

**STATE OF NEW HAMPSHIRE
DEPARTMENT OF REVENUE ADMINISTRATION**

**FINANCIAL AUDIT REPORT
FOR THE FISCAL YEAR ENDED
JUNE 30, 2008**

**STATE OF NEW HAMPSHIRE
DEPARTMENT OF REVENUE ADMINISTRATION**

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This report can be accessed in its entirety on-line at www.gencourt.state.nh.us/lba/audit.html

**STATE OF NEW HAMPSHIRE
DEPARTMENT OF REVENUE ADMINISTRATION**

Reporting Entity And Scope

The reporting entity of this audit and audit report is the New Hampshire Department of Revenue Administration. The scope of this audit and audit report includes the financial activity of the Department of Revenue Administration for the fiscal year ended June 30, 2008. Unless otherwise indicated, reference to the Department or auditee refers to the Department of Revenue Administration.

Organization

The Department was reorganized under the terms of RSA 21-J, effective July 1, 1985. The Department is under the executive direction of a commissioner who is appointed by the Governor, with the consent of the Executive Council (Council), to a four-year term. In addition, the Commissioner is authorized to nominate an Assistant Commissioner and Division Directors of Audits and Documents Processing, subject to confirmation by the Governor and Council. The Commissioner appoints the Directors of Collections, Property Appraisal, and Municipal Services. Embedded personnel from the Department of Information Technology support the Department's automated information systems.

The Department is organized into seven functional areas: the Administrative Unit, the Central Tax Services Unit, the Audit Division, the Collections Division, the Document Processing Division, the Municipal Services Division, and the Property Appraisal Division. At June 30, 2008, the Department employed 165 classified and 23 unclassified employees.

Responsibilities

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

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

Administrative Unit performs administrative functions necessary to support Department operations including accounting, adjudicative and administrative hearings, fleet and facility maintenance, human resources, project management, purchasing, internal control, discovery, and the legal unit.

Central Tax Services Unit, a subunit of the Administrative Unit, provides general assistance to the public for all taxes administered by the Department. This Unit is responsible for the maintenance of the manual tax receivable system for the Department and acts within the Department as an advocate for taxpayers.

Audit Division conducts audits of tax returns of individuals, partnerships, estates, trusts, corporations, and documents filed with the Department to ensure compliance with New Hampshire tax laws and rules.

Collections Division initiates collection activities in pursuit of delinquent tax returns and payments for all taxes administered by the Department.

Document Processing Division receives, sends, processes, stores, and retrieves all tax documents, return payments, and electronic transactions filed with the Department.

Municipal Services Division establishes and approves municipal, school, county, and village district tax rates. Municipal Services provides technical assistance, relative to taxation and finance, to the political subdivisions of the State. In addition, Municipal Services prescribe a uniform chart of accounts for all municipalities, schools, counties, and village districts.

Property Appraisal Division assists and educates municipalities with the methods of appraisal and assessment of real property. They provide appraisal revaluation services statewide to municipalities, and equalize the local assessed valuation of each municipality to bring such valuations to the full and true market value of the property. The Property Appraisal Division advises and assists municipalities and taxpayers in full and true appraisals and timely collection of timber yield tax. In addition, they appraise public utility and railroad property for equalization, as well as local tax purposes. The Property Appraisal Division assists local municipalities with the administration of the current use law (RSA 79-A).

Funding

The financial activity of the Department of Revenue Administration is accounted for in the General and Education Trust Funds of the State of New Hampshire. A summary of the Department's revenues and expenditures for the fiscal year ended June 30, 2008 is shown in the following schedule.

Summary Of Revenues And Expenditures For The Fiscal Year Ended June 30, 2008

	<u>General Fund</u>	<u>Education Trust Fund</u>	<u>Total</u>
Revenues			
Total Unrestricted Revenue	\$ 1,035,491,143	\$ 765,777,984	\$ 1,801,269,127
Total Restricted Revenue	<u>127,629,805</u>	<u>-0-</u>	<u>127,629,805</u>
Total Revenue	<u>1,163,120,948</u>	<u>765,777,984</u>	<u>1,928,898,932</u>
Total Expenditures	<u>16,592,825</u>	<u>3,156,984</u>	<u>19,749,809</u>
Excess (Deficiency) Of Revenues Over (Under) Expenditures	<u>\$ 1,146,528,123</u>	<u>\$ 762,621,000</u>	<u>\$ 1,909,149,123</u>

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

The Education Trust Fund was established to distribute adequate education grants to school districts. Revenue processed by the Department and recorded in the Education Trust Fund includes statewide property and utility taxes, car rentals, and incremental portions of existing business, real estate transfer, and tobacco taxes.

Prior Audit

The most recent prior financial audit of the Department was for the fiscal year ended June 30, 2001. The appendix to this report on page 35 contains a summary of the current status of the observations contained in that prior report. A copy of the prior audit report can be accessed online at www.gencourt.state.nh.us/lba/audit.html.

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 Revenue Administration for the fiscal year ended June 30, 2008. As part of obtaining reasonable assurance about whether the financial statement is free of material misstatement, we considered the effectiveness of the internal controls in place at the Department and tested its compliance with certain provisions of applicable State and federal laws, rules, regulations, and contracts. Major accounts or areas subject to our examination included, but were not limited to, the following:

- Revenues and Expenditures, and
- State Compliance.

Our report on internal control over financial reporting and on compliance and other matters, the related observations and recommendations, our independent auditor's report, financial statement, and supplementary information 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 Statement of Revenues and Expenditures, General and Education Trust Funds, of the New Hampshire Department of Revenue Administration (Department) for the fiscal year ended June 30, 2008 and have issued our report thereon dated February 25, 2009, which was qualified as the governmental fund financial statement does not constitute a complete financial presentation of the Department in the General and Education Trust Funds. We conducted our audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States.

Internal Control Over Financial Reporting

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

Our consideration of internal control over financial reporting was for the limited purpose described in the preceding paragraph and 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. 11 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 that none of the significant deficiencies described above is a material weakness.

Compliance And Other Matters

As part of obtaining reasonable assurance about whether the Department's financial statement is free of material misstatement, we performed tests of the Department's compliance with certain provisions of laws, rules, regulations, and contracts, noncompliance with which could have a direct and material effect on the determination of financial statement amounts. However, providing an opinion on compliance with those provisions was not an objective of our audit, and accordingly, we do not express such an opinion. The results of our tests disclosed no instances of noncompliance or other matters that are required to be reported under *Government Auditing Standards*. However, we noted an immaterial instance of noncompliance which is described in Observation No. 12.

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

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

February 25, 2009

Internal Control Comments
Significant Deficiencies

Observation No. 1: Formal Risk Assessment Process Should Be Established

Observation:

The Department has not conducted a formal risk assessment and does not have risk assessment policies and procedures in place to continually assess where and how things could go wrong, evaluate the likelihood of those occurrences, and establish reasonable responses to those potential occurrences.

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 affecting decisions related to financing, capital expenditures, changing customer needs or expectations, new legislation, natural catastrophes, and others. Internal factors including disruption of information systems, quality of personnel hired, methods of training and motivating employees, and changes in management responsibilities can also affect the way certain controls operate. Risks increase at times of change including changes in organization, personnel, and procedures.

There is no indication the Department has regularly and formally reviewed its operations for exposure and response to risk.

1. 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. While currently, when risks are identified, the Department may react with changes in process, there are no formal policies and procedures to continuously review operations for risks.
2. During fiscal year 2008, the Department had not implemented a comprehensive, documented, Department-wide disaster recovery and business continuity plan to address an emergency or other unplanned events that could cause significant disruption, risk of loss, or other harm to the Department. While during fiscal year 2008 the Department had a disaster recovery plan that was originally placed in operation in the mid 1990's, the plan was not current and employees were not familiar with the plan.
3. The Department does not regularly test its disaster recovery plan. While the Department periodically prepares manual deposits of tax receipts, the Department does not regularly test other critical components of the plan including the quality and ability to use backup systems and data.
4. Neither the Department nor the Department of Information Technology working on its behalf monitors contractor compliance with data security provisions included in the contract with a service organization that collects and holds taxpayer and bank account information.

Management's assessment of and response to risks facing the organization and its systems is an integral component of internal control. The purpose of an entity's risk assessment efforts 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 and should be an ongoing activity.

Without a formal risk assessment activity, the Department may be unaware of and unable to respond timely to significant risks facing its operations.

Recommendation:

The Department should establish a risk assessment process to continuously review operations for exposure to risk and respond by eliminating or mitigating the risk where reasonably possible.

1. The Department should develop formal documented risk assessment policies and procedures that establish and formalize a risk assessment process and provide for a regular and continuous risk assessment of its operations. 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.
2. The Department should update and expand its disaster recovery and business continuity plan to address the risks faced by the Department. The Department should clearly identify relevant emergencies, protocols for the notification of an emergency, the response to an emergency, and the establishment of a crisis management team to direct response operations intended to mitigate any physical, financial, and other damage and disruption that may result.
3. The Department should periodically test, review, and modify its disaster recovery and business continuity plans as appropriate to ensure the plans continue to meet the Department's needs.
4. The Department should monitor contractor compliance with all significant contract provisions, including the contracted service organization's data security over taxpayer and bank account information.

Auditee Response:

The Department concurs. The Department has had in place, since 1994, a written Disaster Recovery Plan. The Department also put in place in 2000 a Contaminated Mail Procedure. Contaminated Mail Procedure drills have been held annually, and, with input from the State's Hazardous Materials Coordinator in 2006, the process has been expanded. Moreover, the Department's new building has been designed to provide maximum assurances in handling contaminated mail and providing for continuity of operations in the event of certain disasters. The last update to the Disaster Recovery Plan was performed in 2005. The Department began the development and held meetings to perform another update to the Plan in Summer, 2008 but the project was put on hold until the Department's move was finalized, so that any new risks and expectancy of new obstacles could be adequately assessed. The Department's move was finalized

in late December, 2008 and the Department will put in place an updated Plan as recommended, together with testing schedules, by the end of 2009.

Department of Information Technology Response:

The Department of Information Technology concurs with the Department of Revenue Administration's (DRA) response and is actively working on updating DRA's plan regarding the IT environment and will also partner with DRA in developing the Department Plan and testing schedules.

Observation No. 2: Planning For Acquisition Of New Tax Information System Should Be Formalized

Observation:

The Department has not documented a plan to transition to a new tax information system envisioned in its Information Technology (IT) Plan. While the Department's IT Plan includes an expectation to implement a new information system in 2010, and while in discussion the Department expressed concern over limitations in the current tax information system, at June 30, 2008, the Department had not documented the need for, and planned actions necessary to replace, the current tax information system.

The Department's current Tax Information Management System (TIMS) is the critical computer application used by the Department to process and warehouse taxpayer information for the major taxes collected by the Department. The Department processed over \$1.7 billion dollars in tax revenue during fiscal year 2008. While the Department's IT Plan for fiscal years 2008-2011 lists the replacement of the TIMS in 2010 as a future IT project, at June 30, 2008 the Department reported it was only then in the process of documenting the need for the replacement of TIMS.

The replacement of any major computer system requires a careful review, detail analysis, and thoughtful consideration. Prior to purchasing any new systems, evidence must be obtained and analyzed to determine the new system purchased is the best and most efficient and effective system given the business needs of an organization and the resources available to fund the system. Through careful review and analysis, the implementation of a new system should provide the agency with more efficient processes, increased data analysis, and reporting capabilities.

The Department began its implementation of TIMS in 1990. During its period of use, limitations in TIMS functionality have resulted in operational inefficiencies at the Department. For example, TIMS can apply a tax payment check to only one tax document. If a single tax payment check is accompanied by two different tax documents, a two-step transaction must be processed where the entire payment is applied first to one tax type and recorded in one revenue source and a second "split-check" transaction is subsequently performed to allocate the revenue to the tax revenue accounts. This two-step process for recording these transactions is inefficient both because it increases the number of transactions that must occur and also because it requires

additional controls to ensure that the split-check transactions occur in a timely and accurate manner.

In addition, TIMS' limited query and reporting capabilities have hampered the Department in providing management, including State policy makers, with timely, detailed, and accurate tax information. As noted in Observation No. 4, the Department was unable to determine the amount of credit carry forwards at June 30, 2008. Annually, the Department is challenged with determining the split between Business Profits and Business Enterprise Taxes. These limitations in available tax information in TIMS have restricted the Department's ability to perform tax data analysis. Tax processing limitations in TIMS have required the Department's use of various subsystems to provide tax processing services and information for State taxes not programmed in TIMS.

The Department's lack of timely efforts to conduct a complete and documented analysis of Department and other user needs and an identification and justification of required funding places the timely replacement of TIMS as planned in the Department's IT Plan at risk.

Recommendation:

Given the Department's concern with the limitations of TIMS, the Department should establish a plan to support the timely replacement of the system. As part of that plan, the Department should document the need for a new tax processing system, including limitations in the current system, the efficiencies and other advantages to be gained with a new system, the anticipated costs in money and efforts to transition to a new tax system. Adequate planning for the replacement of a system as critical as TIMS is a complex, long-term project that requires a formalized and detailed approach.

Auditee Response:

The Department concurs. The Department is pursuing a capital appropriation this session to make enhancements to its Tax Information Management System to provide for greater taxpayer relationship detail, enhanced and targeted collections, audit, and compliance capabilities, and streamlined processing functions for increased customer service. In fiscal year 2009, the Department has put together a detailed overview, full project scope and timing for the various computer enhancements, together with project dependencies, assumptions/constraints, external impacts, and funding justification.

Department of Information Technology Response:

The Department of Information Technology (DoIT) concurs with the Department of Revenue Administration's (DRA) response and supports the capital appropriation to enhance TIMS and provide responsive management information on a timely basis. DoIT has and will continue to work with DRA on TIMS enhancements to ensure centralized data and documentation of business processes in preparation for migration towards a unified system of record.

Observation No. 3: Process For Determining And Reporting Taxes Receivable And Associated Revenues Should Be Reviewed

Observation:

The Department of Administrative Services, Bureau of Financial Reporting (BFR), calculated the accruals of taxes receivable at June 30, 2008 based on information provided by the Department during the fiscal year closing process. Neither the Department nor the BFR challenged overly optimistic revenue growth assumptions on templates used to estimate the receivables.

The Department is currently responsible for making preliminary estimates of taxes receivable during the year-end closing process and records these estimates in the State accounting system (NHIFS). The Department is also responsible for recording and reporting July and August cash receipts by tax type to the BFR. The Department also provides the BFR with other information used to estimate refunds and estimates for uncollectible amounts including actual collection and refund information, outstanding tax notices, and hearings information. The BFR uses this information to perform additional analysis and record final year-end accruals in the State's government-wide and fund financial statements, net of refunds and allowances for uncollectible accounts.

During our review of the year-end taxes receivable work, we noted the following:

- The calculation to estimate business taxes receivable at June 30, 2008 was based on a template developed in 2001. Using the template and data provided by the Department, BFR calculated the business tax receivable at June 30, 2008 to be \$243 million. Upon auditor inquiry as to the validity of the 5% revenue growth assumption in the current economy, with State business tax revenues down 6% in the first quarter of fiscal year 2009, BFR lowered its annual growth assumption to 0% resulting in a revised business tax receivable, on a full-accrual government-wide basis at June 30, 2008 of \$212 million, a difference of \$31 million. While lowering the revenue growth assumption was a reasonable action, neither the Department nor BFR provided support for the appropriateness of the revised flat revenue growth assumption given a general negative revenue growth forecast.
- A clerical error and a flawed methodology in the calculation used to estimate the \$39.2 million interest and dividend accounts receivable was recognized by the audit and resulted in an \$8.5 million adjustment to deferred revenues in the State's Comprehensive Annual Financial Report (CAFR).
- A \$153.3 million fund-level adjustment to business taxes receivable and deferred revenue was recorded entirely as a General Fund transaction even though 36% of the adjustment, or \$55.2 million, related to the Education Trust Fund. The BFR explained the adjustment transaction was not allocated between the General and Education Trust Funds for consistency with past financial reporting practice. BFR chose not to adjust the financial statements in the State's CAFR for this amount.
- The BFR did not completely update its worksheet supporting the allowance for uncollectible business taxes as of June 30, 2008. Had the worksheet been completed, the reported allowance would be increased and deferred revenue decreased by approximately \$1.5

million. BFR chose not to adjust the financial statements in the State's CAFR for this amount.

- A \$1.4 million overstatement of Nursing Facilities Quality Assessment revenue and a June 30, 2008 accounts receivable were recognized by the audit and resulted in adjustments to both the Department's financial statement and the financial statements in the State's CAFR.
- A Department clerical error resulted in \$497,000 of Electricity Consumption Tax not being recorded as fiscal year 2008 revenue and accounts receivable, understating the June 30, 2008 unrestricted unreserved General Fund balance reported in the State's CAFR by \$497,000. The Department's financial statement was adjusted for this amount. BFR chose not to adjust the financial statements in the State's CAFR for this amount.

Recommendation:

The Department should review with BFR the allocation of responsibilities for determining and reporting revenues collected by the Department, including business and other taxes. Based upon that review, the Department should implement policies and procedures for estimating and reporting revenues, including the accrual and deferral of revenue that will meet the needs of the Department, BFR, and the State. As the agency primarily responsible for the collection of the State's tax revenue, the Department should be the most knowledgeable of, and able to respond to, changes in revenue trends. The Department, BFR, and the State should leverage that knowledge and experience to reasonably ensure that revenue collection information, including revenue accruals and deferrals, is based on the best and most current information available.

Policies and procedures implemented by the Department should incorporate the needs of BFR for financial reporting in compliance with applicable standards, including a well documented audit trail that provides support for calculations, assumptions, and estimates on which the reported amounts are based.

Also included should be policies and procedures for a look-back in the subsequent period to review and compare actual revenue collections to estimates to determine whether the estimation policies and procedures continue to provide good and reliable information.

Auditee Response:

The Department concurs. The Department has initiated a meeting with appropriate agency personnel from the Department of Administrative Services, Bureau of Financial Reporting (BFR) and the Legislative Budget Assistant (LBA), to understand BFR's closing process, receivable calculations, and growth assumptions utilized in its year-end accounts receivable work, as well as to develop and implement reallocation of responsibilities for determining and reporting revenues collected by the Department. The Department will continue to work closely with BFR to ensure all appropriate parties have the most accurate information pertaining to the State's revenue generation, collection, and trend.

The Department will undertake the development and continued maintenance of a financial statement that will serve as an audit trail for purposes of financial reporting.

With respect to the observation that the Department overstated the Nursing Facilities Quality Assessment revenue and accounts receivable by \$1.4 million, the Department oversees the processing of monies from the Health and Human Services (HHS) certified facilities. HHS actually performs the year-end receivable calculation, so that overstated accounts receivable is attributable to HHS.

Department of Administrative Services Response:

We concur. BFR has met with DRA to review our closing process related to accounts receivables, our 2008 receivable calculations, and assumptions used. Going forward, BFR will work with DRA to reassess methodologies used in estimating accounts receivables, as well as, evaluate who is in the best position to estimate and report future accounts receivables for revenues collected by DRA. BFR will then collaborate with DRA for concurrence on assumptions and trends used in estimates reported.

Observation No. 4: Tax Overpayments Held By The Department Should Be Reported As Deferred Revenue

Observation:

The Department's Tax Information Management System (TIMS) as currently configured is not able to determine the amount of tax overpayments that are carried forward to apply to future tax periods. These amounts are called credit carry forwards.

If a taxpayer pays more taxes than is owed when a tax return is filed, a tax overpayment results. The taxpayer has the option of requesting a refund of the overpayment or having any or all of the overpayment applied as a credit towards a future period's tax liability. When the taxpayer chooses to apply the overpayment as a credit toward next period's tax liability, the amount held by the Department should be recorded as deferred revenue.

According to the Department, TIMS is not currently configured to accumulate and report these credit carry forward amounts. As a result, the Department recognizes all taxes paid as revenue, regardless of whether the tax payments relate to the current or future tax periods. The Department was unable to determine the total credit carry forward amounts at June 30, 2008 that should be deferred from fiscal year 2008 revenue and recorded as a deferred revenue liability.

Recommendation:

The Department should implement policies and procedure for periodically determining and reporting the amount of credit carry forwards necessary for the proper deferral of revenue, primarily at the State's June 30 fiscal year end.

If the Department determines that TIMS can not be efficiently configured to periodically determine and report the amount of credit carry forward, the Department should implement a

process for determining a reasonable estimate of the amount for the State's financial reporting purposes.

Auditee Response:

The Department concurs with this recommendation and has already begun meeting with the Department of Administrative Services and the Legislative Budget Assistant's Budget Office to introduce a new reporting procedure. In addition, the Department is pursuing a capital appropriation this session to make enhancements to its Tax Information Management System, in part to provide for the reliable determination and reporting of the amount of available credit carry forwards.

Observation No. 5: Understanding Of Relevant Controls At Service Providers Should Be Documented

Observation:

The Department has not formally considered and reacted to how controls or weaknesses at its service providers could impact the Department's financial statement.

The Department, through the Department of Information Technology and the State Treasury, contracts with two service organizations to allow taxpayers to transact certain business electronically.

- One contract allows taxpayers to file electronic Meals and Rental and Interest and Dividends Tax returns and process electronic payments for tax estimates, notices, and extensions for Business Profits, Business Enterprise, Interest and Dividends, Meals and Rental, and Real Estate Transfer taxes. The Department's 2008 Annual Report stated that from July 2007 through June 2008, the Department processed over 43,000 Internet and 23,000 Telefile transactions totaling more than \$290 million.
- The second contract provides for processing electronic fund transfers from a taxpayer's bank account to the State Treasury account.

While the services provided to the Department by these two organizations function outside of the Department's direct control, the activities performed on the Department's behalf by these service organizations are significant components of the Department's information system as they affect significant revenue transactions and the procedures by which these transactions are initiated, recorded, processed, and reported by the Department. As a significant component of the Department's information system, and thereby a significant component of the Department's control system, the Department should have an understanding of the controls and the operation of those controls over those systems and how the controls and weaknesses in those systems affect other controls in place at the Department.

Based on discussions with the Department, the Department has not made efforts to obtain a reasonable understanding of the controls in place at the service organizations and their effect on

the Department. One common method to obtain that understanding is to request an audit of these controls, commonly known as a Statement on Auditing Standards No. 70 (SAS 70) audit of service organizations.

Recommendation:

The Department should obtain a reasonable understanding of the internal controls in place at its service organizations that have an effect on the Department's processing of tax revenues.

The Department should request its two primary service organizations provide SAS 70 reports covering the services provided to the Department. If reports cannot be made available, the Department should perform, or cause to be performed, a review of the controls placed in operation, including a test of their operating effectiveness, at these service organizations.

Auditee Response:

The Department concurs with this recommendation and will diligently pursue a SAS 70 report or similar SAS 70 compliant operations from the contractors. The Department recognizes that these service organizations are significant components of the Department's information system as they affect revenue transactions. The Department has, in the recent past and during the pendency of existing contracts in place, requested SAS 70 compliance from these service providers. These two contracts were negotiated by and are with other departments, namely the Department of Information Services (DoIT) and the State Treasurer and not the Department. DoIT is by far the largest service organization impacting the Department. The Department would welcome any discussion about how a SAS 70 audit of DoIT could be performed.

Department of Information Technology Response:

DoIT concurs with the Department of Revenue Administration's (DRA) response and will work with DRA regarding a cost benefit analysis and funding for any SAS 70 reviews.

Observation No. 6: Collection Of Flood Control Contributions From Other States Should Be Pursued

Observation:

The Department is not collecting the full contribution amounts from the States of Massachusetts and Connecticut for payments made by the Department to New Hampshire cities and towns to offset the loss of property taxes on property acquired for flood control purposes benefiting all three states. The interstate agreements providing for these reimbursement contributions are described in the flood control compacts contained in RSA 484:1 and RSA 484:7. A footnote to the 2008-2009 Operating Budget states, "The Department of Revenue in conjunction with the Department of Justice, shall make every legal effort to collect both past due and current amounts due...[from] the Merrimack River Flood Control Compact...."

During fiscal year 2008, the Department disbursed \$912,884 to cities and towns as contributions towards local property taxes lost to those municipalities as a result of the federal government acquiring land for flood control purposes. According to the cost-sharing formulas in the flood control compacts, the Department should have received a total of \$664,885 from the two states as contributions towards the payments. During fiscal year 2008, the Department collected only \$10,521 of that expected amount.

According to the Department, the commissions established pursuant to RSA 484:1 and 484:7 are primarily responsible for collecting the revenues from Massachusetts and Connecticut even though the revenues are budgeted at the Department and the revenues are received and processed by the Department. The Department reported disagreements related to discrepancies in acreage covered by the contracts as reasons why payments have not been forthcoming.

Recommendation:

The Department should continue to work with the Department of Justice, the Connecticut River Valley and the Merrimack River Valley Flood Control Commissions, and the US Army Corps of Engineers to reconcile the acreage discrepancies and to resolve any other issues that have resulted in the Department not collecting the full flood control contribution amounts from the States of Massachusetts and Connecticut.

Auditee Response:

The Department concurs with this observation. The Department of Revenue Administration, in conjunction with the Department of Justice and Governor's office, will work with the flood commissioners to ensure all affected properties are appropriately assessed, and monies due to the State of NH as a result of the Merrimack River Flood Control Compact, effective December 17, 1957, are duly paid. This plan has been put into effect immediately; Department initiated assessing of affected lands and meetings with towns took place in August of 2008. Meetings with the Attorney General's Office have occurred, and a follow-up meeting with an action plan resulted from a recent joint meeting between the Department, Attorney General's office, and Governor's office.

Observation No. 7: Reconciliation Controls Should Be Monitored

Observation:

During fiscal year 2008, Department management did not periodically review the reconciliation of tax revenues recorded in the Department's primary Tax Information Management System (TIMS) to the same information recorded in the State's accounting system (NHIFS). Reconciliations usually are performed as a control activity to ensure that comparable information is reported in comparable systems and errors or irregularities are detected and corrected in a timely manner. To ensure control activities remain effective, management must regularly monitor the performance of the control activities.

According to the Department, management reviewed the reconciliations during the period the employee responsible for performing the reconciliations was being trained. However, management did not review any of the reconciliations during fiscal year 2008. Management reported it considered the responsible employee capable of performing the reconciliations without review and was also confident that the employee performing the reconciliations would bring forward any difficulties or problems that might be encountered in the reconciliations.

Control monitoring is an integral component of internal control. The lack of a control monitoring process over the critical TIMS to NHIFS reconciliation during fiscal year 2008 is a significant control deficiency. While no issues were noted during the audit related to the TIMS to NHIFS reconciliations, the fact that the reconciliations were not periodically reviewed during fiscal year 2008 increased the risk that errors that might have developed would not have been detected and corrected in a timely manner.

Recommendation:

Department management should reestablish the control monitoring activities over the TIMS to NHIFS reconciliations. Management should ensure that the TIMS to NHIFS reconciliations are periodically reviewed in a manner that would establish and support management's ongoing confidence in the quality of the reconciliations and also reasonably ensure that errors or other issues detected by the reconciliations are appropriately resolved in a timely manner.

Auditee Response:

The Department concurs with this observation. The Department's Internal Auditor will review the monthly reconciliation of the Department's batching system to NHIFS. This review will start immediately with the February, 2009 month ending reconciliation.

Observation No. 8: Additional Training For Reviewing And Approving Tax Relief Payments Should Be Considered

Observation:

Errors noted in the Department's processing of homeowners property tax relief payments indicate additional training may be appropriate for employees processing these payments.

Two errors were noted in a sample of 25 homeowners property tax relief payments (8%). While neither of the two errors was individually significant in amount, the relatively high error rate is indicative of a process that may be in need of management's attention.

- An application for a homeowners property tax relief received after the June 30 due date was processed by the Department even though the application did not contain a required justification from the homeowner that late filing was due to accident, mistake, or misfortune as required by RSA 198:57. While a letter was sent to the claimant requesting justification

for the late filing, the tax relief payment was made without a response to the request being received from the homeowner.

- An applicant's error in calculating a relief amount was not detected and corrected by the Department reviewer prior to payment by the Department. The applicant improperly included social security income in calculating a tax relief amount of \$142. The Department did not notice the error when reviewing the application for accuracy. If the tax relief amount had been calculated as directed in the DP-8 form instructions and social security income had been excluded from reported income, the homeowner would have received \$237 or \$95 more than actually received.

Recommendation:

The Department should review the training and direction provided to employees responsible for reviewing and approving requests for homeowners property tax relief.

The Department should provide training to reviewers and auditors to reinforce knowledge of taxpayer filing requirements related to claims and internal processing procedures in order to ensure that future oversights are minimized.

The Department should attempt to contact the homeowner to confirm whether or not a federal tax return was filed in order to determine if the relief payment of \$142 was calculated accurately, or if an additional relief payment in the amount of \$95 should be issued.

Auditee Response:

The Department concurs with this observation. The Low and Moderate Tax Relief program is a seasonal, part time process. Employees from several divisions of the Department are used to process and review these documents. The Department will put together an enhanced training program for those employees working outside of their normal duties and implement a secondary review process. These changes will be implemented by June 30, 2009.

Observation No. 9: Leave Accounting Controls Should Be Strengthened

Observation:

The Department has not enforced the controlled use of leave slips to document employees' adherence to the State's leave policies.

Approximately 50% of the payroll items tested (12 out of 25) included leave slips supporting leave time taken or reported during the payperiods reviewed. Approximately 50% of those leave slips were noncompliant with standard State payroll practices. Noncompliance included leave slips either prepared or approved subsequent to the leave being taken or submitted to the Department's payroll section after the preparation of the Department's payroll.

Leave slips prepared, approved, or submitted subsequent to the leave being taken prevents the documentation of compliance with the requirement for advanced approval for leave and also increases the risk that the preparation of leave slips may either unintentionally or intentionally be overlooked and not prepared resulting in payroll error, fraud, or other abuse.

Leave slips submitted to the payroll section after the preparation of the Department's payroll require subsequent adjustments to employee leave time records in the State's payroll system (GHRS). By allowing the situation where delayed leave reporting causes regular leave record adjustments, the Department increases its risk of errors or frauds in the employee leave accounting and reporting.

Recommendation:

The Department should improve employee compliance with standard State leave control policies and procedures. Documentation of leave requests and approvals should be completed and forwarded to the Department's payroll section in time to post to biweekly payroll records.

If the Department determines that due to Department operating circumstances the standard, employee leave slip process does not efficiently serve the intended purpose, the Department should investigate the availability and possible advantages of some of the on-line leave control procedures used by other State agencies.

Auditee Response:

The Department concurs with the concept of the recommendation however the Department cannot conform to the State leave control policies with the current State resources in place. At any one time, upwards of 60% of the Department's personnel are required to work outside of the office, traveling both within New Hampshire and throughout the country. This 60% also includes supervisors responsible for signing leave slips. Leave slips for sick leave and unexpected annual leave cannot be approved in advance when some employees report to the office once per month. Further, the Department has requested updated online computer services to be installed in our one satellite office located in Gorham, N.H. for our several employees that work in the North Country; to date no acceptable services are available.

It is the understanding of this Department that the State plans to implement on-line leave capabilities as a later phase of the State Enterprise Resource Planning (ERP) system. The Department will explore this option, being mindful of this Department's confidentiality statutes and on-line security issues. The timing of this plan will coincide with the availability of the on-line leave slip program being proposed through the new State system.

Observation No. 10: Procedures Should Be Established To Remind Board Members Of Statement Of Financial Interests Filing Requirements

Observation:

Not all members of boards associated with Department operations filed timely Statements of Financial Interests (Statement). According to the Department, it does not monitor whether required Statements are filed with the Secretary of State.

RSA 15-A requires a Statement to be filed with the Secretary of State for persons who perform official duties to ensure the duties do not give rise to a conflict of interest. Seven out of 40 individuals (17%) on boards administratively attached to the Department did not file a required Statement and one individual filed 24 days late. In addition, eight board members who did file Statements during calendar 2007 as new members did not file Statements due in January 2008.

Per RSA 15-A:6, “All persons subject to this chapter shall file a statement of financial interests annually no later than the third Friday in January.”

According to RSA 15-A:7, “Any person who knowingly fails to comply with the provisions of this chapter or knowingly files a false statement shall be guilty of a misdemeanor.”

Recommendation:

The Department should establish procedures to annually remind board members of their statutory responsibility to submit timely Statements of Financial Interests to the Secretary of State.

Auditee Response:

The Department concurs in part with this observation. Although the financial reporting to the Secretary of State’s Office is a personal reporting by the individuals appointed by Governor and Council as board members and personal liability attaches pursuant to RSA 15-A:7, the Department will notify the board members of their filing responsibilities and will communicate with the Secretary of State’s office to confirm filing status. The Department will compile a list of non-compliant board members and send letters effective March 30, 2009.

Observation No. 11: Compliance With Municipal Reporting Statute Should Be Encouraged

Observation:

The Department reports it is unable to enforce compliance with the statutory requirements for timely filing of annual city and town financial reports.

RSA 21-J:34, requires each city and town to file a number of reports necessary for the Department to compute and establish the municipality’s property tax rate. Pursuant to RSA 21-J:34, V, the reports are required to be submitted by April 1 if the municipality keeps its accounts

on a calendar year basis or by September 1 if the municipality keeps its accounts on an optional fiscal year basis pursuant to RSA 31:94-a.

None of the three municipalities we selected to review for timely filing of annual reports filed timely reports. Two of the towns filed reports late and one town had not filed as of the date of the review, which was seven months after the report was due.

According to the Department, the lack of timely filing is generally the result of municipalities not having their audits completed in a timely manner. The Department reported the only control it has over compliance with the annual report filing dates is for the Department to withhold setting the municipality's tax rate until the report is received. The Department also reported that it only acts informally by phone call when it identifies a municipality that has not filed its required reports on time.

Recommendation:

The Department should establish formal policies and procedures to monitor for and react to municipalities that are not compliant with the statutory report filing requirements. Municipalities that do not file required reports on time should be officially notified of their status of statutory noncompliance and requested to provide a formal explanation of the circumstances resulting in the noncompliance.

Auditee Response:

The Department concurs. The Department consistently monitors the financial filings of the cities and town in order to set tax rates. Some of the documents that are used in setting the tax rates (warrants, minutes, appropriations forms, budget forms, and official ballots) are due within 20 days of the voting session of the annual meeting. The financial reports are due April 1 for the calendar year municipalities, and September 1 for optional fiscal year municipalities. The revised revenue estimates and property valuations are also due September 1. The Department's Municipal Services Division is informed, by the city or town, of any late reporting. The penalty provision, RSA 21-J:36 was repealed in Chapter Law 182 of the 2007 legislative session. With the financial reports, most of these are prepared by independent CPA auditors, and are frequently late due to the CPA's schedules for performing the field work. The Department stays in contact with both the municipalities and the CPAs during the spring and summer months to ensure that all documents are in prior to the tax rate setting in the fall.

The Department's policy is to not set a tax rate until all statutory report filing requirements are met by September 1, 2009. The Department will implement a procedure to seek from the municipalities more formal explanations of the circumstances resulting in the noncompliance. To be proactive, the Department has developed and implemented a computerized tracking system which generates notices to the municipalities of their noncompliant status.

Compliance Comment

Observation No. 12: Administrative Rules Should Be Current

Observation:

State statutes require the Department to adopt a number of administrative rules. While the Department is generally current with its administrative rules, the Department has not adopted administrative rules required by RSA 83-F:7 relative to Utility Property Tax. The Department also has not updated its administrative rules related to the Medicaid Enhancement Tax necessitated by a statutory change which was effective July 1, 2005.

Recommendation:

The Department should adopt administrative rules required by RSA 83-F:7 relative to the Utility Property Tax and update administrative rules relative to the change in the basis of the Medicaid Enhancement Tax from gross to net patient services revenue, as described in Chapter 260, Laws of 2004.

Auditee Response:

The Department concurs with this observation. The Department is working with the rules committee to adopt rules for the Utility Property Tax (UPT), as well as update the rules for the Medicaid Enhancement Tax (MET). With respect to MET, the Department's rules are predicated upon the rules as established in N.H. Admin Rule, He-C 5001.01(e), and the Department awaited their adjustment to the definition in order to mirror that language. Unfortunately, Health and Human Services' rules expired in October, 2005. The Department will undertake changing the necessary definition, as described in Chapter 260, Laws of 2004. The rules process and updates for both UPT and MET are scheduled to proceed immediately.

Independent Auditor's Report

To The Fiscal Committee Of The General Court:

We have audited the accompanying Statement of Revenues and Expenditures, General and Education Trust Funds, of the Department of Revenue Administration (Department) for the fiscal year ended June 30, 2008. This financial statement is the responsibility of the management of the Department. Our responsibility is to express an opinion on this financial statement based on our audit.

We conducted our audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statement is free of material misstatement. An audit includes consideration of internal control over financial reporting as a basis for designing audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Department's internal control over financial reporting. Accordingly, we express no such opinion. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statement. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audit provides a reasonable basis for our opinion.

As discussed in Note 1, the financial statement of the Department is intended to present certain financial activity of only that portion of the State of New Hampshire that is attributable to the transactions of the Department. The Statement of Revenues and Expenditures, General and Education Trust Funds, does not purport to and does not constitute a complete financial presentation of either the Department or the State of New Hampshire in conformity with accounting principles generally accepted in the United States of America.

In our opinion, except for the matter discussed in the third paragraph, the financial statement referred to above presents fairly, in all material respects, certain financial activity of the Department for the fiscal year ended June 30, 2008, in conformity with accounting principles generally accepted in the United States of America.

Our audit was conducted for the purpose of forming an opinion on the Statement of Revenues and Expenditures, General and Education Trust Funds of the Department. The supplementary information, as identified in the table of contents, is presented for purposes of additional analysis and is not a required part of the financial statement. Such information has been subjected to the auditing procedures applied in the audit of the financial statement. In our opinion, the supplementary information is fairly stated, in all material respects, in relation to the financial statement taken as a whole.

In accordance with *Government Auditing Standards*, we have also issued a report dated February 25, 2009 on our consideration of the Department's internal control over financial reporting and on our tests of its compliance with certain provisions of laws, rules, regulations, contracts, and other matters. The purpose of that report is to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing, and not to provide an opinion on the internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* and should be considered in assessing the results of our audit.

Office Of Legislative Budget Assistant

February 25, 2009

**STATE OF NEW HAMPSHIRE
DEPARTMENT OF REVENUE ADMINISTRATION
STATEMENT OF REVENUES AND EXPENDITURES
GENERAL AND EDUCATION TRUST FUNDS
FOR THE FISCAL YEAR ENDED JUNE 30, 2008**

<u>Revenues</u>	<u>General Fund</u>	<u>Education Trust Fund</u>	<u>Total</u>
Unrestricted Revenues			
Business Profits Tax	\$ 317,438,878	\$ 67,960,648	\$ 385,399,526
Statewide Property Tax (Note 2)	-0-	363,123,985	363,123,985
Business Enterprise Tax	77,710,071	154,989,416	232,699,487
Meals And Rooms/Car Rentals Tax	206,725,075	7,631,485	214,356,560
Tobacco Tax	57,059,952	109,260,569	166,320,521
Interest and Dividends Tax	118,693,161	-0-	118,693,161
Medicaid Enhancement Tax (Note 3)	91,816,141	-0-	91,816,141
Real Estate Transfer Tax	77,689,915	38,616,087	116,306,002
Communications Services Tax	80,931,633	-0-	80,931,633
Utility Property Taxes	-0-	24,195,794	24,195,794
Electricity Consumption Tax	6,782,323	-0-	6,782,323
Other Unrestricted Revenues	643,994	-0-	643,994
Total Unrestricted Revenues	<u>1,035,491,143</u>	<u>765,777,984</u>	<u>1,801,269,127</u>
Restricted Revenues			
Medicaid Enhancement Tax (Note 3)	91,816,141	-0-	91,816,141
Nursing Facility Quality Assessment (Note 3)	35,736,076	-0-	35,736,076
Other Restricted Revenues	77,588	-0-	77,588
Total Restricted Revenues	<u>127,629,805</u>	<u>-0-</u>	<u>127,629,805</u>
Total Revenues	<u>1,163,120,948</u>	<u>765,777,984</u>	<u>1,928,898,932</u>
Expenditures			
Salaries And Benefits	12,106,884	-0-	12,106,884
Property Tax Relief	-0-	3,156,984	3,156,984
Information Technology	1,560,972	-0-	1,560,972
Land Taxes Lost	1,084,057	-0-	1,084,057
Rents And Leases	740,229	-0-	740,229
Current Expenses	418,621	-0-	418,621
Other Expenditures	682,062	-0-	682,062
Total Expenditures	<u>16,592,825</u>	<u>3,156,984</u>	<u>19,749,809</u>
Excess (Deficiency) Of Revenues			
Over (Under) Expenditures	<u>1,146,528,123</u>	<u>762,621,000</u>	<u>1,909,149,123</u>
Other Financing Sources (Uses)			
Transfer To Health And Human Services (Note 3)	(219,368,358)	-0-	(219,368,358)
Net Appropriations (Note 4)	16,515,237	3,156,984	19,672,221
Total Other Financing Sources (Uses)	<u>(202,853,121)</u>	<u>3,156,984</u>	<u>(199,696,137)</u>
Excess (Deficiency) Of Revenues And			
Other Financing Sources Over (Under)			
Expenditures And Other Financing Uses	<u>\$ 943,675,002</u>	<u>\$ 765,777,984</u>	<u>\$ 1,709,452,986</u>

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

**STATE OF NEW HAMPSHIRE
DEPARTMENT OF REVENUE ADMINISTRATION**

**NOTES TO THE FINANCIAL STATEMENT
FOR THE FISCAL YEAR ENDED JUNE 30, 2008**

NOTE 1 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

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

A. Financial Reporting Entity

The Department of Revenue Administration (Department) is an organization of the primary government of the State of New Hampshire. The accompanying financial statement reports certain financial activity of the Department.

The financial activity of the Department is accounted for and reported in the General and Education Trust Funds in the State of New Hampshire's Comprehensive Annual Financial Report (CAFR). Assets, liabilities, and fund balances are reported by fund for the State as a whole in the CAFR. The Department, as a portion of the primary government, accounts for only a part of the General and Education Trust Funds and those assets, liabilities, and fund balances as reported in the CAFR that are attributable to the Department cannot be determined. Accordingly, the accompanying Statement of Revenues and Expenditures, General and Education Trust Funds is not intended to show the financial position or changes in fund balances of the Department of Revenue Administration in the General and Education Trust Funds.

B. Financial Statement Presentation

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

Governmental Fund Types:

General Fund: The General Fund accounts for all financial transactions not specifically accounted for in any other fund. All revenues of governmental funds, 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.

Education Trust Fund: The Education Trust Fund was created in fiscal year 2000 in accordance with Chapter 17:41, Laws 1999. The fund is non-lapsing and is used to distribute adequate education grants to school districts.

C. Measurement Focus And Basis Of Accounting

Governmental fund financial statements are reported using the current financial resources measurement focus and the modified accrual basis of accounting. Revenues are recognized as soon as they are both measurable and available. Revenues are considered to be available when they are collectible within the current period or soon enough thereafter to pay the liabilities of the current period. For this purpose, except for federal grants, the State generally considers revenues to be available if they are collected within 60 days of the end of the current fiscal period. Expenditures generally are recorded when a liability is incurred, as under accrual accounting. However, expenditures related to debt service, compensated absences, and claims and judgments are recorded only when payment is due.

Other Financing Sources (Uses) represent additions to and reductions from governmental resources in fund financial statements that normally result from transfers from/to other funds and include financing provided by bond proceeds. Legally required transfers are reported when incurred as “Transfers In” by the receiving fund and as “Transfers Out” by the disbursing fund.

D. Budget Control And Reporting

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 a separate budget for each year of the biennium, consists of three parts: Part I is the Governor's program for meeting all expenditure needs and estimating revenues. There is no constitutional or statutory requirement that the Governor propose, or that the Legislature adopt, a budget that does not resort to borrowing. Part II is a detailed breakdown of the budget at the department level for appropriations to meet the expenditure needs of the government. Part III consists of draft appropriation bills for the appropriations made in the proposed budget.

The operating budget is prepared principally on a modified cash basis and adopted for the governmental and proprietary fund types with the exception of the Capital Projects Fund. The Capital Projects Fund budget represents individual projects that extend over several fiscal years. Since the Capital Projects Fund comprises appropriations for multi-year projects, it is not included in the budget and actual comparison schedule in the State of New Hampshire CAFR. Fiduciary Funds are not budgeted.

In addition to the enacted biennial operating budget, the Governor may submit to the Legislature supplemental budget requests to meet expenditures during the current biennium. Budgetary control is at the department level. In accordance with RSA 9:16-a, notwithstanding any other provision of law, every department is authorized to transfer funds within and among all program

appropriation units within said department, provided any transfer of \$2,500 or more shall require approval of the Joint Legislative Fiscal Committee and the Governor and Council.

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

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

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

Budget To Actual Schedules for the General and Education Trust Funds are included as supplementary information.

NOTE 2 - STATEWIDE PROPERTY TAX

The Commissioner of the Department of Revenue Administration is charged by RSA 76:8 to calculate the portion of the Statewide Education Tax to be raised by each municipality by multiplying the Uniform Education Property Tax rate by the municipality's tax base. The Commissioner issues a warrant to the selectmen or assessors of each municipality directing them to assess such sum and pay it to the municipality. The Department reports the total amount of Statewide Property Tax raised by the municipalities as unrestricted revenue.

NOTE 3 - TRANSFERS TO DEPARTMENT OF HEALTH AND HUMAN SERVICES

During fiscal year 2008, the Department collected and processed \$183,632,282 in Medicaid Enhancement Tax and \$35,736,076 in Nursing Facility Quality Assessments. The revenue was collected as tax revenue by the Department and transferred to the Department of Health and Human Services for financial reporting in the Department of Health and Human Services' Medicaid Enhancement Fund and Nursing Facility Trust Fund accounts.

NOTE 4 - NET APPROPRIATIONS

Net appropriations reflect appropriations for expenditures in excess of restricted revenue not otherwise used (transferred to the Department of Health and Human Services).

NOTE 5 - EMPLOYEE BENEFIT PLANS

New Hampshire Retirement System

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

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

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

All covered Department employees are members of Group I.

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

The Plan is financed by contributions from the members, the State and local employers, and investment earnings. During the fiscal year ended June 30, 2008, Group I members were required to contribute 5% and Group II members were required to contribute 9.3% of gross earnings. The State funds 100% of the employer cost for all of the Department's employees enrolled in the Plan. The annual contribution required to cover any normal cost beyond the employee contribution is determined every two years by the Plan's actuary.

The Department's payments for normal contributions for the fiscal year ended June 30, 2008 amounted to 8.74% of the covered payroll for its Group I employees. The Department's normal contributions for the fiscal year ended June 30, 2008 were \$717,185.

A special account was established by RSA 100-A:16, II (h) for additional benefits. Effective for fiscal year 2008, legislation was passed that permits the transfer of assets into the special account for earnings in excess of 10 ½ percent as long as the actuary determines the funded ratio of the retirement system to be at least 85 percent. If the funded ratio of the system is less than 85 percent, no assets will be transferred to the special account.

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

Health Insurance For Retired Employees

In addition to providing pension benefits, RSA 21-I:30 specifies that the State provide certain health care benefits for retired employees and their spouses within the limits of the funds appropriated at each legislative session. These benefits include group hospitalization, hospital medical care, and surgical care. Substantially all of the State's employees who were hired on or before June 30, 2003 and have 10 years of service may become eligible for these benefits if they reach normal retirement age while working for the State and receive their pensions on a periodic basis rather than a lump sum. During fiscal year 2004, legislation was passed that requires State Group I employees hired after July 1, 2003 to have 20 years of State service in order to qualify for health insurance benefits. These and similar benefits for active employees are authorized by RSA 21-I:30 and provided through the Employee and Retiree Benefit Risk Management Fund, which is the State's self-insurance fund implemented in October 2003 for active State employees and retirees. The State recognizes the cost of providing these benefits on a pay-as-you-go basis by paying actuarially determined contributions into the fund. The New Hampshire Retirement System's medical premium subsidy program for Group I and Group II employees also contributes to the fund.

The cost of the health benefits for the Department's retired employees and spouses is a budgeted amount paid from an appropriation made to the administrative organization of the New Hampshire Retirement System. Accordingly, the cost of health benefits for retired Department employees and spouses is not included in the Department's financial statement.

The State Legislature currently plans to only partially fund (on a pay-as-you-go basis) the annual required contribution (ARC), an actuarially determined rate in accordance with the parameters of Governmental Accounting Standard Board (GASB) Statement 45. The ARC represents a level of funding that, if paid on an ongoing basis, is projected to cover normal cost each year and amortize any unfunded actuarial liabilities over a period not to exceed 30 years. The ARC and contributions are reported for the State as a whole and are not separately reported for the Department.

**STATE OF NEW HAMPSHIRE
DEPARTMENT OF REVENUE ADMINISTRATION
BUDGET TO ACTUAL SCHEDULE - GENERAL FUND
FOR THE FISCAL YEAR ENDED JUNE 30, 2008**

<u>Revenues</u>	<u>Original Budget</u>	<u>Actual</u>	<u>Favorable/(Unfavorable) Variance</u>
Unrestricted Revenues			
Business Profits Tax	\$ 301,100,000	\$ 317,438,878	\$ 16,338,878
Business Enterprise Tax	90,800,000	77,710,071	(13,089,929)
Meals And Rooms/Car Rentals Tax	212,200,000	206,725,075	(5,474,925)
Tobacco Tax	62,800,000	57,059,952	(5,740,048)
Interest And Dividends Tax	117,000,000	118,693,161	1,693,161
Medicaid Enhancement Tax (Note 2)	91,000,000	91,816,141	816,141
Real Estate Transfer Tax	93,300,000	77,689,915	(15,610,085)
Communications Services Tax	79,900,000	80,931,633	1,031,633
Electricity Consumption Tax	6,400,000	6,782,323	382,323
Other Unrestricted Revenues	<u>508,000</u>	<u>643,994</u>	<u>135,994</u>
Total Unrestricted Revenues	<u>1,055,008,000</u>	<u>1,035,491,143</u>	<u>(19,516,857)</u>
Restricted Revenues			
Medicaid Enhancement Tax (Note 2)	89,705,000	91,816,141	2,111,141
Nursing Facility Quality Assessment (Note 2)	36,015,294	35,736,076	(279,218)
Other Restricted Revenues	<u>648,517</u>	<u>77,588</u>	<u>(570,929)</u>
Total Restricted Revenues	<u>126,368,811</u>	<u>127,629,805</u>	<u>1,260,994</u>
Total Revenues	<u>1,181,376,811</u>	<u>1,163,120,948</u>	<u>(18,255,863)</u>
<u>Expenditures</u>			
Salaries And Benefits	12,943,839	12,106,884	836,955
Information Technology	1,837,593	1,560,972	276,621
Land Taxes Lost	940,103	1,084,057	(143,954)
Rents And Leases	748,200	740,229	7,971
Current Expenses	603,492	418,621	184,871
Other Expenditures	<u>1,297,520</u>	<u>682,062</u>	<u>615,458</u>
Total Expenditures	<u>18,370,747</u>	<u>16,592,825</u>	<u>1,777,922</u>
Excess (Deficiency) Of Revenues			
Over (Under) Expenditures	<u>1,163,006,064</u>	<u>1,146,528,123</u>	<u>(16,477,941)</u>
Other Financing Sources (Uses)			
Transfer To Health And Human Services (Note 2)	(216,720,294)	(219,368,358)	(2,648,064)
Net Appropriations	<u>17,722,230</u>	<u>16,515,237</u>	<u>(1,206,993)</u>
Total Other Financing Sources (Uses)	<u>(198,998,064)</u>	<u>(202,853,121)</u>	<u>(3,855,057)</u>
Excess (Deficiency) Of Revenues And			
Other Financing Sources Over (Under)			
Expenditures And Other Financing Uses	<u>\$ 964,008,000</u>	<u>\$ 943,675,002</u>	<u>\$ (20,332,998)</u>

The accompanying notes are an integral part of this schedule.

**STATE OF NEW HAMPSHIRE
DEPARTMENT OF REVENUE ADMINISTRATION
BUDGET TO ACTUAL SCHEDULE - EDUCATION TRUST FUND
FOR THE FISCAL YEAR ENDED JUNE 30, 2008**

<u>Revenues</u>	<u>Original Budget</u>	<u>Actual</u>	<u>Favorable/(Unfavorable) Variance</u>
Unrestricted Revenues			
Business Profits Tax	\$ 64,500,000	\$ 67,960,648	\$ 3,460,648
Statewide Property Tax	363,000,000	363,123,985	123,985
Business Enterprise Tax	181,600,000	154,989,416	(26,610,584)
Car Rentals Tax	7,800,000	7,631,485	(168,515)
Tobacco Tax	120,600,000	109,260,569	(11,339,431)
Real Estate Transfer Tax	46,700,000	38,616,087	(8,083,913)
Utility Property Tax	22,900,000	24,195,794	1,295,794
Total Unrestricted Revenues	<u>807,100,000</u>	<u>765,777,984</u>	<u>(41,322,016)</u>
Total Revenues	<u>807,100,000</u>	<u>765,777,984</u>	<u>(41,322,016)</u>
 <u>Expenditures</u>			
Property Tax Relief (Note 3)	5,000,000	3,156,984	1,843,016
Total Expenditures	<u>5,000,000</u>	<u>3,156,984</u>	<u>1,843,016</u>
 Excess (Deficiency) Of Revenues Over (Under) Expenditures	<u>802,100,000</u>	<u>762,621,000</u>	<u>(39,479,000)</u>
 Other Financing Sources (Uses)			
Net Appropriations	5,000,000	3,156,984	(1,843,016)
Total Other Financing Sources (Uses)	<u>5,000,000</u>	<u>3,156,984</u>	<u>(1,843,016)</u>
 Excess (Deficiency) Of Revenues And Other Financing Sources Over (Under) Expenditures And Other Financing Uses	<u>\$ 807,100,000</u>	<u>\$ 765,777,984</u>	<u>\$ (41,322,016)</u>

The accompanying notes are an integral part of this schedule.

**Notes To The Budget To Actual Schedule - General And Education Trust Funds
For The Fiscal Year Ended June 30, 2008**

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 2008 as passed by the Legislature in Chapter 262, Laws of 2007.

Budgetary control is at the department level. In accordance with RSA 9:16-a, notwithstanding any other provision of law, every department is authorized to transfer funds within and among all program appropriation units within said department, provided any transfer of \$2,500 or more shall require approval of the Joint Legislative Fiscal Committee and the Governor and Council. Additional fiscal control procedures are maintained by both the Executive and Legislative Branches of government. The Executive Branch, represented by the Commissioner of the Department of Administrative Services, is directed to continually monitor the State's financial system. The Legislative Branch, represented by the Joint Legislative Fiscal Committee, the Joint Legislative Capital Budget Overview Committee, and the Office of Legislative Budget Assistant, monitors compliance with the budget and the effectiveness of budgeted programs.

Unexpended balances of appropriations at year-end will lapse to undesignated fund balance and be available for future appropriations unless they have been encumbered or are legally defined as non-lapsing accounts.

Variances - Favorable/(Unfavorable)

The variance column on the Budget To Actual Schedule highlights differences between the original operating budget and the actual revenues and expenditures for the fiscal year ended June 30, 2008. Actual revenues exceeding budget or actual expenditures being less than budget

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

The unfavorable expenditure variances shown on the Budget to Actual Schedule represents the difference between the actual expenditures incurred during the fiscal year ended June 30, 2008 and the original budget in place at the beginning of fiscal year 2008. The unfavorable expenditure variances do not represent expenditures incurred in excess of appropriations because the original budget amounts do not include supplemental appropriations. The State and the Department use supplemental appropriations to add appropriations to original budget amounts to reflect changes in levels of operations not provided for in the original budget.

Note 2 - Transfer To Health And Human Services

During fiscal year 2008, the Department collected and processed \$183,632,282 in Medicaid Enhancement Tax and \$35,736,076 in Nursing Facility Quality Assessments. The revenue was collected as tax revenue by the Department and transferred to the Department of Health and Human Services for financial reporting in the Department of Health and Human Services' Medicaid Enhancement Fund and Nursing Facility Trust Fund accounts. These tax revenues are budgeted in the Department of Health and Human Services' accounts. There is no budget for these accounts at the Department of Revenue Administration. The amounts reported as Original Budget on the accompanying Budget to Actual Schedule are the amounts budgeted for these accounts at the Department of Health and Human Services.

Note 3 - Property Tax Relief

During fiscal year 2008, the Department expended \$3,156,984 in rebates for Enhanced Education Property Tax Relief. Property Tax Relief payments are budgeted in the Department of Education accounts. There is no budget amount for this account at the Department of Revenue Administration. The amount reported as Original Budget on the accompanying Budget to Actual Schedule is the amount budgeted for this account at the Department of Education.

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APPENDIX - CURRENT STATUS OF PRIOR AUDIT FINDINGS

The following is a summary, as of February 25, 2009, of the current status of the observations contained in the audit report of the Department of Revenue Administration for the fiscal year ended June 30, 2001. A copy of the prior report can be accessed on-line at www.gencourt.state.nh.us/lba/audit.html.

	<u>Status</u>			
<i>Internal Control Comments</i>				
<i>Reportable Conditions</i>				
1. All Divisions Should Have Policies And Procedures Manuals	●	●	●	
2. Monitoring Of Control Activities Should Be Improved	●	●	●	
3. Status Of Outstanding Tax Notices Should Be Tracked More Closely	●	●	●	
4. Controls Over Collections Of Real Estate Transfer Taxes Should Be Consistently Applied	●	●	●	
5. Controls Over Reviews Of Tobacco Tax Stamps Should Be Consistently Applied	●	●	●	
6. Controls Over Tobacco Product Seizures Should Be Improved	●	●	●	
7. Controls Should Be Established Over The Storage And Issuance Of Tax Stamps	●	●	●	
8. Security Over Access To The Telefile System Should Be Enhanced	●	●	●	
9. Controls Should Be Instituted To Monitor Information System Program Changes	●	●	●	
10. Telefile Data Capture And Analysis Should Be Expanded	●	○	○	
11. Formal Written Information Technology Security Plan Should Be Created	●	●	●	
12. Business Continuity Management Plan Should Include Periodic Testing And Evaluation Of Plan Procedures (<i>See Current Observation No. 1</i>)	●	○	○	
13. Cash Receipts Should Be Deposited Daily	●	●	●	
<i>State Compliance Comments</i>				
14. Applicability Of RSA 617 Should Be Reviewed And Procedures For The Seizure Of Tobacco Products Documented	●	●	●	
15. Expired Administrative Rules Related To The Administration Of The Medicaid Enhancement Tax Should Be Revised As Appropriate And Submitted For Adoption (<i>See Current Observation No. 12</i>)	●	●	○	
16. Late Filing Fee Should Be Applied To Local Government Entities Submitting Delinquent Reports	●	●	●	
<i>Management Issues Comments</i>				
17. Process For Recording Receipts In NHIFS Should Be Made More Efficient	●	●	●	
18. Accounts Receivable System Should Be Automated (<i>See Current Observation No. 3</i>)	●	○	○	
<u>Status Key</u>				
Fully Resolved	●	●	●	Count 14
Substantially Resolved	●	●	○	1
Partially Resolved	●	○	○	3
Unresolved	○	○	○	0

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