

Office of the State Auditor
Division of State Audit

Secretary of State's Business Entity And
Accounting Systems
Bismarck, North Dakota

Information System Audit
For the Period January 1, 2002 through December 31, 2002

Client code 2700

Robert R. Peterson
State Auditor



TABLE OF CONTENTS

Transmittal Letter	1
Executive Summary	2
Background Information	3
Background Information.....	3
Accounting	4
Business Entity	4
Future Plans.....	5
Objectives, Scope, and Methodology	6
Are security controls surrounding the systems adequate?	7
Summary of Audit Work Performed	7
Audit Findings	7
Inadequate controls on sensitive screens	7
Inappropriate access rights for programmers.....	7
Auditor's Opinion.....	8
Do the input screens contain necessary edit checks?	9
Summary of Audit Work Performed	9
Audit Findings	9
Inadequate controls surrounding date fields	9
Auditor's Opinion.....	9
Are reports from the systems accurately prepared?	10
Summary of Audit Work Performed	10
Audit Findings	10
Inaccuracy of reports	10
Auditor's Opinion.....	10
Are late fees properly charged for annual reports?	11
Summary of Audit Work Performed	11
Audit Findings	11
Noncompliance with North Dakota Century Code Section 10-33-139	11
Auditor's Opinion.....	11
Is the status properly updated for business entities that fail to file annual reports?	12
Summary of Audit Work Performed	12
Audit Findings	12
Noncompliance with North Dakota Century Code Section 10-19.1-146	12
Auditor's Opinion.....	12

TRANSMITTAL LETTER

July 25, 2003

Honorable John Hoeven, Governor
Members of the North Dakota Legislative Assembly
Al Jaeger, Secretary of State

Transmitted herewith is the information system audit of the Business Entity and Accounting systems for the period January 1, 2002 to December 31, 2002. This audit resulted from the statutory responsibility of the State Auditor under NDCC section 54-10-01.

The Business Entity system is used to maintain records relating to business entity filings, licenses, and registrations. The Accounting system is used to record receipts and refunds and track accounts receivable.

The Business Entity system was selected for this audit because it is considered a high-risk information system for the state of North Dakota, according to the "State Information Technology Systems Risk Assessment" of all state computer systems, issued by the Office of the State Auditor on May 15, 2002. Risk was evaluated based on several factors, including, but not limited to, size and complexity of the system, sensitivity of the data, and regulatory requirements. "High-risk" does not necessarily indicate problems with the system, but indicates a higher potential for significant problems to occur.

The Accounting system was also included in this audit because it processes the accounting transactions related to business entity functions and is closely related to the Business Entity system.

Inquiries or comments relating to this audit may be directed to Donald LaFleur, Information Systems Audit Manager, by calling (701) 328-4744. We wish to express our appreciation to the Secretary of State for the courtesy, cooperation, and assistance provided to us during this audit.

Respectfully submitted,

Robert R. Peterson
State Auditor

EXECUTIVE SUMMARY

The purpose of this report is to provide our analysis, findings, and recommendations regarding our audit of the Business Entity and Accounting systems. This audit was primarily an information system audit; however, we also addressed operational issues related to the systems and their operation within the Secretary of State's office.

The Business Entity system is used to maintain records relating to business entity filings, licenses, and registrations. The Accounting system is used to record receipts and refunds, and track accounts receivable.

The Business Entity system was selected for this audit because it is considered a high-risk information system for the state of North Dakota, according to the "State Information Technology Systems Risk Assessment" of all state computer systems, issued by the Office of the State Auditor on Office May 15, 2002. Risk was evaluated based on several factors, including, but not limited to the, size and complexity of the system, sensitivity of the data, and regulatory requirements. "High-risk" does not necessarily indicate problems with the system, but indicates a higher potential for significant problems to occur.

The Accounting system was also included in this audit because it processes the accounting transactions related to business entity functions and is closely related to the Business Entity system.

Our audit resulted in the following significant findings:

- Inadequate controls on sensitive screens
- Inappropriate access rights for programmers
- Inadequate controls surrounding date fields
- Inaccuracy of reports
- Noncompliance with North Dakota Century Code section 10-33-139
- Noncompliance with North Dakota Century Code section 10-19.1-146

BACKGROUND INFORMATION

Background Information

In 1989, the Secretary of State commenced computerization of its manual recording systems. This effort was initiated on an AS/400 computer that was owned and maintained by the Secretary of State. Soon thereafter, because of data volume, the Secretary of State migrated to the AS/400 that is owned and operated by the Information Technology Department (ITD) of the state of North Dakota. Many additions and enhancements have been made to the programs since inception.

According to the Secretary of State, the automation of these functions has enabled their office to increase filings without an increase in the number of staff.

The Secretary of State maintains and operates many programs, all of which have been written in the RPG programming language and are customized to fit operations. The programs are integrated with each other and include the following:

- Accounting
- Contractor
- Business Entity
- Notaries
- Trade Name
- Trademark/Service Mark
- Partnership
- Fictitious Name
- Chemical Agent Appointment
- Complaints Inquiry
- Select Name
- Charitable Organization
- Public Document Inventory
- Lobbyist
- Miscellaneous Code File
- Management Reports
- Fundraiser/Solicitor

These programs were established to provide:

- Accurate, accessible, durable, and manageable records and transactions administered by the Secretary of State;
- Replacement of the manual certification, correspondence, filing and accounting processes;
- Improved workflow;
- Better utilization of the human resources of the agency; and
- Improved compliance with state laws by individuals and entities seeking licenses to operate in North Dakota.

The Select Name program contains the names of:

- Every individual or business name invoiced by the agency;
- Every business entity that is in some manner registered or licensed by the agency, or is a constituent or owner of a trade name, trademark or service mark, partnership, fictitious name, reserved name, chemical agent, or the subject of a complaint; and
- Every individual that is in some manner licensed or registered as a constituent or owner of a trade name, trademark or service mark, partnership, fictitious name, reserved name, chemical agent, or the subject of a complaint.

The Select Name program identifies all the recordings for the name selected, and allows for an accounting of payments that have been received from and/or applied to filings for the selected name.

While all of the programs identified above are critical to the operations of the agency, the comments of this background will relate to the accounting and business entity programs since these were the primary focus of this audit.

Accounting

The Accounting system replaced a manual process utilizing three-part numbered receipts.

In the automated system, each receipt is entered into the program and given a computer-generated validation number (receipt number) and a computer-generated work order number. Batch totals are computer-generated, reconciled, and entered into the mainframe.

Other features of the Accounting system include the ability to identify workload by individual or division within the Secretary of State's office, control the specific amount charged for a transaction, produce reports and queries identifying outstanding invoices and transaction history, and create revenue projections with the ability to focus on specific transactions.

Business Entity

The Business Entity system replaced a manual record system that was controlled with index cards for each entity and ledgers that had to be cross-referenced whenever an entity changed its name or ceased to exist. The index card was updated with every transaction filed by the entity.

The system is based on the Select Name program whereby a system ID is established for every business entity for which a file is maintained. To this system ID is associated every type of filing the organization has recorded in the agency. Each associated record database contains the "core" information regarding the entity. For example:

- Date the record was created,
- Date of expiration, if any,
- Current status of the record,
- Dates and details relative to reporting requirements,
- Amendment dates,
- Names and addresses of registered agents,
- Paid license fees, and
- Authorized shares.

The automated system has enabled the Secretary of State to pre-fill selected fields on annual reports before mailing them to the entities. In addition, the Secretary of State has an imaging system that is integrated with the Business Entity system, eliminating the manual process of filings and retrievals. The Business Entity database is accessible to the public via the web, reducing the demands on agency staff to provide business details required by the public. Finally, the automated system allows for queries and reports to be run that were not possible with the manual system.

Future Plans

The Secretary of State has identified the following as future improvements to be made to the systems:

- Electronic filing and payments.
- Bar-coding reports and enabling the system to accept and automatically file submissions.
- Enabling the printing of certifications from the web database for good standing certificates of business entities.
- Enabling the automatic transfer of a created document to stored image.

OBJECTIVES, SCOPE, AND METHODOLOGY

The objective of this audit of the Business Entity and Accounting systems for the period January 1, 2002 to December 31, 2002 was to answer the following questions:

1. Are security controls surrounding the systems adequate?
2. Do the input screens contain necessary edit checks?
3. Are reports from the systems accurately prepared?
4. Are late fees properly charged for annual reports?
5. Is the status properly updated for business entities that fail to file annual reports?

This audit was conducted in accordance with *Standards for Information Systems Auditing* issued by the Information Systems Audit and Control Association and *Government Auditing Standards*, issued by the Comptroller General of the United States.

ARE SECURITY CONTROLS SURROUNDING THE SYSTEMS ADEQUATE?

Summary of Audit Work Performed

Security controls are necessary to safeguard information against unauthorized use, disclosure, modification, damage, or loss. Proper security controls ensure that access to systems, data, and programs is restricted to authorized users.

We reviewed access rights for the systems. We also reviewed access rights to individual screens since access is further restricted by the individual screens. We noted that most screens are available to all staff of the Secretary of State. This is to improve the customer service of the department by allowing a single employee to perform all necessary functions for an entity.

In addition, since the systems are maintained on ITD's AS/400 platform, we reviewed the general controls for the AS/400.

Audit Findings**Inadequate controls on sensitive screens**

Accounting report screens and management report screens are not restricted to authorized individuals. Together with the client, we identified sensitive accounting reports and management reports which were available to all staff. Access to data and programs in a system should be assigned on a "need to know" basis. The Secretary of State thought that these screens were already restricted.

Recommendation:

We recommend the Secretary of State implement controls on sensitive screens to limit access to authorized users.

Agency Response:

As stated in the findings, the agency was unaware that these controls were not in place. This very complex system, based on RPG programming language, was created in 1989 under a previous administration. Therefore, it has been a programming challenge for the present administration and staff to fully understand and maintain its many intricacies. The recommended programming has been placed on a schedule to be completed as time and financial resources allow within the present budget.

Inappropriate access rights for programmers

Programmers have full access to the production environment. This means that programmers have the ability to add, change, or delete "live" data and programs. Access controls should restrict programmers from accessing the production environment. This ensures that any modifications are made in a test environment and then transferred to production. The Secretary of State had given this access to make it easier for programming changes to be completed.

Recommendation:

We recommend the Secretary of State prevent programmers from accessing the production environment.

Agency Response:

Neither the agency nor the Information Technology Department has the staff to do the programming necessary to support the AS/400 on which the agency's database is housed. Therefore, the agency must contract with outside programming vendors and allow them access to the production environment. With that access, they can provide immediate "fixes" to the production environment as needed in order for the agency to maintain the high standard of service and dependability it provides its customers internally and through its "real time" 24/7 business records search option on its web site. Access also allows the contracted programmers to develop programming within a test environment, which they then must ultimately transfer to the production environment because neither the agency nor ITD has the staff that can perform the transfer function. Because it is not practical, efficient, logistically workable, or cost effective for the agency to restrict access to its contract programmers, the agency executed, in September 2003, Professional Service Contracts with two programming vendors. These contracts, approved by the agency's legal counsel, cover, but are not limited to, issues of security, documentation, quality, confidentiality, indemnity, insurance, state law, public records, and audit.

State Auditor's Concluding Remarks:

The Secretary of State's response states that ITD does not have the staff that can perform the transfer function. This is misleading because ITD could provide this service to the Secretary of State if requested. In light of the weakness created when programmers have access to the production environment, the Secretary of State should evaluate the feasibility of having ITD perform the transfer function or obtaining the training necessary for the agency staff to perform the transfer function.

Auditor's Opinion

In our opinion, other than the deficiencies referred to in the preceding paragraphs, the security controls for the Business Entity and Accounting systems are adequate.

DO THE INPUT SCREENS CONTAIN NECESSARY EDIT CHECKS?

Summary of Audit Work Performed

We selected the major input screens from the Business Entity and Accounting systems and reviewed these screens to determine that proper edit checks were in place.

Audit Findings**Inadequate controls surrounding date fields**

Edit checks for most date fields are not adequate. Most date fields on input screens allow any date to be entered. Allowing past or future dates to be entered with no restrictions reduces the reliability of the data. Proper edit checks should restrict the fields to only allow reasonable dates. The Secretary of State thought that many date fields already had edit checks in place.

Recommendation:

We recommend the Secretary of State implement proper edit checks for date fields.

Agency Response:

As stated in the findings, the agency was unaware, because of other programming that had been previously completed, that the edit checks were not in place for all date fields. This very complex system, based on RPG programming language, was created in 1989 under a previous administration. Therefore, it has been a programming challenge for the present administration and staff to fully understand and maintain its many intricacies. This is an example of one of them. The recommended programming has been placed on a schedule to be completed as time and financial resources allow within the present budget.

Auditor's Opinion

In our opinion, other than those noted above for date fields, edit checks on input screens for the Business Entity and Accounting systems are adequate.

ARE REPORTS FROM THE SYSTEMS ACCURATELY PREPARED?

Summary of Audit Work Performed

We reviewed Business Entity and Accounting reports to identify major reports used by the Secretary of State. We then reviewed program coding for the reports and used the data files to recreate these reports.

Audit Findings**Inaccuracy of reports**

The AC1-630 Production Report does not properly compute work orders completed or amount of services completed and the AC1-660 Services by Division Report does not reflect revenue correctly.

For the AC1-630 report, the logic for the "Work Orders Completed" column does not reflect work orders completed, but work orders that were started in the time period of the report and had a service completed. Also, because of how refunds are recorded on the system, the amount of the "Services Completed" column would not be correct if there were refunds during the time period. Lastly, negative numbers in the "Amount of Services Completed" column show up as positive. These errors may cause confusion by a user who is not familiar with the report or what it is used for.

For the AC1-660 report, the amount fields are incorrectly calculated. This is due to the fact that refund records do not have a corresponding revenue entry to offset the refunds. This report is used to transfer revenues from the general fund for special revenue funds on the Statewide Accounting and Management Information System (SAMIS). Because of this error, special revenue funds revenues may be misstated on SAMIS when refunds are issued.

Recommendation:

We recommend the Secretary of State review the validity and accuracy of all reports.

Agency Response:

The design of the management reports currently on the agency's system was produced based on the specifications of the previous administration. The present administration has not fully understood those specifications. Therefore, it has never used the reports for management purposes. Therefore, the programs associated with these reports are scheduled for review, revision, replacement, or deletion.

Although the program used for the calculation of the transfer of revenue from the agency's general services operating fund to the general fund was discovered to be inaccurate, the audit concluded that any shortages created were located in the special fund and not in the general fund. Corrective programming is scheduled.

Auditor's Opinion

In our opinion, other than noted in our finding above, reports are accurately prepared.

ARE LATE FEES PROPERLY CHARGED FOR ANNUAL REPORTS?

Summary of Audit Work Performed

When business entities do not file their annual reports in a timely manner, North Dakota Century Code specifies late fees to be charged to the business entity for the late filing. This is a manual process done by Secretary of State employees, who must review the filing to determine if a late fee should be applied.

We performed an analytical review of all transactions identified as late fees to determine that authorized amounts were being charged. We selected a sample of annual report filings and a sample of filings with late fees charged to determine that late fees were properly charged when applicable.

Audit Findings**Noncompliance with North Dakota Century Code Section 10-33-139**

We noted that the Secretary of State did not charge late fees for nonprofit corporations. North Dakota Century Code section 10-33-139 subsection 3 requires nonprofit corporations to pay a late fee of \$5 for annual reports not filed timely. Subsection 8 allows the Secretary of State to waive any penalties when an annual report form could not be delivered to the corporation. To ease the transition for nonprofits filing annual reports, the Secretary of State had decided to waive late fees for all late filings by nonprofit corporations.

Recommendation:

We recommend the Secretary of State comply with North Dakota Century Code Section 10-33-139 by charging late fees to nonprofit corporations.

Agency Response:

In 1995, legislation was passed, effective in 1997, that required nonprofit corporations to file an annual report as was required of all other business entities filed with the agency. This had not been required of nonprofit corporations since statehood in 1889. Therefore, because there had been no method in place to purge the database of non-existent nonprofit corporations, the agency's system contained the names of over 12,000 nonprofit corporations of which an estimated 40% were no longer in existence. In addition, the large majority of them had no current address or registered agent on file. To establish a workable and accurate database required hundreds of hours of telephone calls, numerous letters, and extensive education. Since annual reports had not been required of nonprofit corporations for over a hundred years, it was a challenging process (in a comparatively few years) to gain acceptance of the new annual filing requirement and for nonprofit corporations to understand their value. Until this process was completed, the agency waived the late filing fees for nonprofit corporation annual reports. Well before the findings in this audit report, the agency had decided that it was time to proceed and had already made the decision to commence with the assessment of late fees for those nonprofit corporation annual reports filed after February 1, 2004.

Auditor's Opinion

In our opinion, other than noted above for nonprofit corporations, late fees are properly charged for annual reports that are not filed timely.

IS THE STATUS PROPERLY UPDATED FOR BUSINESS ENTITIES THAT FAIL TO FILE ANNUAL REPORTS?

Summary of Audit Work Performed

When a business entity does not file its annual report timely, North Dakota Century Code specifies that the entity's certificate is not in good standing, or that the business entity is dissolved. The Secretary of State schedules the jobs on the system to update the status of business entities which did not file timely annual reports. These entities are then notified of their change in status.

We reviewed the procedures of the Secretary of State in changing the business status for entities. We performed an analytical review of business status and last report year to identify potential errors and reviewed those entities identified to determine that the status was correct. We also selected a sample of entities that had never yet filed an annual report to determine if their status was proper.

Audit Findings**Noncompliance with North Dakota Century Code Section 10-19.1-146**

We noted that the Secretary of State was not complying with the timeline in state law for notifying a corporation that had not filed its annual report timely that its certificate is not in good standing. North Dakota Century Code section 10-33-146 subsection 6 states that within three months, the Secretary of State shall notify corporations that have not filed annual reports that their certificates are not in good standing. Because of a misinterpretation of the Century Code, the Secretary of State was waiting until after three months had passed to notify corporations.

Recommendation:

We recommend the Secretary of State comply with the time requirement in North Dakota Century Code section 10-19.1-146 subsection 6 in notifying any corporation that has not filed an annual report that its certificate is not in good standing.

Agency Response:

The timeline for notification of "not good standing" status is the standard that has been used by the agency in excess of at least thirty years. Therefore, the agency will consult with the Attorney General, adjust the timeline if required and as advised by the counsel of that office. Then, the agency will seek the adoption of appropriate legislation if deemed necessary.

Auditor's Opinion

In our opinion, other than the deficiency noted above, the procedures for updating business status are adequate.