O L A **OFFICE OF THE LEGISLATIVE AUDITOR**
STATE OF MINNESOTA

FINANCIAL AUDIT DIVISION REPORT

Office of the Secretary of State

Internal Control and Compliance Audit

January 1, 2007, through March 31, 2009

August 27, 2009 **Report 09-28**

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OFFICE OF THE LEGISLATIVE AUDITOR

State of Minnesota • James Nobles, Legislative Auditor

August 27, 2009

Senator Ann H. Rest, Chair
Legislative Audit Commission

Members of the Legislative Audit Commission

The Honorable Mark Ritchie
Secretary of State

This report presents the results of our internal control and compliance audit of the Office of the Secretary of State for the period January 1, 2007, through March 31, 2009.

We discussed the results of the audit with the Office of the Secretary of State's staff on July 30, 2009. The audit was conducted by Amy Jorgenson, CPA (Audit Manager) and Zach Yzermans, CPA (Auditor-in-Charge), assisted by auditors Sara Becker and Tyler Billig.

This report is intended for the information and use of the Legislative Audit Commission and the management of the Office of the Secretary of State. This restriction is not intended to limit the distribution of this report, which was released as a public document on August 27, 2009.

We received the full cooperation of the Office of the Secretary of State's staff while performing this audit.

/s/ James R. Nobles

James R. Nobles
Legislative Auditor

/s/ Cecile M. Ferkul

Cecile M. Ferkul, CPA, CISA
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Report Summary

Conclusions

The Office of the Secretary of State's internal controls were generally adequate to ensure that it safeguarded assets, produced reliable financial information, and complied with finance-related legal requirements. However, the office had some control weaknesses related to its receipt system access, overtime, and travel expenditures. For the items tested, the Office of the Secretary of State generally complied with finance-related legal requirements over its financial activities. However, we found some instances of noncompliance related to overtime and travel expenditures.

Findings

- The Office of the Secretary of State did not always approve employee overtime in advance. (Finding 1, page 7)

- The Office of the Secretary of State did not adequately control access to its receipts subsystem. (Finding 2, page 7)

- Prior Finding Partially Resolved: The Office of the Secretary of State did not pay some employee expense reimbursements in accordance with state travel policies. (Finding 3, page 8)

Audit Objectives and Scope

Objectives
- Internal Controls
- Legal Compliance

Period Audited
January 1, 2007, through March 31, 2009

Programs Audited
- Payroll Expenditures
- Travel Expenditures
- Administrative Expenditures
- Selected Receipts

Office of the Secretary of State

Office Overview

Article V of the Constitution of the State of Minnesota established the Office of the Secretary of State, which operates under *Minnesota Statutes*, Chapter 5. The Secretary of State is elected for a four-year term. Mark Ritchie was the Secretary of State during our audit scope and began his term on January 2, 2007. The main functions of the office included administering elections and recording and preserving various business and government documents. The office operated a statewide computer network that connected counties and allowed access to databases containing business registrations and voter registration information.

The office received a General Fund appropriation to finance the majority of its activities. In addition, the office collected fees from customers who paid for on-line access to the computerized Uniform Commercial Code Network. The office also collected receipts for business filings, records processing, farm liens, and surcharges. It recorded these collections in the General Fund as nondedicated receipts.[1]

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

Table 1 summarizes the office's financial activity for the period July 1, 2007, through June 30, 2008.

Table 1
Summary of Financial Activity
Fiscal Year 2008[1]

Sources	**General Fund**	**Special Revenue Fund**	**Miscellaneous Agency Fund**	**Gift Fund**
Operating Appropriations:				
Secretary of State	$6,150,000	$ 0	$ 0	$ 0
Real Estate Task Force	25,000	0	0	0
Transfers In:				
Technology Carry Forward	0	40,600	0	0
Help America Vote Act	0	1,368,667	0	0
Balance Forward In	0	5,835,173	100	0
Receipts	2,600	2,815,552	(100)	102,900
Total Sources	$6,177,600	$10,059,992	$ 0	$102,900
Uses				
Payroll	$3,820,729	$ 1,497,862	$ 0	$ 10,343
Other Administrative Costs	1,168,182	1,445,230	0	43,636
Rent	373,478	90,896	0	142
Travel	36,663	2,017	0	0
Other Uses – Balance Forward Out	426,502	6,007,366	0	48,779
Other Uses – Transfers Out	352,046	1,016,621	0	0
Total Uses	$6,177,600	$10,059,992	$ 0	$102,900

[1] Our audit scope was January 1, 2007, through March 31, 2009. This scope included the last half of fiscal year 2007, all of fiscal year 2008, and a portion of fiscal year 2009. This table presents activity from the only full fiscal year in our audit scope (2008).

Source: Minnesota Accounting and Procurement System.

Objectives, Scope, and Methodology

Our audit of the Office of the Secretary of State's payroll, travel, administrative expenditures, and selected receipts focused on the following audit objectives for the period of January 1, 2007, through March 31, 2009:

- Were the entity's internal controls adequate to ensure that it safeguarded its assets, complied with legal requirements, and produced reliable financial data?

- Did the entity comply with finance-related legal requirements?

- Did the entity conduct its financial operations in a prudent manner?
- Did the entity resolve prior audit findings?

To answer these questions, we gained an understanding of the office's financial policies and procedures. We considered the risk of errors in the accounting records and noncompliance with relevant legal requirements. We analyzed accounting data to identify unusual trends or significant changes in financial operations. We examined samples of transactions and evidence supporting the agency's internal controls and compliance with laws, regulations, policies, and contracts.

We conducted the audit in accordance with generally accepted government auditing standards. Those standards require that we plan and perform the audit to obtain sufficient, appropriate evidence to provide a reasonable basis for our findings and conclusions based on our audit objectives.

We used various criteria to evaluate internal control and compliance. We used as our criteria to evaluate agency controls the guidance contained in the *Internal Control-Integrated Framework*, published by the Committee of Sponsoring Organizations of the Treadway Commission.[2] We used state and federal laws, regulations, and contracts, as well as policies and procedures established by the departments of Management and Budget[3] and Administration and the agency's internal policies and procedures as evaluation criteria over compliance.

Conclusions

The Office of the Secretary of State's internal controls were generally adequate to ensure that it safeguarded assets, produced reliable financial information, and complied with finance-related legal requirements. However, the office had some control weaknesses related to its receipt system access, overtime, and travel expenditures.

For the items tested, the Office of the Secretary of State generally complied with finance-related legal requirements over its financial activities. However, we found some instances of noncompliance related to overtime and travel expenditures.

[2] The Treadway Commission and its Committee of Sponsoring Organizations were established in 1985 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. The resulting *Internal Control-Integrated Framework* is the accepted accounting and auditing standard for internal control design and assessment.

[3] The Department of Management and Budget consists of the former departments of Finance and Employee Relations.

The office resolved four audit findings from the prior audit report related to receipts, payroll, and security access.[4] The office partially resolved one travel finding related to internal control and compliance.

The following *Findings and Recommendations* provide further explanation about the exceptions noted above.

[4] Office of the Legislative Auditor, Financial Audit Division Report 07-16, *Office of the Secretary of State*, issued July 13, 2007.

Findings and Recommendations

Finding 1

The Office of the Secretary of State did not always approve employee overtime in advance.

The office did not consistently document overtime requests and approvals for its employees. State policy requires advance approval for all nonemergency overtime to ensure the cost is justified and necessary.[5] From January 1, 2007, through March 31, 2009, the office incurred overtime and compensatory time costs totaling about $42,000.

A sample test of 13 overtime payments identified 12 payments (for 322 overtime hours totaling about $9,600) where the office did not have adequate request or approval documentation to support the time paid.

Without a process in place to document special circumstances for overtime and provide management approval in advance, there is an increased risk that the office could incur unnecessary costs.

Recommendation

- *The office should require documentation of advance request and approval for employee overtime requests to ensure compliance with state policy.*

Finding 2

The Office of the Secretary of State did not adequately control access to its receipts subsystem.

The Office of the Secretary of State used a business receipts subsystem to supplement the information recorded on the state's accounting system. The office allowed 25 employees to have the ability to edit or modify client banking information contained in the subsystem; the office used this banking information to obtain receipts electronically. The office reviewed banking information changes each month, but an employee who also had the ability to modify this sensitive information was the person responsible for the review.

Limiting system access is an internal control designed to prevent or promptly detect errors or fraudulent activities. If it is not feasible to adequately limit access, compensating controls or an independent review should be implemented.

[5] Department of Management and Budget Operating Policy and Procedure PAY0012.

Due to the significant receipt activity that takes place daily and the current development of a new receipt subsystem, which will have a focus on collecting more electronic transactions, it is important that the office thoroughly assess its risks and controls related to this area. State policy requires that business risks and internal controls be identified, analyzed, and documented.[6]

Recommendations

- *The office should ensure that it limits employee access to sensitive customer information or that independent reviews exist to monitor the activity.*
- *The office should assess the business risks and internal controls related to its receipts process.*

Finding 3

Prior Finding Partially Resolved:[7] The Office of the Secretary of State did not pay some employee expense reimbursements in accordance with state travel policies.

The office did not always have adequate documentation to support mileage and other employee expense reimbursement claims. Other claims did not comply with collective bargaining units or other applicable agreements, rules, or regulations.[8] During our audit scope, employee expense reimbursements totaled about $45,000.

The office had the following weaknesses in the 19 employee expense reports we tested:

- On three expense reports, the office reimbursed employees $84 for 160 ineligible miles. The office did not appropriately apply collective bargaining agreement rules about determining the amount of reimbursable mileage or paid for mileage that exceeded official mileage between travel points.
- The office did not comply with the state's policy requiring separate reporting of city-to-city trip miles and local mileage. Separating these mileage readings allows a supervisor to better judge the reasonableness of miles claimed.
- On four expense reports, the office reimbursed $48 for meals in which the required time information was not recorded. According to state travel

[6] Department of Management and Budget Policy 0102-01.
[7] Office of the Legislative Auditor, Financial Audit Division Report 07-16, *Office of the Secretary of State*, issued July 13, 2007 (Finding 5).
[8] Department of Management and Budget Operating Policy and Procedure PAY0021.

policy, the time of departure or arrival must be documented when claiming breakfast or dinner, respectively.

Recommendations

- *The office should require employees to support mileage claims with point-to-point measurements and to separately report trip and local miles on the expense reimbursement forms. Employees should also document departure and arrival times to ensure correct reimbursement for meals.*

- *The office should seek reimbursement for the ineligible miles we noted. For those employees who claim large mileage amounts, the office should look for other instances of excessive mileage claims and seek reimbursement from those employees as well.*

Comments About the Secretary of State's Response

In the response that follows, Jim Gelbmann, Deputy Secretary of State, asserts that the Office of the Secretary of State received conflicting direction as it attempted to resolve a mileage reimbursement issue raised in OLA's 2007 audit of the office. Mr. Gelbmann suggests that Finding 3 is based on an interpretation of a state mileage reimbursement policy that is different from the interpretation provided to the office in 2007 by an employee of the Department of Employee Relations.

We acknowledge that some of the state's mileage reimbursement policies can be confusing, and we appreciate Mr. Gelbmann's diligence in trying to apply them correctly. To resolve Finding 3, we recommend the Office of the Secretary of State apply the standard articulated by the commissioner of Management and Budget in response to Mr. Gelbmann's recent inquiry. Commissioner Hanson said that while the policy in question did not specifically address mileage reimbursement claims that occur on weekends and holidays, "the more routine application of the [state's] reimbursement policy would be to reimburse an employee for the lesser of the two mileage calculations." Commissioner Hanson's statement is consistent with OLA's understanding and was the basis for the mileage reimbursement issue raised in Finding 3.

Finally, we want to clarify that OLA did not audit, as Mr. Gelbmann suggests, the methodology used by the Office of the Secretary of State in 2007 to seek a repayment of mileage reimbursement overpayments made to former Secretary of State Kiffmeyer. During our recent audit, we confirmed that the office sought and obtained a repayment from Ms. Kiffmeyer. We later learned from Mr. Gelbmann that the amount of the repayment was calculated based on the advice the office received in 2007 from an employee in the Department of Employee Relations, which was incorrect. However, given the time frame of this audit, misinformation from the Department of Employee Relations about the standard that should be used, and the fact that Ms. Kiffmeyer made a substantial repayment, we did not recommend a recalculation of the amount Ms. Kiffmeyer should have repaid. However, the absence of a recommendation from OLA does not preclude the Office of the Secretary of State from taking that action if it chooses.

STATE OF MINNESOTA
Office of Minnesota Secretary of State
Mark Ritchie

August 18, 2009

Mr. James R Nobles
Legislative Auditor
Office of the Legislative Auditor
140 Centennial Building
658 Cedar Street
Saint Paul, Minnesota 55155

Dear Auditor Nobles:

On behalf of the staff of the Office of the Secretary of State, I want to thank you and the members of your staff who recently completed an audit of this office's internal controls and compliance with state laws, rules, regulations and policies, as well as an audit of this office's compliance with its own policies and procedures. Auditors Amy Jorgenson, Zach Yzermans, Sara Becker and Tyler Billig demonstrated a high degree of professionalism and respect for our employees and our mission. This audit was complicated by the mandatory U.S. Senate recount, both relative to one finding and relative to the level of activity created by the recount while the audit fieldwork was in progress.

This office is pleased that your report concludes, "the Office of the Secretary of State's internal controls were generally adequate to ensure that it safeguarded assets, produced reliable financial information, and complied with finance-related legal requirements." Much of the credit for this overall assessment goes to Finance Director Kathy Hjelm and Fiscal Services Accounting Supervisor Jenny Kurz in this office. These individuals have over 40 years of combined experience maintaining the Secretary of State's internal controls and compliance with all applicable laws, rules, procedures and policies.

Despite the hard work and dedication of Ms. Hjelm and Ms. Kurz, this office recognizes the implications of the three findings contained in your Report. This office is already in the process of addressing your findings. Internal policies have been established to address some areas your audit states need improvement. In addition, staff have been instructed on proper procedures to address several of the errors that resulted in these findings.

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<u>Finding Number One</u>

The Office of the Secretary of State did not always approve employee overtime in advance.

Recommendation

The office should require documentation of advance request and approval for employee overtime requests to ensure compliance with state policy.

Response

The Office of the Secretary of State has already revised its internal policy to better control overtime expenses. The policy, which requires the advance written approval of the Deputy Secretary of State, goes beyond the requirements of state policy, which would allow office managers to approve these requests. However, given the fiscal situation facing the state, we believe this extra layer of review and approval will help reduce the need for overtime expenditures. **This new overtime approval policy is already in place.**

The past year has been unique for the office. Prior to November 4, 2008, this office had relatively small amounts of overtime. In all cases, the overtime incurred was requested prior to its actual use either orally or in writing and approved by the employee's immediate supervisor or manager.

During the Senate recount, a unique situation occurred. Due to the volume of work needed to be done, our MAPE election staff often found themselves staying late into the evening. Under normal circumstances, additional hours are considered part of the job under the MAPE contract. However, the frequency of oral requests for overtime became an issue. When it was brought to my attention, I established a temporary compensatory time policy similar to the one used by the Minnesota House of Representatives during legislative sessions. This office's temporary policy stated that during any two-week pay period, the first four hours of overtime do not count toward an employee's comp time bank. Any overtime hours worked in addition to the first four would be compensated with 40 minutes of comp time for every overtime hour worked. This temporary policy helped improve employee morale during a time of high stress. **These changes have already been made.**

The persons responsible for continued resolution of this issue are Jenny Kurz and me.

<u>Finding Number Two</u>

The Office of the Secretary of State did not adequately control access to its receipts subsystem.

Recommendation

The office should ensure that it limits employee access to sensitive customer information or that independent reviews exist to monitor activity.

Response

The office established an independent review of the monthly Client Maintenance Log, which contains all client maintenance edits. The Business Center Manager now receives a monthly Client Maintenance Log, which is reviewed and approved via e-mail. In addition, any IT related ACH payment edits in the client maintenance application will be reviewed by the QA/Production Support Supervisor, or in his absence, the CIO (Chief Information Officer.) The QA/Production Support Supervisor along with the Business Center supervisors will continually monitor staff having access to the Client Maintenance application and make necessary changes. **These changes have already been made.**

This office's current Profile system is intertwined with various other functions, which include payment edits; therefore, several staff require access to the Client Maintenance application in order to perform other functions of their job such as submitting batch entries and scanning individual filings. This office is currently re-writing the Profile system; therefore, we are breaking out the various functionalities in particular where payment edits are involved. This change will allow us to further limit the number of staff who have access to ACH payment edits.

The persons responsible for continued resolution of this issue are Kathy Hjelm and Jenny Kurz.

Recommendation

The office should assess the business risks and internal controls related to its receipts process.

Response

The office is conducting a risk assessment for the receipts process as well as other financial related items in the agency. In conjunction with the assessment, the office is compiling a Financial Risk Assessment Document that will include internal controls related to the receipts process. **This risk assessment will be completed by October 31, 2009.**

The persons responsible for resolution of this issue are Kathy Hjelm and Jenny Kurz.

<u>Finding Number Three</u>

Prior Finding Partially Resolved: The Office of the Secretary of State did not pay some employee expense reimbursements in accordance with state travel policies.

Recommendation

The office should require employees to support mileage claims with point-to-point measurements and to separately report trip and local miles on the expense reimbursement forms. Employees should also document departure and arrival times to ensure correct reimbursement for meals.

Response

The office recognizes that several employees need to be better trained in state policies related to travel reimbursement. While this office is working to correct inadvertent errors made by staff, we believe further clarification is warranted relative to the state travel reimbursement policy that contributed to this finding.

On July 10, 2007, while working on a response to your previous audit, Heidi Hartwig, our Human Resources Director, was advised by the Department of Employee Relations that an employee should consider their home as their temporary work location on weekends and holidays, and calculate any weekend and holiday mileage for state business from their home. This is the standard that was used to recover excess mileage expenses from former Secretary Kiffmeyer, the individual cited in your 2007 audit. Due to the advice our office received from the Department of Employee Relations, no excess mileage reimbursements were recovered for travel by former Secretary Kiffmeyer when the travel occurred on weekends and holidays.

Our office continued to use the advice we received from the Department of Employee Relations for calculating weekend and holiday mileage for managerial employees during the current administration. Unfortunately, several of the examples of excess mileage reimbursements referenced in your Report occurred on weekends (11-17-2007, 3-2-2008 and 10-19-2008). Your Report alleges the miles for these trips should have been calculated from the Office of the Secretary of State, not from the employee's home.

This interpretation is contrary to what our office was told by the Department of Employee Relations. It is also contrary to the methodology used to determine Secretary Kiffmeyer's reimbursement; a methodology that we believe was audited by your office. While completing field work for the 2009 audit, your auditors reviewed the reimbursement amount collected from former Secretary Kiffmeyer when reviewing documentation on our follow-up to your 2007 audit findings.

I have discussed our concerns relative to weekend mileage with individuals within Minnesota Management and Budget and your auditors, Amy Jorgenson and Zach Yzermans. Mr. Yzermans suggested I seek written clarification from Minnesota Management and Budget. The following is the response I received from Chad Thuet, Assistant State Negotiator/Compensation Manager at Minnesota Management and Budget:

> Hi Jim,
>
> Thank you for your email. Unfortunately, neither my colleagues nor I can recall giving clarification on mileage reimbursements for weekends or holidays. That does not mean that it didn't happen, just that we couldn't find anything in writing or otherwise to confirm having given clarification on the matter. You have asked me for something in writing regarding the eligibility for mileage reimbursement from home to attend a work event on a day they weren't otherwise expected to be in the office.

> I think that from a reasonableness standard, and in recognizing that the Managerial Plan does not take into account the uncommon circumstance in which an employee may have to attend an event on a day they wouldn't otherwise drive their normal commute, it would be reasonable for an employer to reimburse an employee's mileage expenses from home to the work event or activity if the event occurred on a day they wouldn't otherwise drive their normal commute, and when the employee has been authorized or directed to attend on behalf of their employer (in other words, the employer benefits directly from having the employee attend the event or activity).
>
> I hope this helps.
>
> Chad
>
> Chad N. Thuet
> Assistant State Negotiator/Compensation Manager
> Human Resource Management Unit
> Minnesota Management & Budget (MMB)

Yesterday, Commissioner Hanson followed up with another e-mail on this topic:

> Jim,
>
> We've reviewed the information that you provided regarding the potential audit finding on mileage reimbursement. Current staff do not have any recollection of discussing this issue with Heidi Hartwig, and it appears that the conversation may have been with a staff member who has since left the agency.
>
> As Chad Thuet noted in his e-mail to you, the manager's plan does not specifically address reimbursement for mileage on a weekend or holiday. Although the more routine application of the reimbursement policy would be to reimburse an employee for the lesser of the two mileage calculations, it is possible that the Secretary's office received different advice from our agency's former employee, and then acted on that advice in good faith.
>
> Discussions with staff in the various MMB divisions involved in administration of travel reimbursement suggest that clarification is needed on this point and we will do so at our next opportunity.
>
> Tom Hanson | Commissioner
> Minnesota Management & Budget (MMB)

Although Auditor Amy Jorgenson questions whether the Department of Employee Relations was the appropriate Department to contact in July, 2007, for advice on mileage reimbursements, the individual at the Department did not correct Ms. Hartwig, nor did she decline to offer her advice. Ms. Hartwig further notes that the Department of Employee Relations has routinely provided training on mileage reimbursement procedures.

This office agrees that its employees can always benefit from additional training on state policies relating to expense reimbursements. While our Office believes the audit finding relative to weekend travel was the direct result of our Office acting in good faith on advice from the Department of Employee Relations, we will go back and re-calculate all mileage using the new weekend and holiday formula that you recommend. We further agree with Commissioner Hanson that this state policy needs clarification and hope that this can be accomplished soon to avoid future disputes and the high cost of continued confusion among agencies.

All managers will be required to provide additional training to all staff relative to expense and mileage reimbursement procedures. This training will include review of all state and office policies regarding the accurate accounting for mileage, the inclusion of all stops made during travel (including the number of miles between each stop), and the accurate reporting of departure and arrival times to ensure correct reimbursement for meals. **This training will be completed by September 30, 2009. Fiscal staff will also be more watchful for inadvertent errors made on expense reimbursement forms.**

The persons responsible for resolution of this issue are Beth Fraser, Ted Lautzenheiser, Kathy Hjelm, Gary Poser, Jenny Kurz and me.

Recommendation

The office should seek reimbursement for the ineligible miles we noted. For those employees who claim large mileage amounts, the office should look for other instances of excessive mileage claims and seek reimbursement from those employees as well.

Response

Fiscal staff will review all expense reimbursements dating back to January 1, 2007 and will request reimbursement for any excess mileage claimed. **This task will be completed by September 18, 2009.**

The persons responsible for resolution of this issue will be Jenny Kurz (primary responsibility) and me.

My best regards.

Sincerely,

/s/ *Jim Gelbmann*

Jim Gelbmann
Deputy Secretary of State