OLA **OFFICE OF THE LEGISLATIVE AUDITOR**
STATE OF MINNESOTA

FINANCIAL AUDIT DIVISION REPORT

Office of the Secretary of State

Internal Controls and Compliance Audit

January 2011 through June 2013

November 15, 2013 **Report 13-29**

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November 15, 2013

Senator Roger Reinert, Chair
Legislative Audit Commission

Members of the Legislative Audit Commission

The Honorable Mark Ritchie, Secretary of State
Office of the Secretary of State

This report presents the results of our internal controls and compliance audit of the Office of the Secretary of State for the period from January 1, 2011, through June 30, 2013. The objectives of this audit were to determine if the office had adequate internal controls for its financial operations and complied with finance-related legal requirements.

We discussed the results of the audit with the office's staff at an exit conference on November 1, 2013. This audit was conducted by Scott Tjomsland, CPA, CISA (Audit Manager), Kelsey Nistler, CPA (Auditor-in-Charge), and auditors Heather Varez, CPA, and Jessie Hon.

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

James R. Nobles
Legislative Auditor

Cecile M. Ferkul, CPA, CISA
Deputy Legislative Auditor

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Report Summary

Conclusion

The Office of the Secretary of State generally had adequate internal controls to ensure that it safeguarded its financial resources, accurately paid employees and vendors in accordance with management's authorizations, complied with finance-related legal provisions, and created reliable financial data. For the items we tested, the office generally complied with finance-related legal requirements. However, the office had some internal control weaknesses and instances of noncompliance.

Findings

- The Office of the Secretary of State's review of payroll transactions did not ensure that salary increases were authorized or that some employee compensation was accurately paid. (Finding 1, page 7)

- The Office of the Secretary of State did not perform physical inventories of its fixed assets. (Finding 2, page 9)

Audit Objectives and Scope

Objectives
- Internal controls
- Legal compliance

Period Audited
January 1, 2011, through June 30, 2013

Audited Areas
- Payroll expenditures
- Selected administrative expenditures
- Selected receipts

Office of the Secretary of State

Agency Overview

The Office of the Secretary of State is a constitutional office in the executive branch of state government.[1] The main functions of the office, as defined by state statute, include administering elections; preserving documents filed with the state; providing certain business services to the public; and maintaining the recording of financing statements under the Uniform Commercial Code. The office operates a statewide computer network allowing counties to access databases containing business registrations, certain business loan financing statements, and voter registration information. The office also administers the Safe at Home Program to protect the location of domestic violence victims or others who fear for their safety.[2]

The Secretary of State is elected for a four-year term. Mark Ritchie was first elected as the Secretary of State in November 2006 and was re-elected in November 2010.

The office receives a General Fund appropriation to finance the majority of its operating activities, including the Safe at Home Program. In addition, the office collects business filing fees, Uniform Commercial Code filing fees, notary fees, and other miscellaneous fees. Most of those fees get deposited into the General Fund as nondedicated receipts;[3] however, state statutes allow the office to deposit a portion of those fees into a special revenue fund and use that money to offset the costs of providing services.[4] Finally, the office receives grants from the federal government for enhancements to Minnesota's election systems and procedures.

Table 1 summarizes the office's appropriations, receipts, and expenditures for fiscal years 2012 and 2013.

[1] *Minnesota Constitution* Article V.
[2] *Minnesota Statutes* 2013, Chapters 5 and 5B.
[3] Nondedicated receipts revert to the General Fund and are not available to fund the office's operations.
[4] *Minnesota Statutes* 2013, 336.1-110, 336.9-525, and 5.24.

Table 1
Appropriations, Receipts, and Expenditures
July 1, 2011, through June 30, 2013[1]

	Fiscal Years	
Appropriations	2012	2013
General Fund	$ 5,474,000	$ 5,829,000
Receipts		
Fees – Nondedicated General Fund	$12,975,682	$15,090,864
Fees – Dedicated Special Revenue Fund	1,472,122	2,653,381
Grants	1,239,339	811,244
Total Receipts	$15,687,143	$18,555,489
Expenditures		
Payroll	$ 4,688,644	$ 4,795,000
Purchased Services	2,049,001	2,339,329
Supplies/Equipment[2]	111,398	729,495
Grants	194,316	248,489
Other Expenditures	282,366	93,740
Total Expenditures	$ 7,325,725	$ 8,206,053

[1] The scope of our audit also included fiscal year 2011 activity from January 2011 through June 2011.
[2] The office replaced and upgraded old servers and computers in fiscal year 2013.

Source: State of Minnesota's accounting system.

Our prior audit of the office did not report any internal control weaknesses or instances of noncompliance.[5]

In October 2012, two legislators asked our office to assess the legality of state officials (including the Secretary of State) using public money or other public resources to advocate against proposed constitutional amendments. In a memorandum dated January 23, 2013, we concluded that state law does not establish a clear standard for determining whether it is legal for a state official to use public resources to support or oppose a proposed amendment once it is approved by the Legislature and becomes a ballot question. We recommended that the Legislature consider establishing a clear standard in law.[6]

In September 2013, we were asked by several legislators to review the Secretary of State's authority to implement an online voter registration system and the sufficiency of that system's information security controls to protect not public

[5] Office of the Legislative Auditor, Financial Audit Division, Report 11-19, *Office of the Secretary of State*, issued July 14, 2011. The report covered the period from January 2009 through December 2010.
[6] Office of the Legislative Auditor memorandum, January 23, 2013, *Use of Public Money and Resources for Advocacy on Ballot Questions*.

data. In a memorandum dated October 10, 2013, to the legislators, we referenced a legal analysis on the authority issue prepared by an attorney at the House of Representatives Research Department.[7] We indicated that the analysis provided legislators with a professional, nonpartisan assessment of the issue, and we did not think an analysis by OLA was necessary. Our memorandum to the legislators also indicated that we would consider a future information technology audit to assess the adequacy of the online voter registration system's security controls.

Objective, Scope, and Methodology

The objective of our audit of the Office of the Secretary of State for the period of January 1, 2011, through June 30, 2013, was to answer the following questions:

- Did the Office of the Secretary of State have adequate internal controls to ensure that it safeguarded its financial resources, accurately paid employees and vendors in accordance with management's authorizations, complied with finance-related legal provisions, and created reliable financial data?

- Did the Office of the Secretary of State comply with significant finance-related legal requirements?

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 potential noncompliance with relevant legal requirements. We obtained and analyzed the office's accounting data to identify unusual trends or significant changes in financial operations. We examined samples of financial transactions and reviewed supporting documentation to test whether the office's controls were effective and if the transactions complied with laws, regulations, policies, and contract provisions.

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 objective.

We used various criteria to evaluate internal controls 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.[8] We used state laws, regulations, and

[7] Office of the Legislative Auditor memorandum, October r10, 2013, *Online Voter Registration*.
[8] 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.

contracts, as well as policies and procedures established by the office and the Department of Management and Budget as evaluation criteria over compliance.

Conclusion

The Office of the Secretary of State generally had adequate internal controls to ensure that it safeguarded its financial resources, accurately paid employees and vendors in accordance with management's authorizations, complied with finance-related legal provisions, and created reliable financial data. For the items we tested, the office generally complied with finance-related legal requirements. However, the office had some control weaknesses and instances of noncompliance.

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

Findings and Recommendations

Finding 1

The Office of the Secretary of State's review of payroll transactions did not ensure that salary increases were authorized or that some employee compensation was accurately paid.

The review of payroll transactions performed by the office did not verify the authorization or accuracy of performance-based salary increases and did not detect some payroll errors. State policy requires the review of the payroll register each pay period as a primary control to ensure the authorization and accuracy of payroll transactions.[9] The different terms and conditions of the state's various employee bargaining agreements and personnel plans increases the risk that errors could occur.

The Secretary of State's staff reviewed the payroll register each pay period, but the review was not effective because the office did not have sufficient documentation to support the following transactions:

- Salary Increases - Staff reviewing the payroll register did not verify that salary increases were paid as authorized. The office did not have any documentation of the Secretary of State's authorization of performance-based increases effective January 2012 and January 2013.[10] The only documentation for the performance-based salary increases, effective June 2011, was an e-mail from one of the employees that received an increase stating that the Secretary of State had authorized the increases. Without documentation, staff performing the payroll register review could not validate the authorization for salary increases included on the payroll register or assure that the increases were accurately entered into the state's payroll system.

  The Secretary of State told us that he had authorized all of the performance-based salary increases; however, there was no documentation to support the authorization. Other than the lack of documented authorization, the increases complied with the terms of the applicable bargaining agreements or personnel plans.

  Staff reviewing the payroll register also did not verify that employees' annual "step" increases were paid as provided for in the applicable

[9] Minnesota Management and Budget Policy PAY0028, *Agency Verification of Payroll and Human Resources Transactions.*
[10] The Managerial Plan and Commissioner's Plan provide for performance-based salary increases at the discretion of the appointing authority.

bargaining agreements.[11] The office contracted with the Department of Administration for human resources services, and the Department of Administration provided these increases automatically, without specific authorization from the Secretary of State.[12] In January 2013, the Department of Administration discovered that it inappropriately gave an annual "step" increase in September 2012 to an employee covered by the Commissioner's Plan, even though the Commissioner's Plan did not provide that type of an increase. The Department of Administration decided not to adjust the employee's salary because it believed the employee was eligible for performance-based salary increases in 2012 and 2013, but did not obtain authorization from the Secretary of State for that decision; in fact, the office was not aware of the error until we informed them during the audit.

- Staff reviewing the payroll register did not verify the accuracy of employees' overtime payments or compensatory time accruals.[13] They did not consider the differing overtime and compensatory time compensation rates that employees were eligible for depending on the applicable bargaining agreement or personnel plan. Our testing of all overtime and compensatory time transactions identified that the office underpaid an employee about $420 for 20 hours of overtime and 15 hours of compensatory time because it used the wrong rate.

- Staff reviewing the payroll register did not validate the accuracy of lump sum payments, such as severance or retroactive payments, because it did not compare documentation of those payment calculations to the actual payments. The office overpaid $34 for severance to one employee when it paid the employee for 100 percent of the sick leave balance, instead of the 40 percent allowed.[14]

The lack of documentation for salary increases and other types of payments weakened the effectiveness of the payroll register review because staff performing the review could not validate that pay increases and other payments entered into the state's payroll system were authorized or entered accurately. The review of the payroll register report is a fundamental internal control to ensure the authorization and accuracy of the state's payroll transactions.

[11] Some bargaining agreements, including the American Federation of State, County and Municipal Employees and Minnesota Association of Professional Employees, include an increase to the next "step" in an employee's salary range on the anniversary of the employee's position start date, provided the employee has had satisfactory performance evaluations.
[12] The Department of Administration's Small Agency Resource Team provided the services.
[13] Employees may be compensated at the rate of time and one half or straight time for overtime and compensatory time, depending on each employee's employment contract and position.
[14] Minnesota Association of Professional Employees employment contract, article 13, section 1, provides for severance pay equal to 40 percent of the first 900 hours of the unused sick leave balance.

Recommendations

- *The office should provide staff reviewing the payroll register with the documentation needed to ensure that all payroll payments are authorized and accurate, including authorizations for salary increases, applicable overtime and compensatory time rates, and support for the calculation of severance payments.*

- *The office should review the salary of the employee that received an inappropriate "step" increase and determine if any salary adjustments are necessary.*

- *The office should resolve the overtime underpayment and the severance overpayment with the affected employees.*

Finding 2

The Office of the Secretary of State did not perform physical inventories of its fixed assets.

As of September 2013, the office had not completed a physical inventory of its fixed assets since 2010. The office's policy is to conduct annual physical inventories of fixed assets. However, since converting to the state's new accounting system in July 2011, the office had been unable to obtain fixed asset inventory reports needed to perform the physical inventories. In October 2013, the office told us it had recorded all its assets (approximately 900 assets totaling about $3.7 million) on its own inventory system, rather than using the fixed asset module in the state's new accounting system. Performing periodic physical inventories is a fundamental internal control to safeguard fixed assets against theft and loss.

Recommendation

- *The office should perform physical inventories of its fixed assets.*

STATE OF MINNESOTA
Office of Minnesota Secretary of State
Mark Ritchie

November 8, 2013

James R. Nobles
Legislative Auditor
140 Centennial Building
658 Cedar Street
Saint Paul MN 55155

Dear Auditor Nobles,

This letter constitutes the response of the Office of the Secretary of State (OSS) to the recently concluded Office of the Legislative Auditor's (OLA) Internal Controls and Compliance Audit.

As an organization with a financial model that differs from many state agencies due to the large number of revenue transactions in our day-to-day operations, audits such as these are always a window into improvements we can make to that operating model. We appreciate the time, effort and professionalism of the audit staff assigned to this office.

In this audit, there were two findings. The findings relate to personnel and inventory issues. Our response to the recommendations made as a result of those findings is set forth below.

OSS notes that there were no findings with respect to the hundreds of thousands of transactions that the public has with our office, and the many millions of dollars in fees they pay, for filing and information retrieval services and for other services provided by OSS each year. This underscores the ongoing commitment over many decades that OSS has to insuring that our internal systems are accurate in all aspects, and especially in dealings with the public. We appreciate the audit process as a way of assuring that these transactions are handled properly, efficiently and with the public's trust in mind.

Finding 1.

The Office of the Secretary of State's review of payroll transactions did not ensure that salary increases were authorized or that some employee compensation was accurately paid.

Recommendations:

180 State Office Building | 100 Rev. Dr. Martin Luther King, Jr. Blvd. | Saint Paul, MN 55155-1299
Phone: 651-201-1324 or 1-877-600-8683 | Fax: 651-215-0682 | MN Relay Service: 711
E-mail: secretary.state.@state.mn.us | Web site: www.sos.state.mn.us

The office should provide staff reviewing the payroll register with the documentation needed to ensure that all payroll payments are authorized and accurate, including authorizations for salary increases, applicable overtime and compensatory time rates, and support for the calculation of severance payments.

The office should review the salary of the employee that received an inappropriate "step" increase and determine if any salary adjustments are necessary.

The office should resolve the overtime underpayment and the severance overpayment with the affected employees.

OSS agrees with the recommendations.

With respect to the first recommendation, OSS has already instituted a greater level of scrutiny for all payroll register, salary increase, overtime and compensatory time rates as well as severance payments. This greater scrutiny will help to insure the accuracy of all of these transactions. The OSS Fiscal Services supervisor will be receiving a report from Department of Administration (SmART), this report lists any employees that are eligible for increases or have a probation end date within the next two months. This report will be reviewed by the Fiscal Services Supervisor and notes will be made regarding affected pay periods. After the payroll has processed, SmART will provide the Transaction report that indicates the SEMA4 changes. The Fiscal Services Supervisor will compare the two reports to verify that the correct SEMA4 entry was done by SmART, as well as reviewing the Payroll Register and sign off on them. The Increase/Probation End Date report, Transaction Report, Payroll Register and any other related items, including worksheets for calculating retroactive pay, vacation or sick leave payouts, or other types of salary- or leave- related adjustments will be given to the Business Services Manager & Budget Director for final review and approval.

With respect to the second recommendation, OSS will undertake a review of the entire transaction history for the employee in question and based upon that review will determine the appropriate action, if any, to be taken with respect to salary adjustments. This review will be conducted in conjunction with the Department of Administration (SmART), with which OSS contracts for human resources services.

With respect to the third recommendation, OSS has calculated the underpayment and overpayment amounts and has made arrangements for a payment to the former employee who was underpaid and has sent a letter to that former employee notifying them of this payment, and has sent a letter to the former employee who was overpaid requesting the remittance of the overpayment to the State.

Persons Responsible for Implementation: Jenny Kurz, Fiscal Services Supervisor and Kathy Hjelm, Business Services Manager and Budget Director
Date Projected for Completion of All Items: November 30, 2013

Finding 2.

The Office of the Secretary of State did not perform physical inventories of its fixed assets.

Recommendation:

The office should perform physical inventories of its fixed assets.

OSS agrees with the recommendation.

With respect to this recommendation, OSS has already commenced, prior to the date of this response, a physical inventory of the fixed assets of the office using the information available from the Financial Asset Information System (FAIS), the predecessor to the SWIFT system; the SWIFT system contains the majority of the fixed asset information, but at this time and at all times covered by the audit, did not and does not yet permit the creation of reports from that system in order to conduct the physical inventory. OSS will conduct annual inventories using the FAIS until the SWIFT system module is functional and available to OSS for inventory purposes and will then proceed to using the information produced by the SWIFT system.

Persons Responsible for Implementation: Jenny Kurz, Fiscal Services Supervisor and Gerry Brakke, Infrastructure Division
Date Projected for Completion: December 31, 2013

Thank you for your time and effort on this audit.

Sincerely,

Mark Ritchie

Mark Ritchie
Secretary of State