

**STATE OF NEW HAMPSHIRE
DEPARTMENT OF TRANSPORTATION
FUEL DISTRIBUTION SECTION**

**FINANCIAL AUDIT REPORT
FOR THE NINE MONTHS ENDED
MARCH 31, 2012**

**STATE OF NEW HAMPSHIRE
FUEL DISTRIBUTION SECTION**

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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 FUEL DISTRIBUTION SECTION

Reporting Entity And Scope

The reporting entity of this audit and audit report is the Fuel Distribution Section of the New Hampshire Department of Transportation. The scope of this audit and audit report includes the financial activity of the Fuel Distribution Section for the nine months ended March 31, 2012. Unless otherwise indicated, reference to the Section refers to the Fuel Distribution Section and reference to the Department refers to the Department of Transportation.

Organization

Fuel Distribution is a section within the Department of Transportation, Division of Operations, Bureau of Highway Maintenance. The Department's Division of Finance and Contracts supports the Section's financial activities.

The Section operates 93 fueling sites located throughout New Hampshire. The Section's main office is at the Department's headquarters at 7 Hazen Drive, Concord, New Hampshire.

At March 31, 2012, the Section had six full-time employees.

Responsibilities

The primary responsibility of the Section is the operation of its 93 fueling sites. During the nine months ended March 31, 2012, the Section sold approximately 3.6 million gallons of diesel fuel and gasoline to approximately 255 billable customers. The function of the Section was established by Chapter 423:15, Laws of 1983, which enacted RSA 228:24-a and established the Motor Fuel Inventory Fund and authorized the Commissioner of the Department to operate an automated State fleet fuel distribution and records management system and to sell motor fuel to all State agencies, political subdivisions of the State, and federal agencies. Subsequent amendments to the statute have broadened the authority to allow sales to eligible nonprofit corporations providing transportation under contract with the Department for the elderly, disabled, or the general public.

The operation of the Section is intended to provide efficiencies for governmental fuel purchases, allowing customers to purchase fuel at near wholesale costs and avoid state and federal fuel tax refund processing, and to promote environmental controls of government fuel storage and distribution by centralizing operations at regional sites. The fuel inventory maintained by the Section also provides the State with a strategic fuel reserve.

Funding

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

The financial activity related to the purchase and sale of motor fuel is accounted for in a revolving fund in the State's accounting system. Revenue from the sale of fuel is intended to cover operating costs and the purchase of additional inventory for sale. While the purchase and sale of motor fuel is not budgeted or subject to appropriations, certain administrative costs of the Fuel Distribution Section are subject to budget and appropriations. The Section's budgeted administrative costs are funded by a transfer of revenue from the revolving fund.

A summary of the Section's revenues and expenditures for the nine months ended March 31, 2012 is shown in the following schedule.

**Summary Of Revenues And Expenditures
For The Nine Months Ended March 31, 2012**
(In Thousands)

	<u>Highway Fund</u>	<u>Capital Projects Fund</u>	<u>Total</u>
Total Revenues	\$ 11,466	\$ -0-	\$ 11,466
Total Expenditures	<u>11,517</u>	<u>534</u>	<u>12,051</u>
Excess (Deficiency) Of Revenues Over (Under) Expenditures	<u>\$ (51)</u>	<u>\$ (534)</u>	<u>\$ (585)</u>

Prior Audits

The most recent prior financial audit of the Section was for the fiscal year ended June 30, 2001. The appendix to this report on page 37 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 on-line at www.gencourt.state.nh.us/lba/AuditReports/FinancialReports/pdf/dotfuel2001_full.pdf.

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 Fuel Distribution Section for the nine months ended March 31, 2012. 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 Section and tested its compliance with certain provisions of applicable State and federal laws, rules, regulations, and contracts. Major accounts or areas subject to our examination included, but were not limited to, revenues and expenditures.

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



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

To The Fiscal Committee Of The General Court:

We have audited the Statement of Revenues and Expenditures – Governmental Funds, of the Fuel Distribution Section (Section) of the New Hampshire Department of Transportation (Department) for the nine months ended March 31, 2012, and have issued our report thereon dated September 4, 2012 which was qualified as the financial statement does not constitute a complete financial presentation of the Section. 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

Management of the Section is responsible for establishing and maintaining effective internal control over financial reporting. In planning and performing our audit, we considered the Section'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 Section's internal control over financial reporting. Accordingly, we do not express an opinion on the effectiveness of the Section's internal control over financial reporting.

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

Our consideration of internal control over financial reporting was for the limited purpose described in the first paragraph of this section and was not designed to identify all deficiencies in internal control over financial reporting that might be deficiencies, significant deficiencies, or material weaknesses. We did not identify any deficiencies in internal control over financial

reporting that we consider to be material weaknesses as defined above. However, we identified certain deficiencies in internal control over financial reporting, as described in Observations No. 1 through No. 8 that we consider to be significant deficiencies in internal control over financial reporting. A *significant deficiency* is a deficiency or combination of deficiencies in internal control that is less severe than a material weakness, yet important enough to merit attention by those charged with governance.

Compliance And Other Matters

As part of obtaining reasonable assurance about whether the Section's financial statement is free of material misstatement, we performed tests of the Section'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. 9.

The Section's response is included with each observation in this report. We did not audit the Section'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 Section, others within the Department, and the Fiscal Committee of the General Court and is not intended to be and should not be used by anyone other than these specified parties.


Office Of Legislative Budget Assistant

September 4, 2012

Internal Control Comments
Significant Deficiencies

Observation No. 1: Accountability Controls Over Fuel Sales At Fuel Sites Should Be Improved

Observation:

The Section has not required customers to adhere to Section control policies and procedures intended to establish and maintain accountability for access to, and therefore controlled sales at, the Section's automated and manual fuel sites. The Section reported that, in response to certain user requests, it set up some customer accounts in a manner that avoids the Section's operator accountability and vehicle identity controls.

The Section's standard policies and procedures assign each authorized customer (primarily State and municipal agencies) separate devices to identify the operator of the vehicle and the vehicle being fueled, usually in the form of a driver card or PIN (identification number) and a vehicle card or scan tag. The Section's information system contains data on operator names and vehicle make, model, fuel type, and tank capacity. When purchasing fuel at an automated site, both the operator and vehicle identifiers need to be utilized, which authorizes the transaction and identifies the individual pumping the fuel, the vehicle receiving the fuel, the fuel type, date and time, and gallons pumped in the fuel-sale transaction record.

- In nine of 45 (20%) sales transactions selected for testing, the fuel sales data captured by the Section's information system did not include the identity of the operator who pumped the fuel. The Section reported, based upon the requests of customers, it had programmed the identification device for certain customers to be used as both an operator and vehicle identifier in the fueling system. In fueling transactions using those devices, no individual is identified as the pump operator. A review of Section data indicated approximately 1,900 of the approximately 8,200 (23%) operator identifiers in the system do not specify a named individual.
- In four of 45 (9%) sales transactions tested, the fuel sales data did not include vehicle make and model. In another 11 of 45 (24%) tested transactions, the vehicle make and/or model was identified as "unknown." A review of the Section's vehicle data information system noted the make and model data field for approximately 2,100 of the approximately 7,300 (29%) vehicles in the system was either blank or identified as unknown.
- While obtaining an understanding of the fuel sales process, and in three of 45 (7%) transactions tested, auditors noted the gallons of fuel pumped in a sale exceeded the tank capacity of the registered vehicle.
- In three of 45 (7%) sales transactions tested, auditors could not determine if the amount of fuel pumped was reasonable, because there was no associated vehicle identifying data on file.
 - For one of the three transactions, the recorded vehicle year was 1900, and there was no data for make, model, or tank capacity. The plate number was recorded. A review of the Section's vehicle data on May 24, 2012 noted 167 vehicles with no data recorded in the vehicle identification data fields other than a license plate number.

- For the other two transactions, vehicle data in the Section's information system had been updated since the time of the original transaction and all the data associated with the old vehicle that processed the transaction was no longer readily available in the system.

As also noted in the fiscal year 2001 audit, the Section does only a limited review of its fueling system database to review for possible misuse of fuel by its customers, including other State agencies. Fueling data such as gallons pumped, vehicle tank capacity, and fueling frequency are not reviewed for unusual transactions, beyond confirming with customers the propriety of single purchases of greater than 100 gallons.

Recommendation:

The Section should monitor and enforce its control policies and procedures intended to establish accountability for controlled sale of fuel at the Section's fuel depots. All customers should be required to provide operator and vehicle information necessary to reasonably enable the Section's accountability controls to operate and lessen the potential for the improper sale and use of tax-free fuel.

As noted in the prior audit, the Section should increase its fuel-use monitoring procedures. Fuel sales transactions in excess of vehicle tank capacities, or of fuel types that are inconsistent with vehicle information, should be identified and flagged to notify the Section and its customers of possible misuse of vehicle card or tag identifiers or other violations of fueling policies. These fuel-use monitoring procedures should be performed both as a fraud detection activity and as a review to identify customers who may need additional training or assistance in Section policies and procedures. Identifying this exception data to the customers will aid in making the customers more effective participants in ensuring that employees responsible for performing and recording fueling transactions are trained and compliant with Section policies and procedures and that vehicle information in the Section's database is current.

Auditee Response:

We concur in part.

The Section does not require customers to have Personal Identification Numbers (PIN) for each employee/driver who may utilize a fuel site, but it does recommend this practice to all customers. For example, as a good business practice, NHDOT requires department employed drivers to have an assigned PIN, all others have the option to have individual PIN's or a single Driver PIN assigned to a vehicle.

As a matter of practicality, non NHDOT customers are given the choice. For example, other customers may have a very transient population (school, fire and police departments) and managing the acquisition and deletion of PIN's would be time consuming and may interrupt operations to change information in a timely manner. The point is well taken and to raise awareness to this issue, the Section could add a passage on the Driver Pin Number Request Form that the "Section is not able to track individual use if the card is assigned to multiple drivers".

The Section has made it clear in the User's Agreement that it is ultimately the customers' responsibility to provide the accountability and integrity to their fuel purchases.

The amount of time and resources needed to increase fuel monitoring for all customers is beyond the resources of the Section. If the Department implements the full capabilities of the Fuel Management System, enhanced fuel-use monitoring could be made available for customers to better monitor their own fleet.

Observation No. 2: Controls At Manual Fuel Sites Should Be Improved

Observation:

Deficiencies identified in a review of controls in place at the Section's manual fueling sites indicate the Section should better monitor the effectiveness of its control activities at those sites.

- In a transaction noted during a document review, a gap in recorded meter readings on a manual transaction log made it unclear as to the amount of fuel purchased by two customers. While in the noted instance the eight unaccounted-for gallons were billed to a customer, the allocation to a customer's account was made without the Section establishing the actual purchaser of the fuel. According to stated policy, a Fuel Site Manager should perform a review of accuracy of the manual transaction log prior to forwarding the transaction log to the Section at the end of the day. While Section personnel may review each submitted log in total, they apparently do not consistently perform a line-by-line review of the log as this inconsistent fueling data should have been detected. Upon the auditor's inquiry to the Section, the Section reviewed the manual transaction logs for April 2012 fuel sales and reported approximately ten similar errors were identified in their review.
- In a transaction selected for audit testing, it was noted that the Section allowed a vehicle, which was not registered with the Section, to purchase fuel at a manual site. When auditors inquired about the transaction, the Section reported one of its employees had directed a customer using a non-registered vehicle to identify the vehicle as "Spare" on the manual transaction log. Section management reported it considered the employee's direction to the customer to be counter to the Section's policies and procedures.
- The Section has not maintained inventory control over keys issued to manual "key lock" sites, increasing the risk that accountability for the keys and access to the pumps may be lost. Physical keys are issued to the users of manual key lock sites to allow access to the pumps. The Section has not maintained a current and complete record of issued keys. As a result, the Section cannot be certain that only currently authorized individuals have possession of keys controlling access to the key lock fuel pumps.

Recommendation:

The Section should improve its control procedures at its manual fueling sites as well as its control monitoring efforts.

- Manual fuel logs should be reviewed timely at sufficient detail to provide reasonable assurance of accurate recording of fueling transactions and to allow for timely research and correction of apparent erroneous or ambiguous transactions.
- Employees should be periodically reminded of the Section's policies and procedures to allow only authorized customers and registered vehicles access to tax-free fuel at the Section's fuel sites.
- Accountability for keys controlling access to the key lock fueling sites should be established and maintained.

Auditee Response:

We concur.

- To enhance the timely review of manual fuel logs in sufficient detail, the Section will submit a request to our Fuel Management System (FMS) vendor asking them to modify the manual fuel entry screen. The request will be for automatic field fill from previous entries, calculations of fuel used, and driver name field.
- Only authorized customers are allowed access to the Section's fuel sites and the Section does its best to have qualified vehicles pre-entered and registered in to the system. On occasion however, an authorized customer may access fuel for a non-entered system registered vehicle. This primarily results from a temporary replacement of the customers system registered vehicle and more often than not, pertains to a school bus. The Section will change policy to reflect practice.
- A key numbering system has been implemented (July 2012) for manual key lock sites with a request sheet similar to the vehicle tag sheet currently used. The request sheet will include the "customer" sign for the keys and log the numbers on the sheet.

Observation No. 3: Business And Other Critical Plans Should Be Developed

Observation:

In our fiscal year 2001 audit report, it was observed the Section had not formally developed or established a long-term business plan to identify goals and methods to measure progress toward those goals. That condition continued as of March 31, 2012.

The Section does not have a formal plan for important aspects of its continuing operations including goals and resources needed to reach those goals. While the Section does have plans for the replacement of certain older fuel tanks by 2015 in line with environmental requirements, decisions such as the replacement of other existing tanks and pump equipment, determining when and where to expand fueling sites and automate existing sites, how and when to incorporate new, more efficient technologies, and developing fuel purchasing and reserve strategies are made without the benefit of formal Section planning documents to assist in making decisions in a coordinated and concerted effort.

The Section has also not developed or established formal disaster recovery and business continuity plans to minimize possible disruptions to operations, including availability of its strategic reserves of fuel, in the event of a disaster, vendor or system failure, or other disruptive event.

Recommendation:

The Section, in conjunction with the Department's planners, should develop written business plans supporting the Section's operations.

1. The business plan should include the goals of the Section, how management intends to meet those goals, and methods to measure progress toward the goals.

The business plan should be periodically reviewed and updated to reflect changing operating conditions. Potential areas to consider in developing the Section's business plan include but are not limited to: 1) determining the timing of tank and pump equipment replacements, 2) determining the location of fuel sites, 3) determining whether to increase the number of automated fuel sites, 4) the use of new technologies, 5) the development of a fuel reserve strategy, and 6) contracting for fuel delivery services.

2. The disaster recovery and business continuity plan should address the performance of critical jobs and activities necessary to mitigate disruptions to services in the event of a disaster or other event impacting the Section's normal operations. The Section should consider coordinating this plan with the Department of Safety's Homeland Security and Emergency Management operations.

These plans should include risk assessments, the assignment of responsibilities, arrangements for facilities and services, and procedures for regular review of, and training in, the implementation of the plans.

Auditee Response:

We concur.

The Section will begin the process of developing a formal business and disaster recovery and business continuity plan as recommended. The Section will make its best effort in accomplishing this task in a reasonable and timely manner.

Observation No. 4: All Costs Of Operations Should Be Considered For Recovery When Setting Fuel Prices

Observation:

The Section bases its fuel prices on set mark-ups, or margins, over the cost of fuel. The margins used during the audit period were established by the Section with the intent to recover certain costs of operations while maintaining compliance with RSA 228:24-a, I, which states the Motor Fuel Inventory Fund (Fund) is not to exceed \$1.0 million. While the Section has maintained the Fund at approximately \$1.0 million, the Section has not included all of the costs to create and operate its fueling sites in determining the costs to be recorded in the fund and recovered by the pricing margins.

RSA 228:24-a authorizes the assessment of a fair and equitable charge for the sale of motor fuel sufficient to defray all administrative, transportation, storage, amortization, and other costs incurred by the Department in administering the fuel program.

As also noted in our fiscal year 2001 audit, while the cost for fuel and budgeted Section administrative costs are known and recorded in the State accounting system, not all of the costs of operating the fuel program are recognized as such. For example, the Department and Section do not include certain costs incurred in the creation and maintenance of the fuel sites, including the costs of the tanks, pumps, associated equipment, and site improvements, as recoverable costs in the fuel sales price calculations. These costs are paid by the Department, largely through bonded capital costs paid from the Department's Highway Fund appropriations, and are not recovered by the Section through fuel sales. While the Department is working to accumulate complete fixed asset information, the Department estimates the audit period's amortization (depreciation) costs to be approximately \$900,000 for underground storage tanks and equipment installed since the start of fiscal year 2009.

Incomplete reporting of costs hinders effective planning and other decision-making activities related to changes and improvements in fuel distribution activities.

Recommendation:

All costs of operations need to be determined before establishing a sales price sufficient to defray the costs and provide a sufficient margin to administer the fuel distribution program.

The Department and the Section should establish policies and procedures to properly determine and periodically report all costs related to the operation of the fuel distribution program. Based on the total costs of operations, the Section should establish margins and sales prices that are fair and equitable yet sufficient to cover those costs of operations. The margins should recover the amortization costs of the Section's fuel distribution property and equipment.

Auditee Response:

We do not concur.

RSA 228:24-a authorizes the assessment of a fair and equitable charge for the sale of motor fuel, including amortization (capital) costs and the New Hampshire Department of Transportation (NHDOT) has determined that an increase in current markup for capitalized costs would negatively affect the program as outlined below:

	Unleaded	Diesel
NHDOT		
Contract cost	\$2.98	\$3.065
Administrative fee	.15	.20
Capitalized cost	<u>.23</u>	<u>.27 (a)</u>
Total	<u>\$3.36</u>	<u>\$3.53</u>
RETAIL		
Fuel Price	\$3.66	\$3.86 (b)
Less Fed & State Fuel Tax	<u>.364</u>	<u>.424</u>
Total	<u>\$3.296</u>	<u>\$3.436</u>

Footnote:

(a) $\$900,000$ (Unleaded $1,947,859$ gals \times $\$0.23 = \$448,007$ Diesel $1,646,704 \times \$0.27 = \$444,610$)

(b) AAA Fuel Gage Report (8/09/2012)

The Section currently includes a \$0.15 and \$0.20 additional markup above the cost of motor fuel, respectively, for unleaded and diesel products to recoup all administrative and operational costs of this program. The addition of a markup for capital costs (tanks, pumps, associated equipment, and site improvements) based on annualized depreciation costs of \$900,000, would increase fuel sales prices by \$0.23 and \$0.27, respectively, for unleaded and diesel products. Compared to retail prices at the pump, and assuming all eligible customers would be entitled to refunds of both the Federal and State road toll (fuel tax), NHDOT fuel charges would exceed retail by \$0.06 and \$0.09, respectively, on unleaded and diesel. The loss of fuel sales as a result of the additional markup would negatively impact the purchase price to NHDOT and other state agencies as a result of lost discounts due to a decrease in volume sales. Further, because NHDOT and other state agencies account for approximately 50% or more of total unleaded and diesel fuel sold, this increase would cost an additional \$450,000 annually in increased fuel costs in the operating budgets of all State agencies.

Any negative impact to the sales volume will ultimately drive up costs for fuel currently incurred by NHDOT and other state agencies. The program provides effective uninterrupted fuel delivery 24/7 for department operations including critical snow maintenance activities. Other state agencies also rely on this program for operations and public safety. Lastly, NHDOT also recognizes the value of the program as a strategic resource of fuel delivery at the national, federal, and state level should a disruption in supply occur.

LBA Rejoinder:

We understand the Section's concern that including recovery of the amortization costs in the price of fuel may result in the loss of some customers and sales. However, a sales price that includes amortization costs would recover those costs from all users of the service, reflecting their proportionate use of the fuel system. The Department and State Highway Fund should not solely support the amortization costs of the fuel system in order to protect other State agencies, local governments, and other system users from increased fuel costs. As recommended in Observation No. 3, the development of a written business plan could assist in developing operational strategies, including recovery of amortization costs in setting fuel prices.

Observation No. 5: Contract Provisions Should Be Reviewed

Observation:

The Section has not taken advantage of an available quality control procedure or required the fuel vendors to comply with certain other conditions in its fuel contracts. The Section reports it considers certain contract requirements as safeguards, with enforcement only necessary in the case of disputes with the vendors. The Section also reports that, because of acceptable vendor performance to date, it has not seen the need to enforce compliance with certain contract provisions.

The State's fuel contracts address the following:

Product Testing and Compliance Monitoring

"The State may request an analysis, from an approved laboratory, of the fuel delivered at no cost to the State."

- During the nine months ended March 31, 2012, the Section purchased approximately \$11.5 million of fuel. According to discussions with the Fuel Distribution Manager, vendor compliance with contractual product requirements and specifications is not monitored on an ongoing basis. The Section reports it does not currently test, nor require the vendor to provide a lab analysis of, fuel delivered unless prompted by customer complaints about fuel quality. The Section reports it did not receive any complaints regarding fuel quality during the nine months ended March 31, 2012. A similar observation was noted during the fiscal year 2001 audit.

Contract Consumption - Tracking/Reporting

"The successful bidder shall submit consumption reports on a monthly basis to DOT The report shall include the following data, at a minimum: district number, delivery agency, physical location with tank ID with applicable date of delivery, gallons delivered, product type, total gallons delivered to date by delivery type per district."

- The Section reports it had not received any contract consumption reports specified in the applicable contracts, although the Section has requested them from the vendor on more than

one occasion. In order to compensate for the lack of reporting, the Section created a spreadsheet to track gallons delivered for the current contracts. The Section entered delivery data from fuel invoices and tracked total gallons delivered under the contract, by each site and district, for each product (gasoline and diesel). However, the Section did not have information on fuel purchased through the contracts by the Department of Safety, which made it impossible for the Section to accurately monitor gallons remaining on the contract and price changes at the end of the contract.

- In two of 25 (8%) fuel deliveries selected for testing, auditors were unable to confirm the invoiced price per gallon was accurate as the invoice price reflected a change from a fixed price to an indexed price, presumably because the fixed-price volume limit had been exceeded. However, because the Section did not receive the consumption reports specified by the contract, the Section was unable to provide auditors with documentation to evidence that the fixed-price contract volume had in fact been reached. If the contract volume had not been reached and the fixed price contract remained in place, the Section would have paid approximately \$2,500 less for the two tested fuel deliveries.

Deliveries

“All deliveries will be made within 48 hours after receipt of order, regardless of method of delivery (tank wagon or motor transport).”

- During tests of fuel purchases auditors noted 10 of 25 (40%) fuel deliveries reviewed were made outside of the 48 hour contract delivery window. Late deliveries ranged from approximately one-half to 52 hours late. There are no sanctions identified in the contract for the late delivery of fuel and the Section reports it has not taken any actions against the vendors, as the late deliveries have not resulted in any of the sites running out of fuel.

Price Changes

The contract includes a revision notation as follows: “Revised - TT Locations Converted To Fixed Price 10/11/2011.”

- During expenditure testing, auditors noted a purchase of diesel fuel which was ordered and delivered on the effective date of a contract provision change. The per-gallon price invoiced by the vendor was based on the daily journal of commerce price plus applicable contract mark-up, in accordance with the prior indexed format contract provision, rather than on the fixed price per-gallon contract provision, which became effective the date of delivery. The Section reported it recorded the change in contract pricing methodology as being effective the following day. The Section was overbilled and overpaid the fuel delivery cost by approximately \$38 in this tested transaction.

Recommendation:

The Section should work with the Department of Administrative Services to ensure that contract language is explicit and clear in all significant conditions, including effective dates.

The Section should ensure all significant contract terms are enforced. The Section should develop and implement a regular testing program to prove the continued quality of the delivered fuel.

The Section should ensure that employees processing invoices for payment are aware of the relevant conditions of applicable contracts and should especially review transactions occurring at the point of contract changes to ensure that changes are implemented accurately and timely.

Auditee Response:

We concur in part.

The Section works very closely with the Department of Administrative Services (DAS), Purchase and Property to ensure the contract terms are as explicit as possible and we will continue to do so.

Specific to the auditor's comments:

- Although the State may request an analysis of fuel, the Section is satisfied and has no reason to request such an analysis due to lack of complaint or concern for fuel performance. There have been no issues to date and should a problem come to the attention of the Section, an analysis will be requested.
- The Section will continue to work with DAS Purchase and Property, the originators of the contracts, to establish the consumption-reporting requirement.
- The Section has not pressed for the 48-hour delivery clause as provided for in the contract and instead works with the vendors to find mutually beneficial solutions as a result of storm delays and other variables. Conversely, when tank levels are consumed faster than Section Foreman recognize, the vendor will be contacted and without hesitation will insure immediate delivery.
- The contract fixed price was effective October 11 and this finding was the result of a vendor order that was delivered October 11 at the old index rate. This issue was the result of timing and the Section fully implemented the change in cost the following day. The Section in the future will work to ensure that changes are implemented more timely.

Observation No. 6: Policies And Procedures Addressing The Purchase Of Biodiesel Fuel Should Be Established

Observation:

The Section has not established policies and procedures necessary to ensure compliance with RSA 228:24-a, II, regarding the purchase of diesel fuel containing biodiesel.

Pursuant to RSA 228:24-a, II, which became effective January 1, 2009, "The commissioner shall only purchase diesel fuel that contains at least 5 percent biodiesel, as defined in RSA 362-A:1-a, I-b, except if such fuel is unavailable or is more costly than 100 percent petroleum diesel, in

which case such purchase shall be at the discretion of the commissioner. The commissioner, when using such discretion, shall consider at a minimum any savings related to equipment maintenance and longevity that may result from biodiesel use.”

According to RSA 362-A:1-a, I-b, “[b]iodiesel’ means a renewable diesel fuel substitute that is composed of mono-alkyl esters of long chain fatty acids, is derived from vegetable oils or animal fats, and meets the requirements of the American Society for Testing and Materials (ASTM) specification D6751.”

The Section reports it has not performed a cost analysis to determine if including a biodiesel requirement in its fuel purchase contract would exceed the cost of purchasing 100% petroleum diesel product. While the Section noted vendors may include up to 5% biodiesel in their diesel products without disclosure, in accordance with ASTM International Standards D975-08A, the Section was unaware of whether the product it purchased during the audit period included biodiesel.

According to the Section, the Department of Administrative Services, Bureau of Purchase and Property, is ultimately responsible for the content of the State-wide fuel contracts and the biodiesel requirement was not in the contract in effect during the audit period.

Recommendation:

The Section should establish policies and procedures for performing periodic analyses of the costs and benefits of including biodiesel requirements in its fuel purchase contracts. The analysis should consider, at a minimum, potential savings related to equipment maintenance and longevity that may result from biodiesel use.

Auditee Response:

We concur.

Currently the ASTM standards, and laws (Federal and State) allow diesel fuel to include a bio component up to 5%, and be sold as straight diesel. With the mandate of Ultra Low Sulfur Diesel (USLD), vendors need to include a bio component to meet industry standards of lubricity and cetane. The Section will develop a policy and procedure to perform periodic analysis of the cost benefits associated with the minimum biodiesel requirement.

Observation No. 7: Information Technology System Accountability Controls Should Be Strengthened

Observation:

The Section has not established strong accountability controls over its information technology (IT) systems to reasonably ensure IT system integrity, including the data contained in, and reported by, those systems.

1. Three of the six Section employees, including all Section business office employees, have administrator-level access to the Section's primary fuel sales IT system. In addition, a former employee who was transferred to another area of the Department, and Department IT personnel providing support to the Section also have administrator access to the fuel sales system. The Section reports full access to the IT system was given to employees to facilitate a 2009 implementation of related software. Allowing employees unnecessary administrator access authority to an IT system presents a significant risk to the effectiveness of all IT system controls.

All users with administrator access, including the three Section users noted above, have the ability to "zero-out" transactions without a secondary review. While it is the Bureau's informal policy to document all zero-corrections made, there is no thorough review of daily activity to ensure that documentation is on file for every zero-dollar transaction processed and there is no requirement for that documentation to be reviewed and approved. Auditors were unable to determine whether three of ten zero-dollar transactions reviewed were valid or were inappropriately zeroed-out.

2. The Section utilizes database applications developed in-house for billing and tracking fuel purchases. While access to these applications is somewhat secured through the use of secured folders, the applications were not password protected during the nine months ended March 31, 2012.

Recommendation:

The Section should strengthen the accountability controls over its IT systems. Policies and procedures should be established and followed to ensure accountability controls, including user passwords, are properly established, used, and maintained.

1. The assignment of administrative-level access should be extremely limited. An adequate segregation of duties should exist, supported by appropriate IT access authorities, to prevent or detect unauthorized data use, damage, loss, or modification.

All zero-dollar transactions should be subject to a documented review and approval control.

2. Password controls should be used for all significant IT systems. User access should be regularly managed and cancelled or modified in a timely manner upon an employee's termination, transfer, and change in job responsibilities.

Auditee Response:

We concur in part.

1. Current administrative-level access reflects the Section's need to balance limited staff resources to the need to operate the fuel distribution system. The Section will further review the need to limit administrative-level access and limit as recommended if there is no compromise in operations.

Zero-dollar transactions will be subject to a documented review and approval process as recommended.

2. User access will be cancelled in a more timely manner.

As indicated, the Section will further review administrative-level access and implement the other recommendations by October, 2012.

Observation No. 8: Manuals And Handbooks Should Be Current

Observation:

The Section's user manuals and customer handbook issued in 2003 were not current as of March 31, 2012. The Section's operating manuals for the automated and manual fueling sites and the customer handbook were in the process of being revised during the audit period.

The lack of current and comprehensive user manuals and customer handbook increases the risk that important information will not be effectively and consistently conveyed to the Section's site operators and customers.

The fiscal year 2001 audit recommended the Section prepare a customer handbook.

Recommendation:

The Section should continue its updating of the operating manuals and customer handbook.

The manuals and handbook should be expanded as appropriate to include provisions not previously included in those documents to ensure timely and effective communication is maintained among Department employees responsible for fueling activities and all Fuel Distribution Section customers.

Auditee Response:

We concur.

As indicated, the Section is in the process of updating the manuals and customer handbook. Each site and customer will receive the manual and handbook and both will also be available on the Fuel Distribution intranet and internet websites. It is anticipated that this update will be completed by October, 2012.

State Compliance Comment

Observation No. 9: Policies And Procedures For Determining Eligibility For Tax-Free Fueling Privileges Should Be Reviewed And Formalized

Observation:

The Section has not established and implemented formal policies and procedures to reasonably ensure tax-free fuel sold at its sites is available only to statutorily authorized entities for statutorily authorized purposes. As a result, the Section may be inadvertently providing entities ineligible exemption from the State road toll (fuel tax).

RSA 228:24-a, I, authorizes the Department to sell motor fuels to “all departments and institutions of the state, political subdivisions of the state, eligible nonprofit corporations operating transportation under contract with the department of transportation for elderly or disabled persons, or for the general public and agencies of the federal government.”

RSA 260:52-e, I, provides “[e]ligible nonprofit corporations whose vehicles are registered in accordance with RSA 261:92 [government plates] shall be entitled to a refund of any tolls [State fuel tax] paid by them to the extent that their vehicles are being used exclusively for the transportation of elderly or disabled persons by virtue of a contract with the department of transportation.”

The Section’s “User Agreement” requires customers to certify fuel purchased through the Section is for the exclusive use of: 1. New Hampshire local government, 2. School bus while engaged in transportation of students and school employees, 3. School district, 4. School administrative unit, 5. Intercity bus engaged in furnishing transportation to the general public along regularly scheduled routes for compensation or nonscheduled routes if the bus seats 20 adults, not including the driver, operating under contract with the NHDOT, 6. Solid waste management district, or 7. Any other use that the user certifies is exempt from federal fuel excise taxes.

Customers claiming eligibility under condition number 7 are required to provide the Section with “proof” of exemption from federal fuel excise tax, such as an opinion letter from legal counsel or a certified public accountant. The Section refers questions concerning customer eligibility to the Department of Justice. However, in considering customer eligibility under condition 7, the Section does not also require customers to provide proof of exemption from State fuel-tax statutes.

The criteria for exemptions from the federal fuel tax are not exactly the same as the exemptions from the State fuel tax. For example, federal regulations allow federal fuel tax exemptions for the sale of fuel to a nonprofit educational organization for its exclusive use; however, State statute does not appear to provide a similar exemption from the State fuel tax. It is not clear that the Section’s consideration of customer eligibility under condition 7 has appropriately considered both federal and State tax.

A similar comment was included in the prior audit report.

Recommendation:

The Section should establish and implement formal policies and procedures to reasonably ensure tax-free fuel sold at its sites is available only to entities meeting **both** State and federal eligibility criteria for statutorily authorized purposes.

The Section should review whether the criteria it currently uses to determine customer eligibility for tax-free fuel is in compliance with State and federal regulations. The Section should seek advice from the Department's Bureau of Rail and Transit; Department of Safety, Road Toll Administration; and legal counsel to assist in this review. Upon the completion of the review, current customers should be compared to the criteria to ensure they remain eligible. The basis for the determination of each customer's eligibility should be documented.

The Section should establish policies and procedures for ongoing reviews for those customers whose continued eligibility is subject to ongoing contract performance or other similar conditions subject to change.

The Department of Safety Road Toll Administration should review RSA 260:52-e, I, to determine whether to request the statute be revised to include contracts for the transportation of the general public, which was added to RSA 228:24-a by Chapter 281:1, Laws of 2008.

The Section and the Department of Safety Road Toll Administration should consider whether other revisions to the State fuel-tax law should be requested to clarify criteria for the use of tax-free motor fuel.

Auditee Response:

We concur in part.

The Section did request and receive eligibility requirements from the NH Department of Justice back in 2007. As a result, the exemption certificate the Department of Administrative Services provides to the State fuel vendor was revised, RSA 228:24-a was amended to better reflect DOT practices, and a User Agreement requiring fuel system users to certify that they are using fuel exclusively for exempt purposes was drafted and implemented.

The Section will now seek further guidance from other agencies as recommended to ensure that fuel sold is available only to entities meeting both State and federal eligibility criteria. Once this criteria has been established, policies and procedures will be developed to facilitate on-going reviews of its customer base to ensure continued eligibility.

Department of Safety, Road Toll Administration Response:

The Department of Safety Road Toll Bureau (Bureau) concurs in part with the LBA finding.

The Bureau does not administer the federal fuel tax. While the Bureau is familiar with the federal fuel excise tax, it is not versed in all aspects of exemptions pertaining to non-profit entities that provide transportation for elderly, disabled persons, or the general public through contract with a state's Department of Transportation (DOT).

In accordance with RSA 260:32 the following governmental entities are exempt from the State's Road Toll.

1. The United States, its agencies or instrumentalities, and diplomatic or consular personnel certified by the U.S. Department of State;
2. The State of New Hampshire or its agencies;
3. Any city, town, county, school district, or village district.

There is no exemption in RSA 260:32 for non-profit entities that provide transportation services to the elderly, disabled, or the general public through a contract with the DOT. As noted in the observation, RSA 260:52-e does provide for a refund mechanism that enables non-profits with government plates that are contracted with the DOT to provide transportation services to the elderly and disabled persons. This does not include transportation to the general public.

While the Bureau is opposed to introducing an exemption for non-profits that have contracts with DOT within RSA 260:32, because it would cause an undue administrative burden on motor fuel distributors who are ultimately responsible for collecting and remitting the road toll to the Bureau, the Department is willing to work with DOT to seek an amendment to RSA 260:52-e that would add transportation of the general public as eligible for a refund.

The Bureau does not concur that the State's motor vehicle road toll statute needs to be further clarified. The Bureau has interpreted RSA 228:24-a such that it was the Legislature's intent to authorize DOT to sell fuel in this way and, based upon this statute, the Bureau has determined that DOT is in compliance with the Road Toll Law.



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Independent Auditor's Report

To The Fiscal Committee Of The General Court:

We have audited the accompanying Statement of Revenues and Expenditures – Governmental Funds of the Fuel Distribution Section (Section) of the New Hampshire Department of Transportation (Department) for the nine months ended March 31, 2012. This financial statement is the responsibility of the management of the Section and Department. 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 Section'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 of the Section 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 Section. The Statement of Revenues and Expenditures - Governmental Funds, does not purport to and does not constitute a complete financial presentation of either the Section 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 Section for the nine months ended March 31, 2012, 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 - Governmental Funds of the Section. 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 is the responsibility of management and was derived from and relates directly to the underlying accounting and other records used to prepare the financial statements. The information has been subjected to the auditing procedures applied in the audit of the financial statement and certain additional procedures, including comparing and reconciling such information directly to the underlying accounting and other records used to prepare the financial statement or to the financial statement itself, and other additional procedures in accordance with auditing standards generally accepted in the United States of America. 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 September 4, 2012 on our consideration of the Section'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

September 4, 2012

**STATE OF NEW HAMPSHIRE
FUEL DISTRIBUTION SECTION
STATEMENT OF REVENUES AND EXPENDITURES-GOVERNMENTAL FUNDS
FOR THE NINE MONTHS ENDED MARCH 31, 2012
(In Thousands)**

	<u>Highway Fund</u>	<u>Capital Projects Fund</u>	<u>Total</u>
<u>Revenues</u>			
Restricted Revenues			
Sale Of Fuel	\$ 11,466	\$ -0-	\$ 11,466
Total Restricted Revenues	<u>11,466</u>	<u>-0-</u>	<u>11,466</u>
Total Revenues	<u>11,466</u>	<u>-0-</u>	<u>11,466</u>
<u>Expenditures</u>			
Purchase Of Fuel	11,060	-0-	11,060
Salaries And Benefits	346	-0-	346
Maintenance	48	-0-	48
State-owned Equipment Usage Fees	34	-0-	34
Current Expenses	15	-0-	15
Equipment	8	-0-	8
Heat, Electricity, And Water	4	-0-	4
Consultants	2	-0-	2
Underground Fuel Tanks	-0-	494	494
Automated Fuel Systems	-0-	40	40
Total Expenditures	<u>11,517</u>	<u>534</u>	<u>12,051</u>
Excess (Deficiency) Of Revenues Over (Under) Expenditures	<u>(51)</u>	<u>(534)</u>	<u>(585)</u>
Other Financing Sources (Uses)			
Net Appropriations (Note 2)	-0-	534	534
Total Other Financing Sources (Uses)	<u>-0-</u>	<u>534</u>	<u>534</u>
Excess (Deficiency) Of Revenues And Other Financing Sources Over (Under) Expenditures And Other Financing Uses	<u>\$ (51)</u>	<u>\$ -0-</u>	<u>\$ (51)</u>

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

**STATE OF NEW HAMPSHIRE
FUEL DISTRIBUTION SECTION**

**NOTES TO THE FINANCIAL STATEMENT
FOR THE NINE MONTHS ENDED MARCH 31, 2012**

NOTE 1 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

The accompanying financial statement of the Fuel Distribution Section of the Department of Transportation 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 Transportation is an organization of the primary government of the State of New Hampshire. The accompanying financial statement reports certain financial activity of the Fuel Distribution Section (Section) of the Bureau of Highway Maintenance of the Department of Transportation (Department) of the State of New Hampshire (State).

The financial activity of the Section is accounted for and reported in the Highway and Capital Projects Funds in the State's Comprehensive Annual Financial Report (CAFR). Assets, liabilities, and fund balances are reported by fund for the State as a whole in the CAFR. The Section, as an organization of the primary government, accounts for only a small portion of the Highway and Capital Projects Funds and those assets, liabilities, and fund balances as reported in the CAFR that are attributable to the Section cannot be determined. Accordingly, the accompanying financial statement is not intended to show the financial position or fund balance of the Section in the Highway and Capital Projects Funds nor the changes in fund balances of the Section in those funds.

B. Financial Statement Presentation

The State and the Section 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 Section reports its financial activity in the funds described below.

Governmental Fund Type:

Highway Fund: The Highway Fund is used to account for the revenues and expenditures used in the construction and maintenance of the State's public highways and the supervision of traffic thereon.

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

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

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

D. Revenues And Expenditures

In the governmental fund financial statements, revenues are reported by source. For budgetary control purposes, revenues are further classified as either “unrestricted” (general purpose) or “restricted”. Unrestricted revenues are credited directly to the appropriate fund balance upon recording in the State’s accounting system. Pursuant to the State’s operating budget, unrestricted or general purpose revenues collected by an agency are not used as a direct source of funding for agency operations but are available to fund any activity accounted for in the fund. The recording of unrestricted revenues has no effect on an agency’s authorization to expend funds. The Section had no unrestricted revenue during the nine months ended March 31, 2012.

Restricted revenues are either by State law or by outside restriction (e.g. federal grants), available only for specified purposes and are credited to the agency’s accounting unit to which the restricted revenue is budgeted upon recording in the State’s accounting system. Restricted revenues recorded by an agency are direct sources of funding for budgeted agency operations (appropriations). Footnote I to the State Operating Budget generally requires agencies to reduce appropriations (authorizations to expend funds) in the event restricted revenues are anticipated to be less than the amount of budgeted restricted revenue.

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

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

E. Budget Control And Reporting

General Budget Policies

The statutes of the State 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 Highway Fund and other governmental funds, with the exception of the Capital Projects Fund and certain proprietary funds. 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 addition to the enacted biennial operating budget, the Governor may submit to the Legislature supplemental budget requests necessary to meet expenditures during the current biennium. Appropriation transfers can be made within a department without the approval of the Legislature; therefore, the legal level of budgetary control is at the departmental level.

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

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

Pursuant to RSA 228:24-a, I, the sale and purchase of motor fuel is accounted for in the Motor Fuel Inventory Fund, a revolving fund. Revenues and expenditures are not budgeted in a revolving fund. Expenditures are limited by the offsetting revenues into the fund.

F. Encumbrances

Contracts and purchasing commitments are recorded as encumbrances when the contract or purchase order is executed. Upon receipt of goods or services, the encumbrance is liquidated and the expenditure and liability are recorded. The Section's unliquidated encumbrance balance at March 31, 2012 was \$49,219 in the Highway Fund and \$601,020 in the Capital Projects Fund.

G. Estimates

The preparation of financial statements in conformity with GAAP requires management to make estimates and assumptions that affect the amounts reported in the financial statement and accompanying notes. Actual results could differ from those estimates.

NOTE 2 - NET APPROPRIATIONS

Net appropriations reflect appropriations for expenditures in excess of restricted revenue. Net appropriations are made from the fund balance of the Highway Fund.

NOTE 3 - POLLUTION REMEDIATION OBLIGATIONS

GASB Statement No. 49, Accounting and Financial Reporting for Pollution Remediation Obligations (PRO), requires governments to reasonably determine potential polluted sites and provides guidance regarding when to recognize PRO as a liability. Pollution liabilities of \$1.2 million were reported for underground fuel storage facilities at June 30, 2011. These liabilities were measured using the actual contract cost, where no changes in cost are expected, or a method that is materially close to the expected cash flow technique. Liability estimates are subject to change due to price increases or reductions, technology, or changes in applicable laws or regulations governing the remediation efforts. As of March 31, 2012, no significant changes in the liability calculation have occurred.

NOTE 4 - EMPLOYEE BENEFIT PLANS

New Hampshire Retirement System

The New Hampshire Retirement System is the administrator of a cost-sharing multiple-employer Public Employee Retirement System (The Plan) established in 1967 by RSA 100-A:2 and is qualified as a tax-exempt organization under Sections 401(a) and 501(a) of the Internal Revenue Code. The Plan is a contributory defined-benefit plan providing service, disability, death, and vested retirement benefits to members and beneficiaries. The Plan covers substantially all full-time state employees, public school teachers and administrators, permanent firefighters, and police officers within the state of New Hampshire.

Full-time employees of political subdivisions, including counties, municipalities, and school districts, are also eligible to participate as a group if the governing body of the political subdivision has elected participation. The Plan is divided into two membership groups. Group I consists of State and local employees and teachers. Group II consists of firefighters and police

officers. All assets are in a single trust and are available to pay retirement benefits to its members and beneficiaries.

Group I members at age 60 (age 65 for members beginning service on or after July 1, 2011) qualify for a normal service retirement allowance based on years of creditable service and average final compensation (AFC). The yearly pension amount is 1/60 (1.67%) of average final compensation multiplied by years of creditable service (1/66 of AFC times creditable service for members beginning service on or after July 1, 2011). AFC is defined as the average of the three highest salary years for members vested prior to January 1, 2012 and five years for members not vested on January 1, 2012. At age 65, the yearly pension amount is recalculated at 1/66 (1.5%) of AFC multiplied by years of creditable service.

Members in service with 10 or more years creditable service who are between age 50 and 60 or members in service with at least 20 or more years of service, whose combination of age and service is 70 or more, are entitled to a retirement allowance with appropriate graduated reduction based on years of creditable service.

Group II members who are age 60, or members who are at least age 45 with a minimum of 20 years of creditable service (age 50 with a minimum of 25 years of creditable service or age 60 for members beginning service on or after July 1, 2011) can receive a retirement allowance at a rate of 2.5% of AFC for each year of service not to exceed 40 years (2% of AFC times creditable service up to 42.5 years for members beginning service on or after July 1, 2011).

All covered Section 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.

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

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

In 2007, legislation was passed that permits the transfer of assets into the special account for earnings in excess of 10 1/2 percent as long as the actuary determines the funded ratio of the consolidated 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.

In fiscal year 2011, two pieces of legislation passed that impacted the special account. The first required an \$89 million transfer from the special account to the state annuity accumulation fund effective May 11, 2011. The other, required the balance remaining in the special account, less

funds set aside to comply with the temporary supplemental allowances required by RSA 100-A:41-d,III, to be transferred to the respective components of the State annuity accumulation fund, effective June 30, 2011. This resulted in an additional transfer from the special account to the State annuity accumulation fund totaling \$167.3 million.

The New Hampshire Retirement System issues a publicly available financial report that can be obtained by writing to them at 54 Regional Drive, Concord, NH 03301-8507 or from their web site at <http://www.nhrs.org>.

Funding Policy

The Plan is financed by contributions from the members, the State and local employers, and investment earnings. In fiscal year 2012, by statute, Group I members contributed 7.0% of gross earnings. Employer contributions required to cover that amount of cost not met by the members' contributions are determined by a biennial actuarial valuation by the system's actuary using the entry age normal funding method and are expressed as a percentage of gross payroll. The State funds 100% of the employer cost for all of the Section's employees enrolled in the Plan.

Chapter 224, Laws of 2011 (House Bill 2) directed the Board of Trustees of the New Hampshire Retirement System to recalculate employer contribution rates for State fiscal years 2012 and 2013 to reflect the requirements of amendments to RSA 100-A in the 2011 legislative session, which resulted in the use of two different contribution rates paid by the Section during the nine months ended March 31, 2012. The Section's normal contribution rate was 10.71% of the covered payroll for its Group I employees from July 1, 2011 through July 31, 2011 and 8.48% from August 1, 2011 through March 31, 2012. The Sections' normal contributions for the nine months ended March 31, 2012 were \$21,209.

Other Postemployment Benefits

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

The Section's Medical Subsidy normal contribution rate during the nine months ended March 31, 2012 was 1.60% of the covered payroll for its Group I employees. The Sections' contributions for the Medical Subsidy for the nine months ended March 31, 2012 were \$3,906.

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

The cost of the health benefits for the Section's retired employees and spouses is paid by the Department of Transportation using a Highway Fund appropriation.

**STATE OF NEW HAMPSHIRE
FUEL DISTRIBUTION SECTION
BUDGET TO ACTUAL SCHEDULE - HIGHWAY FUND
FOR THE NINE MONTHS ENDED MARCH 31, 2012
(In Thousands)**

	Original Budget <u>(12 Month)</u>	Actual <u>(9 Month)</u>	Favorable (Unfavorable) Variance
<u>Revenues</u>			
Restricted Revenues			
Sale Of Fuel (Note 1)	\$ 1,284	\$ 11,466	10,182
Total Restricted Revenues	<u>1,284</u>	<u>11,466</u>	<u>10,182</u>
Total Revenues	<u>1,284</u>	<u>11,466</u>	<u>10,182</u>
<u>Expenditures</u>			
Purchase Of Fuel (Note 1)	-0-	11,060	(11,060)
Salaries And Benefits	558	346	212
Maintenance	480	48	432
State-owned Equipment Usage Fees	34	34	-0-
Current Expenses	48	15	33
Equipment	31	8	23
Heat, Electricity, And Water	5	4	1
Consultants	127	2	125
In-State Travel	1	-0-	1
Total Expenditures	<u>1,284</u>	<u>11,517</u>	<u>(10,233)</u>
Excess (Deficiency) Of Revenues Over (Under) Expenditures	<u>-0-</u>	<u>(51)</u>	<u>(51)</u>
Other Financing Sources (Uses)			
Net Appropriations (Note 2)	-0-	-0-	-0-
Total Other Financing Sources (Uses)	<u>-0-</u>	<u>-0-</u>	<u>-0-</u>
Excess (Deficiency) Of Revenues And Other Financing Sources Over (Under)			

The accompanying notes are an integral part of this schedule.

**Notes To The Budget To Actual Schedule – Highway Fund
For The Nine Months Ended March 31, 2012**

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 Highway Fund and other governmental funds, 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 2012 as passed by the Legislature in Chapter 223, Laws of 2011, including the 2012 legislative approved \$28,448 reduction to Fuel Distribution Section's salaries and benefits budget amounts.

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 \$10,000 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 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 original budget column on the Budget to Actual Schedule - Highway Fund for the nine months ended March 31, 2012 represents the 12 month budget approved by Chapter 223, Laws

of 2011 (HB-1), including the 2012 biennium legislative approved reduction of \$28,448 to Section salaries and benefits. The variance column highlights differences between this original 12-month operating budget and actual revenues and expenditures for the nine months ended March 31, 2012.

Revenue variances are caused by actual revenue exceeding budget, generating a favorable variance, or actual revenue being less than budgeted, generating an unfavorable variance. A favorable expenditure variance results from actual expenditures for the reporting period being less than the amount budgeted for the fiscal year. The favorable expenditure variances represent a combination of available balances and unliquidated encumbrances. Unfavorable expenditure variances represent actual expenditures for the reporting period exceeding the amount budgeted for the fiscal year.

Unfavorable variances are expected for revenues and favorable variances are expected for expenditures when comparing nine months of actual revenues and expenditures to an annual budget.

The unfavorable expenditure variance on the Budget to Actual Schedule-Highway Fund reflects the Section using a revolving fund to account for motor fuel sales and purchases. Revenues and expenditures are not budgeted in a revolving fund. Expenditures are limited by the offsetting revenues and available balance in the revolving fund account.

Note 2 - Net Appropriations

Net appropriations reflects appropriations for expenditures in excess of restricted revenue. Net appropriations are made from the fund balance of the Highway Fund.

**STATE OF NEW HAMPSHIRE
FUEL DISTRIBUTION SECTION
SCHEDULE OF BUDGET AND EXPENDITURES – CAPITAL PROJECTS FUND
FOR THE NINE MONTHS ENDED MARCH 31, 2012
(In Thousands)**

<u>Chapter Law, Program</u>	<u>Budget</u>	<u>Expenditures July 1, 2011 - March 31, 2012</u>	<u>(Unaudited) Prior Period Expenditures</u>	<u>(Unaudited) Total Expenditures</u>	<u>(Unaudited) Unexpended</u>
Chapter 264:2, II, E, Laws Of 2007					
Fuel Center Computer System	\$ 800	\$ 40	\$ 620	\$ 660	\$ 140
Chapter 145:2, II, A, Laws Of 2009					
Chapter 253:2, III, A, Laws Of 2011					
Statewide Underground Fuel Tank Replacement	5,000	494	2,131	2,625	2,375
Chapter 145:2, II, C, Laws Of 2009					
Replacement Of Automated Fueling Sytem Phase 2	<u>500</u>	<u>-0-</u>	<u>-0-</u>	<u>-0-</u>	<u>500</u>
Total	<u>\$ 6,300</u>	<u>\$ 534</u>	<u>\$ 2,751</u>	<u>\$ 3,285</u>	<u>\$ 3,015</u>

The accompanying note is an integral part of this schedule.

**Note To The Schedule Of Budget And Expenditures - Capital Projects Fund
For The Nine Months Ended March 31, 2012**

Note - Capital Budget

Prior to May 2004, capital projects appropriations lapsed at the end of the biennium unless extended into 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.

Capital improvement projects Chapter 264:2, II E, Laws of 2007, and Chapter 145:2 II C, Laws of 2009, provided \$800,000 and \$500,000, respectively, for automated fueling system improvements.

Capital improvement projects Chapter 145:2 II A, Laws of 2009, and Chapter 253:2 III A, Laws of 2011, provided \$3 million and \$2 million, respectively, to replace single walled underground storage tanks owned and maintained by the Fuel Distribution Section.

Obligations incurred by contract are recorded as encumbrances when the contract is executed. Upon satisfactory fulfillment of the contracted services, the encumbrance is liquidated and the expenditure and liability are recorded. Subsequently, capital projects that have been allowed to legislatively lapse, will record expenditures in the following fiscal period to the extent contractual obligations were entered into prior to the project's lapse date.

Unexpended Expenditures For The Budget To Actual Schedule - Capital Projects Fund

The Schedule Of Budget And Expenditures - Capital Projects Fund shows unexpended funds at March 31, 2012 for the Section's automated fueling systems and underground fuel storage tanks of approximately \$3.0 million (**unaudited**) out of the \$6.3 million budgeted for those projects.

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APPENDIX - CURRENT STATUS OF PRIOR AUDIT FINDINGS

The following is a summary, as of September 4, 2012, of the current status of the observations contained in the financial and compliance audit report of the Fuel Distribution Section for the fiscal year ended June 30, 2001. The prior audit report can be accessed on-line at www.gencourt.state.nh.us/lba/AuditReports/FinancialReports/pdf/dotfuel2001_full.pdf.

	<u>Status</u>		
<i>Internal Control Comments</i>			
<i>Material Weakness</i>			
1. Fixed Asset Management System Should Be Established	●	●	○
<i>Other Reportable Conditions</i>			
2. Review Of Fuel Usage Should Be Performed (<i>See Current Observation No. 1</i>)	●	○	○
3. Procedures For Determining Eligibility For Tax-Free Fueling Privileges Should Be Reviewed And Formalized (<i>See Current Observation No. 9</i>)	●	○	○
4. Price Markup On Fuel Cost Should Be Based On Analysis Of Actual Costs Of Operations (<i>See Current Observation No. 4</i>)	●	○	○
5. Testing Program To Monitor Quality Of Fuel Purchases Should Be Implemented (<i>See Current Observation No. 5</i>)	○	○	○
6. Fuel-Storage Integrity Evaluations Should Be Documented	●	●	○
7. Continued Validity Of Fuel-Card Information Should Be Periodically Reestablished (<i>See Current Observation No. 1</i>)	○	○	○
8. Fuel Site Operating Guides Should Be Emphasized (<i>See Current Observation No. 8</i>)	●	○	○
9. Customer Handbook Should Be Prepared (<i>See Current Observation No. 8</i>)	●	○	○
10. Standardization/Policies For Initiating Reorders Should Be Established	●	●	●
11. Segregation Of Duties Over Equipment Controls Should Be Improved	●	●	●
12. Formal Policy For The Collection Of Accounts Receivable Should Be Established	●	●	○
13. Method Of Recording Recovery Of Operating Costs Should Be Changed To Prevent Overstatements Of Revenues And Expenditures	●	●	●
14. More Emphasis Should Be Placed On Determining Accurate Year-End Accounts Receivable Amounts	●	●	●
<i>Management Issues Comments</i>			
15. Long-Term Business Plan Should Be Developed (<i>See Current Observation No. 3</i>)	●	○	○
16. Policy Of Setting Separate Fuel Prices For Each Location Should Be Reviewed	●	●	●

<u>Status Key</u>				<u>Count</u>
Fully Resolved	●	●	●	5
Substantially Resolved	●	●	○	3
Partially Resolved	●	○	○	6
Unresolved	○	○	○	2

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