OLA

OFFICE OF THE LEGISLATIVE AUDITOR
STATE OF MINNESOTA

Financial Audit Division Report

Office of the Secretary of State

January 1, 2005, through December 31, 2006

July 13, 2007 **07-16**

Financial Audit Division

The Office of the Legislative Auditor (OLA) is a professional, nonpartisan office in the legislative branch of Minnesota state government. Its principal responsibility is to audit and evaluate the agencies and programs of state government (the State Auditor audits local governments).

OLA's Financial Audit Division annually audits the state's financial statements and, on a rotating schedule, audits agencies in the executive and judicial branches of state government, three metropolitan agencies, and several "semi-state" organizations. The division also investigates allegations that state resources have been used inappropriately.

The division has a staff of approximately forty auditors, most of whom are CPAs. The division conducts audits in accordance with standards established by the American Institute of Certified Public Accountants and the Comptroller General of the United States.

Consistent with OLA's mission, the Financial Audit Division works to:

- Promote Accountability,
- Strengthen Legislative Oversight, and
- Support Good Financial Management.

Through its Program Evaluation Division, OLA conducts several evaluations each year.

OLA is under the direction of the Legislative Auditor, who is appointed for a six-year term by the Legislative Audit Commission (LAC). The LAC is a bipartisan commission of representatives and senators. It annually selects topics for the Program Evaluation Division, but is generally not involved in scheduling financial audits.

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OLA
OFFICE OF THE LEGISLATIVE AUDITOR
State of Minnesota • James Nobles, Legislative Auditor

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Legislative Audit Commission

Members of the Legislative Audit Commission

The Honorable Mark Ritchie
Secretary of State

The Financial Audit Division conducted an audit of the Office of the Secretary of State for the period January 1, 2005, through December 31, 2006. Our audit scope included revenue, payroll, and administrative expenditures. Our objectives focused on a review of the office's internal controls over these financial activities and its compliance with applicable legal provisions.

The enclosed Report Summary highlights our overall audit conclusions. The specific audit objectives and conclusions for each area are contained in the individual chapters of this report.

We would like to thank the staff from the Office of the Secretary of State for their cooperation during this audit.

/s/ James R. Nobles	*/s/ Cecile M. Ferkul*
James R. Nobles Legislative Auditor	Cecile M. Ferkul, CPA, CISA Deputy Legislative Auditor

End of Fieldwork: February 28, 2007

Report Signed On: July 10, 2007

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Audit Participation

The following members of the Office of the Legislative Auditor prepared this report:

Cecile Ferkul, CPA, CISA	Deputy Legislative Auditor
Tom Donahue, CPA	Audit Manager
Joan Haskin, CPA, CISA	Auditor-in-Charge
David Westlund	Auditor

Exit Conference

We discussed the results of the audit with the following representatives of the Office of the Secretary of State at an exit conference on June 28, 2007:

Tom Durand	Assistant Secretary of State
Kathy Hjelm	Budget Director

Report Summary

Overall Conclusion:

The Office of the Secretary of State's internal controls generally were adequate, and the office complied with material finance-related legal provisions. However, the office had the following weaknesses in its operations:

Key Findings:

- Staff at the Office of the Secretary of State did not understand how to properly reconcile certain transactions on the state's accounting system with its business system. (Finding 1, page 6)
- The office lacked delegated authority for some of the personnel transactions it made. (Finding 3, page 10)
- The office did not adequately monitor some payroll transactions. (Finding 4, page 11)
- The office did not pay some mileage reimbursements in accordance with state travel policies. (Finding 5, page 12)

This report contained five findings related to internal control and legal compliance. The office resolved all five audit findings from our prior report.

Audit Scope

Audit Period:
January 1, 2005, to December 31, 2006

Programs Audited:

- Revenue
- Payroll
- Administrative Expenditures

Agency Background:

The Office of the Secretary of State has primary responsibility to ensure that elections are conducted in accordance with state legal requirements. The office operates a statewide network connecting all counties and allowing access to business loan and voter registration databases.

The office is funded by a General Fund appropriation and fees deposited into the Special Revenue Fund. Mary Kiffmeyer was the Secretary of State during the audit period. Mark Ritchie was elected Secretary of State in November 2006 and took office on January 2, 2007.

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Chapter 1. Introduction

The Office of the Legislative Auditor audits all constitutional offices every two years according to a Legislative Audit Commission policy. We conduct our audits at the mid-point and at the end of each constitutional officer's term.

Office of the Secretary of State Overview

Article V of the Minnesota State Constitution established the Office of the Secretary of State, which operates under *Minnesota Statutes* 2006, chapter 5. The Secretary of State is an elected position, serving a four-year term. Mary Kiffmeyer was the Secretary of State during the timeframe of our audit. Mark Ritchie is the current Secretary of State, beginning his term on January 2, 2007.

The main functions of the office include administering elections, recording business documents, financing statements for business loans, and filing and preserving the official documents of the state. The office operates a statewide network connecting all counties and allowing access to databases containing business loan financing statements and voter registration information.

The office receives a General Fund appropriation to finance the majority of its activities. In addition, the office collects fees from customers who pay for on-line access to the computerized Uniform Commercial Code Network. The office retains these fees and uses them to maintain the network. The office also collects receipts for business filings, records processing, farm liens, and surcharges. It records these collections in the General Fund as nondedicated receipts.[1] The office receives federal funding to implement the Help America Vote Act. The office records this activity in the Miscellaneous Special Revenue Fund. Our audit scope did not include these funds as we audited them as part of our annual federal audit work.

Table 1-1 provides a summary of the Office of the Secretary of State's financial activities for fiscal year 2006.

[1] Nondedicated receipts revert to the General Fund and are not available to fund the office's operations.

Table 1-1
Sources and Uses of Funds (Note 1)
Budget Fiscal Year 2006

Sources:	
State Appropriation	$5,905,000
Direct Access Receipts	1,021,123
Other Receipts	1,802
Balance Forward In From Fiscal Year 2005	190,179
Total Revenue	7,118,104
Refunds (Note 2)	(1,900)
Total Sources	$7,116,204
Uses:	
Payroll	$4,525,653
Professional and Technical Services	176,306
Communications	394,120
Space Rental	473,125
Supplies and Equipment	150,141
Printing and Advertising	362,287
Other	300,904
Total Expenditures	$6,382,536
Balance Forward Out to Fiscal Year 2007	733,668
Total Uses	$7,116,204

Note 1: Amounts do not include nondedicated receipts or Federal Help America Vote Act activity.
Note 2: This amount is a refund of contested name registration deposits (*Minnesota Statutes* 2006, 5.22).
Source: Minnesota Accounting and Procurement System for budgetary fiscal year 2006.

Audit Approach

We conducted our audit in accordance with *Government Auditing Standards* issued by the Comptroller General of the United States. Those standards require that we obtain an understanding of the office's internal controls relevant to the audit objectives. We used the guidance contained in *Internal Control-Integrated Framework*, published by the Committee of Sponsoring Organizations of the Treadway Commission,[2] as our criteria to evaluate agency controls. The standards also require that we plan the audit to provide reasonable assurance that the office complied with financial-related legal provisions that are significant to the audit. In determining the office's compliance with legal provisions, we considered requirements of laws, regulations, contracts, and grant agreements.

To meet the audit objectives, we gained an understanding of the Office of the Secretary of State's financial policies and procedures. We considered the risk of errors in the accounting records and noncompliance with relevant legal provisions. We analyzed accounting data to identify unusual trends or significant changes in financial operations and reviewed security clearances for various computer systems. We examined a sample of evidence supporting the office's internal controls and compliance with laws, regulations, contracts, and grant provisions.

[2] The Treadway Commission and its Committee of Sponsoring Organizations was established in the mid-1980s by the major national associations of accountants. One of their primary tasks was to identify the components of internal control that organizations should have in place to prevent inappropriate financial activity.

Chapter 2. Revenue

Chapter Conclusions

The Office of the Secretary of State's internal controls provided reasonable assurance that it accurately recorded revenue in the accounting records, adequately safeguarded receipts, and complied with significant finance-related legal provisions and management's authorizations. However, the office did not understand how to properly reconcile certain transactions on the state's accounting system to its business system. In addition, one employee had inappropriate security access to the state's accounting system.

For the items tested, the office complied with significant finance-related legal provisions concerning revenue.

Audit Objectives

Our review of revenue focused on the following questions:

- Did the Office of the Secretary of State's internal controls provide reasonable assurance that it accurately recorded revenue in the accounting records, adequately safeguarded receipts, and complied with significant finance-related legal provisions?

- For the items tested, did the office comply with the significant finance-related legal provisions concerning revenue?

Background Information

The Office of the Secretary of State collected revenue from three main business processes:

- Annual registrations, including fees for corporate registrations, reinstatements, nonprofit amendments, legal newspaper registrations, renewal of assumed names, and filing annual and biennial reports.

- Business services, primarily to provide a central depository for the public to register and obtain information related to businesses operating in Minnesota.

- Uniform Commercial Code Network and related fees to support its function as an information clearinghouse for liens recorded for businesses across the state.

In addition, the office collected other fees for special registrations and services, as provided in statute. The office deposited these receipts into the state's General Fund as nondedicated revenue; these receipts were not available to the office for spending. Table 2-1 summarizes nondedicated fee revenue by source for fiscal year 2006.

Table 2-1
Nondedicated Revenue by Source
Fiscal Year 2006

Annual Registrations	$ 2,915,410
Business Services	8,473,445
Uniform Commercial Code and Related Fees	2,525,296
Other	507,267
Net Revenue	$14,421,418

Source: Minnesota Accounting and Procurement System.

The office also collected direct access fees charged to business entities requesting electronic access to certain public records maintained by the office. Customers prepaid the office for fees associated with accessing the data. *Minnesota Statutes* authorize the office to deposit these fees as dedicated revenue[3] in the state's Special Revenue Fund. The office used this revenue to maintain the computerized network. These receipts totaled nearly $1,005,597 in fiscal year 2006.

Our audit of revenue identified the following issues:

1. Staff at the Office of the Secretary of State did not understand how to properly reconcile certain transactions on the state's accounting system with its business system.

The office incorrectly adjusted some revenue account balances recorded on the state's accounting system. Although the office performed a monthly reconciliation between its business system and the state's accounting system, staff did not have an adequate understanding of the reconciliation process or completely understand the business system reports used in the reconciliation. The office incorrectly believed that unresolved differences between the two systems were due to the timing of credit card transactions. However, the office's IT Division had incorrectly written a query that erroneously included revenue from credit card transactions on the reconciliation report.

Accounting staff adjusted the state's accounting system for the differences so the two systems would agree, moving amounts between the clearing account and other revenue accounts. Individual adjustments ranged from $20 to $3,300. However, no adjustments were necessary and should not have been made.

[3] Dedicated revenue can be retained by the office to supplement its operational resources.

Recommendation

- *The office needs to properly identify the transactions resulting in reconciling items and correctly determine the need for adjustments.*

2. One employee at the office had inappropriate security clearance to access the state's accounting system.

One employee had access to enter cash receipts on the state's accounting system but did not need the access to perform her job duties. The office was not aware that the employee had this security access. The employee counted the cash and checks and prepared the daily bank deposit. However, having security access to enter receipts into the accounting system increased the risk of errors or improprieties. Currently, another employee enters the cash receipts into the state's accounting system. State policy[4] requires that an agency limit an employee's access to the state's accounting system to only those duties essential to the position's responsibilities.

The office had a designated security liaison to work with the Department of Finance in matters relating to security access. The Department of Finance annually sends the liaison a report of employees and their security access. The liaison was to review the report ensuring employees had appropriate access and then sign and return the report to the Department of Finance. The office's security liaison stated that the security reports were difficult to understand.

Recommendations

- *The office should delete the employee's cash receipts access or develop mitigating controls.*

- *The office should work with the Department of Finance to gain a better understanding of the security access reports.*

[4] Department of Finance Policy 1101-07.

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Chapter 3. Payroll and Administrative Expenditures

Chapter Conclusions

The Office of the Secretary of State's internal controls generally provided reasonable assurance that it safeguarded assets and accurately recorded payroll and administrative expenditures in the state's accounting system. However, the office processed some unauthorized personnel transactions. In addition, the office did not adequately monitor Self Service Time Entry payroll transactions.

The office complied with significant finance-related legal provisions concerning payroll and administrative expenditures. However, the office did not set some wages in accordance with state rules and bargaining agreements. In addition, the office did not pay some mileage reimbursements in accordance with state travel policies.

Audit Objectives

Our review of payroll and administrative expenditures focused on the following questions:

- Did the Office of the Secretary of the State properly authorize payroll and administrative expenditures and accurately report these expenditures in the accounting records, in all material respects?

- For the items tested, did the office comply with significant finance-related legal provisions over payroll and administrative expenditures?

Payroll

Payroll, the largest expenditure category for the Office of the Secretary of State, included regular, part-time, overtime, and premium pay, as well as other benefits. Payroll expenditures were approximately $5.3 million and $5.6 million in calendar years 2005 and 2006, respectively. As of January 2007, the Office of the Secretary of State employed about 80 employees.

In 2005, the office began using the state's Self Service Time Entry to record actual hours worked by employees. Employees entered their hours on-line and then forwarded those hours to their supervisors for review and authorization. On the last day of the pay period, the supervisors electronically approved the hours worked.

Office of the Secretary of State

The office had appropriately separated the incompatible duties of the payroll officer and the personnel representative. The personnel representative entered human resources transactions into the state's payroll and personnel system and worked with employees on human resources matters. The payroll officer reviewed various payroll reports to ensure transactions were recorded correctly on the accounting system.

Other Administrative Expenditures

The Office of the Secretary of State incurred other administrative expenditures totaling $3.8 million and $2 million in calendar years 2005 and 2006, respectively. Table 1-1 shows the expenditures by category for fiscal year 2006. Significant decreases occurred from calendar year 2005 to 2006 for professional/technical services, equipment, and printing and advertising. This was due to the development of a new computer system in 2005 and printing costs related to elections. The office leased space in several buildings in the St. Paul area, including the State Office Building, the retirement systems building (Empire Building), and a storage area on Grove Street. The Department of Administration's Real Estate Management Division negotiated lease agreements on behalf of the office.

Our audit of payroll and administrative expenditures identified the following issues:

3. The office did not have authorization for some of the personnel transactions it made.

The office did not obtain approval from the Department of Employee Relations before processing/entering some personnel transactions in the state's payroll and personnel system. The office did not have the authority to process these transactions. We noted two instances where the office lacked delegated authority: First, the office hired some employees at a rate higher than allowed; second, the office promoted one employee to a pay rate higher than allowable.

- The office hired 16 employees at a compensation rate that was greater than allowed by the bargaining agreement. The new hires received compensation rates that ranged from approximately 13 to 64 percent over the minimum of the salary range or up to $11 over the allowable hourly rate. These higher compensation rates resulted in over $190,000 in overpayments during the audit period. *Minnesota Rules* 3900.2100 states "salary upon entry into civil service should usually be at the minimum rate for the classification. An appointing authority may make an appointment at the second or third step of a range or within 12 percent of the minimum rate for the class when the salary range does not contain steps." However, the office could have hired the employees at the higher rates with approval from the Department of Employee Relations.

- The office promoted one employee to a position with a rate higher than allowed by the bargaining agreement. The employee received a compensation rate of $31.46 per hour. According to the bargaining agreement, the highest rate the employee could have received was $28.64. During the period in which the employee was in the position, the employee was overpaid approximately $11,000.

At one time, the office had a personnel representative to whom the Department of Employee Relations had delegated the authority to process certain transactions, such as setting starting and promotion pay rates above the maximum. However, after this employee left in January 2005, the office mistakenly believed it retained this delegated authority. According to the Department of Employee Relations, the delegation of authority resides with the individual and not the office. Therefore, the office did not have the authority to process certain transactions once this employee left.

Recommendations

- *The office should obtain the Department of Employee Relations' approval or seek delegation of authority prior to processing human resources transactions.*

- *The office should work with the Department of Employee Relations to determine whether any funds should be recovered.*

4. The office did not adequately monitor self service time entry payroll transactions.

The office did not review a key system report available through the state's payroll system to ensure that biweekly payroll transactions were accurate. For each of the seven pay periods tested, there was no evidence of review of the self service time entry audit report. The office printed and filed the reports but did not review them. The Department of Finance policy PAY0017 requires agencies to review the self service time entry audit report. This report identifies transactions that bypassed key certification and authorization controls. It identifies employee timesheets either not completed by the employee or not approved by the employee's primary supervisor.

For seven pay periods tested, the self service time entry audit report identified 60 timesheets where employees did not certify their hours worked. Employees certify their timesheets when they check a box identifying the time sheet as "complete." If an employee does not check this box, or if someone other than the employee makes changes to the reported hours after the employee has certified them, the timesheet will appear on the audit report. It is the nature of this report to bring into question the payment for a service not certified by the provider of the service (employee) or the payment by the office for a service not authorized for payment by the supervisor.

Recommendation

- *The office should review self service time entry audit reports and document the resolution of exceptions noted.*

5. The office overpaid some mileage reimbursement claims.

The office overpaid the Secretary of State for mileage traveled beyond the limits established under state travel policies. The secretary received reimbursement for mileage from her residence to several locations. The mileage should have been calculated from the State Office Building, the secretary's permanent work location. For example, the secretary made six trips from her residence to the Minneapolis - Saint Paul International Airport. The secretary claimed reimbursement for 52 miles for a one-way trip. The distance from the State Office Building to the airport is eight miles. The secretary also received mileage reimbursement for six trips from her residence to the State Fair. The secretary recorded 47 miles for a one-way trip, where the distance from the office to the State Fair is five miles. According to the bargaining agreement, allowable mileage is the lesser of the mileage from the employee's residence to the first stop or from the employee's permanent work location to the first stop.

In addition, the Secretary of State requested reimbursement for some travel events in which the public purpose for the travel was unclear. For 17 events we reviewed, the public purpose of the trip was not adequately identified. These events included travel between the airport and home, various receptions, celebrations, and charity events.

Recommendations

- *The office should ensure all employee expense reports are adequately documented and paid in accordance with applicable bargaining agreements and state compensation plans. The office should ensure that the travel was work related.*
- *The office should calculate the amount of overpayment and seek reimbursement.*

Status of Prior Audit Issues
As of February 28, 2007

Most Recent Audit

Legislative Audit Report 05-40, issued in July 2005, examined certain activities of the Office of the Secretary of State for the two years ended December 31, 2004. The scope included revenue, payroll, and other administrative expenditures. The report contained one finding recommending the Office of the Secretary of State improve procedures when canceling contracts. The office implemented the recommendation. The report also contained four findings relating to the Help America Vote Act, which were resolved.

State of Minnesota Audit Follow-Up Process

The Department of Finance, on behalf of the Governor, maintains a quarterly process for following up on issues cited in financial audit reports issued by the Legislative Auditor. The process consists of an exchange of written correspondence that documents the status of audit findings. The follow-up process continues until Finance is satisfied that the issues have been resolved. It covers entities headed by gubernatorial appointees, including most state agencies, boards, commissions, and Minnesota state colleges and universities. It is not applied to audits of the University of Minnesota and quasi-state organizations, such as the metropolitan agencies or the State Agricultural Society, the state constitutional officers, or the judicial branch.

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MINNESOTA SECRETARY OF STATE OFFICE
Mark Ritchie, Secretary of State

July 9, 2007

James Nobles
Legislative Auditor
140 Centennial Building
658 Cedar Street
St. Paul, Minnesota 55155-1603

Dear Auditor Nobles:

As requested in your audit report for the Office of Secretary of State completed for the period ending December 31, 2006, the following is our response to the findings and recommendations along with plans for resolution or correction of the issues noted. We very much appreciated the professionalism and courtesy shown by your staff during their review and thank you and them for identifying areas for improvement in financial controls. While this audit period precedes my election to the Office of Secretary of State, I take seriously the need to make these corrections and resolve any issues.

The following actions have been or will be taken to make the recommended corrections to the noted items:

Audit Finding One: The reconciliation of the unresolved differences between the office's accounting system and the state's accounting system was done with an understanding that the differences were a result of the timing of certain events. It has been determined that the discrepancies were a result of the office's report not correctly accounting for the transactions. These problems have been corrected and staff is now aware of the proper process for reviewing the two reports and understands the adjustment actions to take in the event of a difference. The person responsible for resolution of this issue is Jenny Kurz and it is complete.

Audit Finding Two: In setting up security clearances for an employee in the Fiscal Unit, the Department of Finance access module assigned to that employee contained one authorization not needed by that employee which was in conflict with other authorities contained in the module. Steps have been taken to eliminate that specific authorization and the employee no longer has this conflict. The office better understands the system used to assign security clearances and will ensure against future potential conflicts found within modules. The changes have been made and documented by Kathy Hjelm.

Audit Finding Three: The office believed that it had delegated authorization to process certain employee transactions without the approval of the Department of Employee Relations because

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that delegation had not been rescinded pursuant to DOER Administrative Procedures #36 dated March 29, l982. If the delegation was, in fact, no longer authorized, pay rates established between January 2005 and December 2006 should have been submitted to DOER for approval. In setting each employee's pay rate, issues such as prior experience, educational qualifications, job market pressures, time-frame for completion of federal mandates, and internal equity were all considered by managers in the same manner as they would have been in a submission to the Department of Employee Relations for their approval.

In any case, the office has requested that DOER conduct a retroactive review based upon the justification used by the office for the pay rate decisions during this period. Appropriate actions will be taken based upon this review and Department of Employee Relations' policies.

All pay rate assignments since January 1, 2007 have been submitted to the Department of Employee Relations in cases where the rate proposed is over the minimum authorized to the office. At this time the office does not intend to seek delegated authority for personnel decisions and will continue to submit pay rate and other personnel issues to the Department of Employee Relations for their approval. The person responsible for resolution of this issue is Heidi Hartwig and it is anticipated that the issues will be resolved by August 1, 2007.

Audit Finding Four: The procedure for reviewing and monitoring payroll under the new employee self service time entry was not adequately understood when it was implemented and reports were not examined to identify discrepancies. Review of the reports would have shown that proper certification by employees did not, in some cases, take place and that corrections were made by supervisory employees without being certified to by employees. Procedures will be developed to ensure that employees properly certify their time and that any changes are documented and approved and that audit reports are examined and appropriate actions taken. The person responsible for resolution of this issue is Jenny Kurz and the changes will be completed and communicated to supervisors and employees by August 1, 2007.

Audit Finding Five: Mileage calculation and inadequate documentation of the purpose for certain travel were noted by the audit team in the case of several of the former secretary of state's requests for travel reimbursement. Mileage should have been calculated based upon the lesser of the distance from her home or office to the first and/or the final stop of the day that were eligible for travel reimbursement. In addition, certain events did not clearly state a purpose that justified a reimbursement. These issues are in the process of being communicated to former Secretary Kiffmeyer and appropriate clarification and/or reimbursement obtained from her. The person responsible for resolving this issue is Tom Durand and the target date for resolution is August 1, 2007.

Please call me if you have any questions or concerns.

Sincerely,

/s/ Mark Ritchie

Mark Ritchie
Secretary of State