

Audit Report

Office of the Secretary of State

June 2018



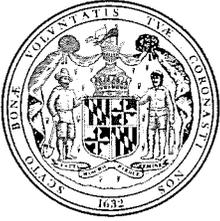
OFFICE OF LEGISLATIVE AUDITS
DEPARTMENT OF LEGISLATIVE SERVICES
MARYLAND GENERAL ASSEMBLY

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DEPARTMENT OF LEGISLATIVE SERVICES
OFFICE OF LEGISLATIVE AUDITS
MARYLAND GENERAL ASSEMBLY

Victoria L. Gruber
Executive Director

Thomas J. Barnickel III, CPA
Legislative Auditor

June 4, 2018

Senator Craig J. Zucker, Co-Chair, Joint Audit Committee
Delegate C. William Frick, Co-Chair, Joint Audit Committee
Members of Joint Audit Committee
Annapolis, Maryland

Ladies and Gentlemen:

We have conducted a fiscal compliance audit of the Office of the Secretary of State for the period beginning June 4, 2014 and ending December 4, 2017. Under the Maryland Constitution and State statutes, the Office performs a variety of duties including attesting to the Governor's signature on all public papers, registering and regulating charitable organizations, administering the Notary Public laws, and compiling and publishing the State's administrative regulations.

Our audit disclosed that the Office did not have adequate procedures to ensure that information reported by charitable organizations was accurately recorded and that the proper registration fees were paid. This reported information is used to monitor each organization's compliance with registration and reporting requirements and appears on the Office's public website. In addition, the Office did not establish adequate controls over its cash receipts to provide assurance that all collections were subsequently deposited.

The Office's response to this audit is included as an appendix to this report. We wish to acknowledge the cooperation extended to us by the Office during the course of this audit.

Respectfully submitted,

Thomas J. Barnickel III, CPA
Legislative Auditor

Background Information

Agency Responsibilities

The Office of the Secretary of State attests to the Governor's signature on all public papers and documents, and is the repository for the Governor's Executive Orders. The Office's many other duties and responsibilities include the following:

- The Charities and Legal Services Division registers, regulates, and informs the public about charitable organizations (including foundations affiliated with State agencies) and professional solicitors; administers the Notary Public laws and issues Notary Public commissions; registers trademarks; prepares and processes extraditions and requisitions issued by the Governor; and registers public offering statements for condominiums and timeshares.
- The Office's Division of State Documents compiles and publishes all of the State's administrative regulations in the Maryland Register and the Code of Maryland Regulations (COMAR).
- The Office's Safety and Support Services Division administers the Maryland Safe at Home Address Confidentiality Program, which is designed to protect victims of domestic violence by providing them an alternate mailing address to prevent offenders from locating them.

According to the State's records, the Office's operating expenditures during fiscal year 2017 totaled approximately \$3.2 million.

Status of Findings From Preceding Audit Report

Our audit included a review to determine the status of the three findings contained in our preceding audit report dated January 9, 2015. We determined that the Office satisfactorily addressed two of these findings. The remaining finding is repeated in this report.

Findings and Recommendations

Charitable Organizations

Finding 1

Procedures and controls were not sufficient to ensure that the Office of the Secretary of State accurately recorded critical data reported by charitable organizations, and that these organizations remitted the proper fees.

Analysis

The Office lacked adequate procedures and controls to ensure that critical information submitted by charitable organizations in their annual reporting, such as total annual contributions received, was accurately recorded, and that the proper registration fees were paid. Accurate recording is critical since this information is used to determine each organization's registration and reporting requirements and the amount of the annual registration fee, including if an organization is exempt from this fee. The recorded information also appears on the Office's public website. As of June 2017, the Office's records showed approximately 13,600 active charities. The Office recorded revenue from registration fees, renewal fees, and fines received from charities totaling approximately \$2.2 million during fiscal year 2017.

Office employees recorded contributions, payments, and other information in the Office's database from each charitable organization's annual reporting forms, and were responsible for ensuring that the proper registration fees were remitted based on that information. However, independent supervisory reviews were not performed to verify that these data had been accurately recorded and registration fees were, in fact, proper. Annual registration fees range up to a maximum of \$300 depending on the total contributions the organization received for the reporting year.

Our test of 20 charitable organizations as of January 2018 disclosed that, while the Office accurately recorded the most recent information reported by these charities, 2 of the charities submitted excess fees totaling \$400 and these overpayments were not detected by Office personnel. An independent supervisory review would be designed to detect these overpayments.

Recommendation 1

We recommend that the Office perform independent verifications to ensure that information reported by charitable organizations is accurately recorded in the Office's database and that the proper fees are collected from each organization.

Cash Receipts

Finding 2

Adequate controls were not established over cash receipts.

Analysis

The Office had not established adequate controls over its cash receipts. According to State records, the Office deposited approximately \$9.6 million during the period from July 1, 2014 through November 3, 2017, including \$1.1 million in credit card transactions. These collections primarily included charitable organization registration fees, notary commission fees, sales from publications, and certification fees. The Office collects certification fees, for example, for authenticating vital records, such as birth certificates, to be used for international transaction purposes.

- Only checks received for certification fees were restrictively endorsed and recorded immediately by the employee who opened the mail. This employee forwarded all remaining checks, which represented the vast majority of the Office's collections, to another employee for restrictive endorsement and recordation.
- The supervisory employee who approved voided transactions was not independent because this employee also had physical access to the related collections.
- Cash receipts were not verified to deposit by an independent employee. Rather, the employee who performed this function also had access to all collections, and was responsible for the initial recordation of the majority of the Office's receipts.
- The Office lacked procedures to verify that all credit card collections were deposited into the State's bank account. Credit card receipts were initially processed by a third-party credit card vendor. However, the office did not verify that all credit card receipts were properly credited to the State's bank account.

Under these conditions, errors or other discrepancies could occur without timely detection. The Comptroller of Maryland's *Accounting Procedures Manual* requires that checks be restrictively endorsed and recorded immediately upon receipt, and that the reconciliation of the initial record of all collections to the amount deposited be performed by an employee independent of the cash receipts function.

Similar conditions were commented upon in our preceding audit report. The conditions regarding immediate restrictive endorsement and verification of recorded collections to deposit were commented upon in our two preceding audit reports.

Recommendation 2

We recommend that the Office

- a. restrictively endorse (repeat) and record all checks immediately upon receipt;**
- b. ensure that a supervisory employee independent of the cash receipts process performs a documented review to verify the propriety of voided transactions (repeat); and**
- c. ensure that an employee independent of the cash receipts process verifies that all collections, including credit card transactions, are subsequently deposited and credited to the State's bank account (repeat).**

We advised the Office on accomplishing the necessary separation of duties using existing personnel.

Audit Scope, Objectives, and Methodology

We have conducted a fiscal compliance audit of the Office of the Secretary of State for the period beginning June 4, 2014 and ending December 4, 2017. The audit was conducted 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 believe that the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objectives.

As prescribed by the State Government Article, Section 2-1221 of the Annotated Code of Maryland, the objectives of this audit were to examine the Office's financial transactions, records, and internal control, and to evaluate its compliance with applicable State laws, rules, and regulations.

In planning and conducting our audit, we focused on the major financial-related areas of operations based on assessments of significance and risk. The areas addressed by the audit included charitable organizations, cash receipts, and equipment. We also determined the status of the findings contained in our preceding audit report.

Our audit did not include certain support services provided to the Office by the Executive Department – Governor. These support services (for example, maintenance of accounting records and related fiscal functions) are included within the scope of our audits of the Executive Department – Governor.

To accomplish our audit objectives, our audit procedures included inquiries of appropriate personnel, inspections of documents and records, observations of the Office's operations, and tests of transactions. Generally, transactions were selected for testing based on auditor judgment, which primarily considers risk. Unless otherwise specifically indicated, neither statistical nor non-statistical audit sampling was used to select the transactions tested. Therefore, the results of the tests cannot be used to project those results to the entire population from which the test items were selected.

We also performed various data extracts of pertinent information from the State's Financial Management Information System (such as revenue and expenditure data). The extracts are performed as part of ongoing internal processes established by the Office of Legislative Audits and were subject to various tests to determine data reliability. We determined that the data extracted from this source were sufficiently reliable for the purposes the data were used during this audit.

In addition, we extracted data from the Office's automated system used to record information relating to charitable organizations for the purpose of testing the Office's procedures for ensuring compliance with certain requirements in the law applicable to such organizations. We performed various tests of the relevant data and determined that the data were sufficiently reliable for the purposes the data were used during the audit. Finally, we performed other auditing procedures that we considered necessary to achieve our audit objectives. The reliability of data used in this report for background or informational purposes was not assessed.

The Office's management is responsible for establishing and maintaining effective internal control. Internal control is a process designed to provide reasonable assurance that objectives pertaining to the reliability of financial records, effectiveness and efficiency of operations including safeguarding of assets, and compliance with applicable laws, rules, and regulations are achieved.

Because of inherent limitations in internal control, errors or fraud may nevertheless occur and not be detected. Also, projections of any evaluation of internal control to future periods are subject to the risk that conditions may change or compliance with policies and procedures may deteriorate.

Our reports are designed to assist the Maryland General Assembly in exercising its legislative oversight function and to provide constructive recommendations for improving State operations. As a result, our reports generally do not address activities we reviewed that are functioning properly.

This report includes findings relating to conditions that we consider to be significant deficiencies in the design or operation of internal control that could adversely affect the Office's ability to maintain reliable financial records, operate effectively and efficiently, and/or comply with applicable laws, rules, and regulations. Our report also includes a finding regarding a significant instance of noncompliance with applicable laws, rules, and regulations.

The Office's response to our findings and recommendations is included as an appendix to this report. As prescribed in the State Government Article, Section 2-1224 of the Annotated Code of Maryland, we will advise the Office regarding the results of our review of its response.

APPENDIX

STATE OF MARYLAND

EXECUTIVE DEPARTMENT

LARRY HOGAN

GOVERNOR

BOYD K. RUTHERFORD

LT. GOVERNOR



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JOHN C. WOBENSMITH

SECRETARY OF STATE

May 30, 2018

Thomas J. Barnickel III, CPA
Legislative Auditor
State of Maryland
Office of Legislative Audits
State Office Building, Room 1202
301 West Preston Street
Baltimore, Maryland 21201

Dear Mr. Barnickel:

Thank you for providing me with a draft copy of the audit report to the members of the Joint Audit Committee regarding the audit of the Office of the Secretary of State for the period beginning June 4, 2014 and ending December 4 2017. The Office of the Secretary of State has cooperated openly and fully with the Office of Legislative Audits to ensure that the Maryland General Assembly, the Executive Branch, and the citizens of Maryland can have the highest confidence in their State government.

Described below are the responses of this Office to the audit findings and recommendations.

1. Charitable Organizations

We recommend that the Office perform independent verifications to ensure that information reported by charitable organizations is accurately recorded in the Office's database and that the proper fees are collected from each organization.

The Office of the Secretary of State concurs with the recommendation.

File Review: *The Charities & Legal Services Division did have supervisory review of forms and payments submitted. The Division Administrator has conducted a random file review of 15-20 files monthly since January 2017. He randomly selects and reviews files in the charities database to verify the data and financials are accurate. That said, a formalized process documenting the file review has since been established and implemented, which records the findings in an electronic file that is cross referenced in the case notes of those files reviewed.*

Fees: *Two (2) of twenty (20) files were identified as having an error in refunding money. In each case, the charity overpaid their registration fee; the original error was made by the charity. That said, an oversight resulted in a refund not being issued to the two charities identified. The Charities database is*

in the process of being modernized, which includes online registration and e-commerce functionalities. The e-commerce functionalities of the new database is expected to mitigate errors moving forward. Further, a random file review will continue, and corrective action taken, as appropriate. A formalized process documenting the file review has since been established and implemented, which records the findings in an electronic file that is cross referenced in the case notes of those files reviewed.

To clarify, refunds do not impact a charity's status on the SOS website. Therefore, the two (2) charities identified would have been accurately reported on the website.

Excellence is our goal. During the FY '14 Legislative Audit errors were found in 13 of the 15 files reviewed. The sample size increased by 13, 20 files were reviewed during the FY '18 Audit. While we strive for a 0 % error rate, an error in 10% of the files reviewed is a stunning 23% improvement over the FY '14 Audit. Our commitment to excellence is evident in the process improvements previously implemented, which are now formalized to mitigate future errors.

2. Cash Receipts

a. Restrictively endorse (repeat) and record all checks immediately upon receipt

The Office of the Secretary of State concurs with the recommendation. Established procedures are being followed to ensure all checks received via incoming mail are immediately stamped to read "Deposit Only – Secretary of State" and is part of the check sorting process. The Fiscal Officer regularly monitors mail processing and cash receipts to ensure all checks are restrictively endorse immediately when received.

b. Ensure that a supervisory employee independent of the cash receipts process performs a documented review to verify the propriety of voided transactions (repeat)

The Office has taken steps to ensure this recommendation is implemented. Currently void transactions are reviewed by the lead analyst via the daily Void / Non-Void report for accuracy and completeness. The lead analyst initials each voided transaction on the report. To meet this recommendation the fiscal officer has assumed the responsibility to review all voided transactions. Further, the Department of Information Technology (DoIT) will be tasked to modify the Daily Receipt Report – Void / Non-Void form from the database to display the justification for the voided transaction. The fiscal officer will initial each voided transaction after review.

c. Ensure that an employee independent of the cash receipts process verifies that all collections, including credit card transactions, are subsequently deposited and credited to the State's bank account (repeat).

The Office concurs and will enhance its processes to address this recommendation. Currently none of the finance reporting databases capture credit card transactions data for reporting. The Office will immediately task the Department of Information Technology (DoIT) to modify each finance reporting database to allow reporting of daily credit card transactions. Once DoIT has completed the database upgrade the reports will be reconciled against daily credit card receipts for verification. The fiscal officer will perform independent verification of all collections and ensure deposits are correctly credited to the State's bank. The process will be in place by June 30, 2018.

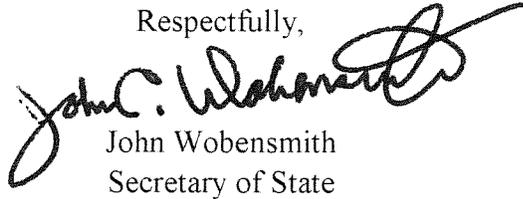
We advised the Office on accomplishing the necessary separation of duties using existing personnel.

The Office of the Secretary of State concurs and is currently taking steps to ensure adequate separation of duties responsibilities are assigned re-assigned to staff to meet requirements of State Accounting Procedures manual.

The Office of the Secretary of State appreciates the time and effort taken by the legislative audit team to conduct our audit. With each audit, the Office continues to make great progress discharging its multitude of duties and responsibilities by streamlining operations through improved technology, process analysis, and enhanced professional capabilities of our staff. We are very proud of our record of providing high quality service to the individuals and organizations subject to our administration and regulations, as well as to the citizens of Maryland.

Should you have any further questions about the audit, please contact my Assistant Secretary for Finance and Operations, Frederick Smalls, at 410-260-3853.

Respectfully,

A handwritten signature in black ink, appearing to read "John C. Wobensmith". The signature is fluid and cursive, with a large initial "J" and "W".

John Wobensmith
Secretary of State

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