUDIT FINDINGS

The following is a summary, as of July 18, 2008, of the current status of the observations related to the Department of State contained in the audit report of the Department of State and Related Boards and Commissions for the ten months ended April 30, 1996. A summary of the prior audit report can be accessed at the Office of Legislative Budget Assistant website. [www.gencourt.state.nh.us/lba/audit.html](http://www.gencourt.state.nh.us/lba/audit.html)

	<u>Status</u>		
<b><i>Internal Control Comments</i></b>			
<i>Reportable Conditions</i>			
1. Controls Over Revenue Processing ( <i>See Current Observation No. 6</i> )	●	○	○
2. Untimely Deposit And Recording Of Revenue ( <i>See Current Observation No. 6</i> )	●	○	○
3. Controls Over Equipment ( <i>See Current Observation No. 25</i> )	●	○	○
4. Reporting Equipment ( <i>See Current Observation No. 25</i> )	○	○	○
5. Capital Lease	●	●	●
6. Segregation of Duties – Expenditures ( <i>See Current Observation No. 14</i> )	●	○	○
7. Controls Over Electronic Data Processing (EDP) ( <i>See Current Observations No. 3 and No. 7</i> )	○	○	○
<b><i>State Compliance Comments</i></b>			
8. Related Boards And Commissions	○	○	○
9. Administrative Rules	●	○	○
10. Required Examination Of Issuer-Dealers	●	●	●
11. Annual Financial Statements	●	●	●
12. Board Of Auctioneers – Administrative Rules	●	○	○

<u>Status Key</u>	●	●	●	<u>Count</u>
Fully Resolved	●	●	●	3
Substantially Resolved	●	●	○	0
Partially Resolved	●	○	○	6
Unresolved	○	○	○	3

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**APPENDIX B – EXECUTIVE BRANCH ETHICS COMMITTEE ADVISORY OPINION  
2008-001**

**STATE OF NEW HAMPSHIRE  
EXECUTIVE BRANCH ETHICS COMMITTEE**



33 Capitol Street  
Concord, New Hampshire 03301-6397

David L. Nixon, Chairman  
Dale S. Kuehne, Vice Chairman  
John E. Blair, Secretary

Patricia B. Quigley  
Deborah J. Schachter  
Karol A. Lacroix

**Advisory Opinion**

**2008-001**

**Question Presented**

May a department head or other supervisor within a prospective employee's chain of command participate, directly or indirectly, in the hiring of a family member?

If it is determined that such employment is permissible, what, if any, limitations or obligations do the ethics statutes place on the department head or supervisor participating in the hiring process or supervision of their family member as an employee? If it is determined that such employment is not permissible, what effects, if any, would such a determination have on the department head, supervisor, or family member so hired?

**Summary Answer**

An executive branch official who serves as a department head or supervisor must recuse himself or herself from a hiring process when either a spouse or a dependent family member is a candidate for employment within the official's department.

Likewise, an executive branch official should not directly participate in any supervisory decisions regarding an employee who is a spouse or a dependent family member.

A department head or supervisor who violates the ethics statutes may be charged with a misdemeanor or may face disciplinary action. RSA 21-G:34. In the event that an individual who is a spouse or a dependent family member of a department head or supervisor is employed by the State in a process where the department head or supervisor

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*"The people's government, made for the people, made by the people, and answerable to the people."  
Daniel Webster, Jan. 16, 1830*

was improperly involved in the hiring decision, the ethics statutes do not impose a consequence on the person hired.

The ethics statute does not currently define other family relationships that may give rise to a conflict of interest under these circumstances.

#### **Facts**

An individual who is a spouse or family member of an executive branch department head or supervisor seeks employment with the State in the department where the family member serves. Individuals who are members of the same family, some of whom are dependents, are employed by the same department of State government. Over time one family member may be promoted or transferred into a supervisory role over the other.

#### **Legal Authority**

RSA 21-G:21, II; RSA 21-G:22; RSA 21-G:23; RSA 21-I:52

#### **Analysis**

RSA 21-G:22 prohibits executive branch officials from participating "in any matter in which they, or their spouse or dependents, have a private interest which may directly or indirectly affect or influence the performance of their duties." This section therefore precludes hiring, promotion and supervisory decisions from being made with regard to a spouse or dependent.

The conflict of interest statute, RSA 21-G:22, requires executive branch officials to avoid conflicts of interest. A conflict of interest is a "situation, circumstance or financial interest which has the potential to cause a private interest to interfere with the proper exercise of a public duty." RSA 21-G:21, II. Although the Legislature has not defined this further as it relates to non-dependent family members or spouses, the Committee recognizes there may be private interests other than pecuniary ones that could well come into consideration and violate the Ethics Code. For instance, if the family member hires their brother or aunt out of loyalty or affection, they are allowing their private interest, their relationship with that individual, to interfere with their proper exercise of a public duty, in this case, of conducting a fair and impartial hiring process.

In describing the common law on conflict of interest, the New Hampshire Supreme Court has described the restriction as follows:

In New Hampshire the requisite personal interest has been defined as a pecuniary interest which is immediate, definite, and capable of demonstration; not remote, uncertain, contingent and speculative, that is, such 'that men of ordinary capacity and intelligence would not be influenced by it.

*Marsh v. Town of Hanover*, 113 N.H. 667, 673 (1973)(internal citations and quotations omitted).

A spouse or dependent family member has a personal financial interest in employment. Therefore, a decision to fill a vacancy where the decision maker's spouse or dependent family member is a candidate for the position is a situation which has the potential to cause the private interest to interfere with the proper exercise of the public duty to select the most suitable candidate.

Once employed by the State, the spouse or dependent family member has a personal financial interest in retaining that job, obtaining pay increases, and promotions. Therefore, a supervisory decision to discharge or retain, to change compensation for, or to promote a spouse or dependent family member has the potential to cause the private interest to interfere with the proper exercise of the public duty to make supervisory decisions in the best interest of the people of the State.

A department head or supervisor is required by RSA21-G:22 not to participate in such hiring or supervisory decisions, therefore, recusal is required. Recusal means not participating in deliberations, making recommendations, giving advice, considering resumes or evaluations, or in any other way assuming responsibility for or participating in any aspect of the work or decision-making relating to filling the vacancy or supervising the spouse or dependent family member. Recusal from supervision will typically require establishing an alternative supervisor for the spouse or dependent family member. Likewise, because there may be a non-pecuniary conflict with other family members, the same process as discussed above should be utilized.

The ban on a department head or supervisor participating in the decision to hire or supervise a spouse or dependent family member does not bar that person from seeking or obtaining employment with the department. The Human Rights law, RSA chapter 354-A, prevents discrimination in employment based on marital status and discrimination generally based on familial status. While New Hampshire courts have not addressed the question, the Minnesota Supreme Court has found that an anti-discrimination statute very similar to RSA chapter 354-A prohibits enforcement of an employer's anti-nepotism rule. *Kraft v. State*, 284 N.W. 2d 386, 387 (Minn. 1979).

New Hampshire's legislature has not established an explicit anti-nepotism law. The United States and several states have adopted explicit anti-nepotism laws. 5 U.S.C. § 3110; Missouri Constitution Article VII §6; Louisiana LSA-R.S. 42:1119. These and other anti-nepotism statutes reflect significant policy choices with some limited to immediate family and others extending out to four degrees of consanguinity. Some prohibit only immediate supervisory relationships while others bar any form of employment within the same department.

RSA 21-I:52 prohibits the consideration of political considerations or the receipt of any other consideration in hiring, compensation, and promotion decisions to positions in the classified service. It does not apply to positions outside the classified service and it does not include familial relations as a prohibited consideration.

In light of the presence of the Human Rights statute and the absence of an explicit anti-nepotism statute, extending the prohibition on conflict of interest beyond a requirement of recusal for the department head or supervisory family member is a policy decision properly made by the legislature.

The misuse of position statute, RSA 21-G:23, prevents an executive branch official from using "his or her position with the state to . . . secure governmental privileges or advantages for others." Each time anyone is employed by the State some executive branch official has used his or her position to secure a governmental privilege, employment, for another. Until the legislature clarifies what improper conduct is necessary to make the securing of a governmental privilege for others unethical, it would be an unjustifiable conclusion that this statute prevents a department head or supervisor from participating in decisions regarding the employment or supervision of a family member.

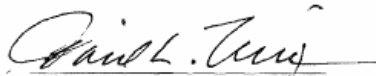
A department head or supervisor who violates the ethics statutes may be charged with a misdemeanor or may face disciplinary action. RSA 21-G:34. Furthermore, departments are authorized by RSA 21-G:27 to establish supplemental ethical codes. Executive branch officials should review their department ethics code to determine if a more restrictive departmental anti-nepotism code applies.

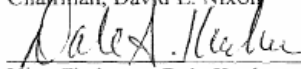
#### **Conclusion**

An executive branch official has a duty to recuse himself or herself from the selection of a candidate to fill a vacancy when his or her spouse or dependent family member is a candidate for the position. An executive branch official also has a duty to recuse himself or herself from supervising a spouse or dependent family member.

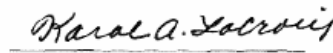
Although RSA 21-G:30, I (c) only addresses spouse and dependents, the Committee recognizes that other family relationships could present conflicts as well with respect to non-pecuniary interests. The Committee does urge those individuals with hiring and supervisory authority to be mindful of the possible appearance of impropriety or a conflict of interest when dealing with hiring and supervision involving family members.

This Advisory Opinion is issued by the Executive Branch Ethics Committee on April 2, 2008, pursuant to RSA 21-G:30, I (c).


  
Chairman, David L. Nixon

  
Vice Chairman, Dale Kuehne

Secretary, John Blair  
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Karol A. Lacroix

  
Patricia Quigley

  
Deborah Schachter