

SECRETARY OF STATE

BISMARCK, NORTH DAKOTA

Audit Report

For the Two-year Period Ended
June 30, 2012

ROBERT R. PETERSON
STATE AUDITOR



Office of the State Auditor
Division of State Audit

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STATE OF NORTH DAKOTA
OFFICE OF THE STATE AUDITOR
STATE CAPITOL
600 E. BOULEVARD AVENUE - DEPT. 117
BISMARCK, NORTH DAKOTA 58505

Transmittal Letter

May 9, 2013

The Honorable Jack Dalrymple, Governor
Members of the North Dakota Legislative Assembly
The Honorable Al Jaeger, Secretary of State

We are pleased to submit this audit of the Secretary of State for the two-year period ended June 30, 2012. This audit resulted from the statutory responsibility of the State Auditor to audit or review each state agency once every two years. The same statute gives the State Auditor the responsibility to determine the contents of these audits.

In determining the contents of the audits of state agencies, the primary consideration was to determine how we could best serve the citizens of the state of North Dakota. Naturally we determined financial accountability should play an important part of these audits. Additionally, operational accountability is addressed whenever possible to increase efficiency and effectiveness of state government.

The in-charge auditor for this audit was Angela Klubberud. Amanda Pierce was the staff auditor. Paul Welk, CPA, was the audit manager. Inquiries or comments relating to this audit may be directed to the audit manager by calling (701) 328-2241. We wish to express our appreciation to Mr. Jaeger and his staff for the courtesy, cooperation, and assistance they provided to us during this audit.

Respectfully submitted,

A handwritten signature in cursive script that reads "Bob Peterson".

Robert R. Peterson
State Auditor

Executive Summary

Introduction

The North Dakota Secretary of State receives, records, and files original bills and resolutions from each Legislative Assembly; keeps a register of and attests the official acts of the Governor; and is the custodian of the Great Seal and other official state documents.

The Secretary of State serves as a member and secretary of the Emergency Commission, is a member of the Board for the State Historical Society, is a member of the Theodore Roosevelt Rough Rider Awards Committee, and is the secretary of the State Canvassing Board. The Secretary of State is also the state's chief election officer and is the Commissioner of Combative Sports (Boxing and Mixed Martial Arts).

The office registers and files reports for over forty different administrative functions related to businesses and is the central depository for lien filings related to the Uniform Commercial Code, agriculture, and other miscellaneous items. Among other duties, the Secretary of State registers lobbyists and charitable organizations, licenses contractors, and the commissioning of notaries public.

Additional information is available at the Secretary of State's website at www.nd.gov/sos.

The Legislative Audit and Fiscal Review Committee (LAFRC) requests that certain items be addressed by auditors performing audits of state agencies. Those items and the Office of the State Auditor's responses are noted below.

Responses to LAFRC Audit Questions

1. What type of opinion was issued on the financial statements?

Financial statements were not prepared by the Secretary of State in accordance with generally accepted accounting principles so an opinion is not applicable. The agency's transactions were tested and included in the state's basic financial statements on which an unqualified opinion was issued.

2. Was there compliance with statutes, laws, rules, and regulations under which the agency was created and is functioning?

Yes.

3. Was internal control adequate and functioning effectively?

Yes.

4. Were there any indications of lack of efficiency in financial operations and management of the agency?

No.

5. *Has action been taken on findings and recommendations included in prior audit reports?*

There were no recommendations included in the prior audit report.

6. *Was a management letter issued? If so, provide a summary below, including any recommendations and the management responses.*

No, a management letter was not issued.

LAFRC Audit Communications

7. *Identify any significant changes in accounting policies, any management conflicts of interest, any contingent liabilities, or any significant unusual transactions.*

There were no significant changes in accounting policies, no management conflicts of interest were noted, no contingent liabilities were identified or significant unusual transactions.

8. *Identify any significant accounting estimates, the process used by management to formulate the accounting estimates, and the basis for the auditor's conclusions regarding the reasonableness of those estimates.*

The Secretary of State's financial statements do not include any significant accounting estimates.

9. *Identify any significant audit adjustments.*

Significant audit adjustments were not necessary.

10. *Identify any disagreements with management, whether or not resolved to the auditor's satisfaction relating to a financial accounting, reporting, or auditing matter that could be significant to the financial statements.*

None.

11. *Identify any serious difficulties encountered in performing the audit.*

None.

12. *Identify any major issues discussed with management prior to retention.*

This is not applicable for audits conducted by the Office of the State Auditor.

13. *Identify any management consultations with other accountants about auditing and accounting matters.*

None.

14. Identify any high-risk information technology systems critical to operations based on the auditor's overall assessment of the importance of the system to the agency and its mission, or whether any exceptions identified in the six audit report questions to be addressed by the auditors are directly related to the operations of an information technology system.

ConnectND Finance, Human Resource Management System (HRMS), and the AS400 (Business Registration and Accounting System) are high-risk information technology systems critical to the Secretary of State.

Audit Objectives, Scope, and Methodology

Audit Objectives

The objectives of this audit of the Secretary of State for the two-year period ended June 30, 2012 were to provide reliable, audited financial statements and to answer the following questions:

1. What are the highest risk areas of the Secretary of State's operations and is internal control adequate in these areas?
2. What are the significant and high-risk areas of legislative intent applicable to the Secretary of State and are they in compliance with these laws?
3. Are there areas of the Secretary of State's operations where we can help to improve efficiency or effectiveness?

Audit Scope

This audit of the Secretary of State is for the two-year period ended June 30, 2012. We conducted this performance 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 believe the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objectives.

The Secretary of State has operations in the following locations. Each location was included in the audit scope:

- State Capitol
- North Dakota Association of Counties Building
1661 Capitol Way
Bismarck, ND

Audit Methodology

To meet the objectives outlined above, we:

- Prepared financial statements from the legal balances on the state's accounting system tested as part of this audit and the audit of the state's Comprehensive Annual Financial Report and reviewed management's discussion and analysis of the financial statements.
- Performed detailed analytical procedures including computer-assisted auditing techniques. These procedures were used to identify high-risk transactions and potential problem areas for additional testing.
- Tested internal control and compliance with laws and regulations which included selecting representative samples to determine if controls were operating effectively and to determine if laws were being followed

consistently. Non-statistical sampling was used and the results were projected to the population. Where applicable, populations were stratified to ensure that particular groups within a population were adequately represented in the sample, and to improve efficiency by gaining greater control on the composition of the sample.

- Interviewed appropriate agency personnel.
- Queried the ConnectND (PeopleSoft) system. Significant evidence was obtained from ConnectND.
- Observed Secretary of State's processes and procedures.

In aggregate there were no significant limitations or uncertainties related to our overall assessment of the sufficiency and appropriateness of audit evidence.

Management's Discussion and Analysis

The accompanying financial statements have been prepared to present the Secretary of State's revenues and expenditures on the legal (budget) basis. The accompanying financial statements are not intended to be presented in accordance with generally accepted accounting principles (GAAP).

The following management discussion and analysis was prepared by the Secretary of State's management. We have applied certain limited procedures, which consisted primarily of inquiries of management regarding the methods of measurement and presentation of this supplementary information to ensure it does not conflict with the knowledge we gained as part of our audit.

For the two-year period ending June 30, 2012, operations of the Secretary of State were primarily supported by appropriations from the state's general fund. Additional revenue was received from the federal government related to elections and from fees credited to the agency's general services operating fund.

Financial Summary

For the state's general fund, the agency received revenue related to its various administrative responsibilities including, but not limited to, documents pertaining to over 40 business categories; contractor licensing; registering charitable organizations and lobbyists; commissioning of notaries public; and the filing of security documents in the agency's central indexing system (CIS) concerning lending and other secured transactions, e.g., Uniform Commercial Code (UCC), agricultural products, livestock, and certain miscellaneous liens.

As allowed by the provisions of N.D.C.C. § 54-09-08, the revenue received for the sale of public information related to businesses is deposited into a special fund titled the General Services Operating Fund. It allows the agency to retain revenue to cover, in direct correlation to the demand, the expenses for providing the information.

According to the provisions of the Help America Vote Act of 2002 (HAVA), North Dakota is designated to receive up to \$20,000,000. The first installment of \$5,000,000 did not require a state match. The second and third installments of \$4,150,000 and \$7,446,803, respectively, appeared as revenue for the period ending June 30, 2005. For the period ending June 30, 2009 and June 30, 2010, the state received three additional HAVA allocations of \$575,000, \$500,000, and \$350,000 respectively. In fiscal year 2012, the state received additional funding of \$6,454. The remaining balance due to the state, subject to congressional approval, is \$1,971,743.

As required by HAVA, the 2003 Legislative Assembly created an election fund in which funds received under the Act and the state's match are deposited. The funds remain in the account until the need exists to expend them. As required by HAVA, any interest earned on the unexpended funds is deposited back into the election fund. A portion of the federal funds are invested in certificates of deposit at the Bank of North Dakota to earn additional interest. The accumulated interest provides additional financial resources to fund election administration and voter education. In addition, it will extend the life of the election fund much longer by leveraging and earning interest off of the federal/state funds deposited into it.

According to the North Dakota HAVA State Plan adopted in 2004, after all of the requirements in HAVA are fulfilled, the remaining funds, plus interest earned, will be used to pay “on-going” election expenses. These expenses are identified in the state plan as, “To assist counties with programming expenses, maintenance, equipment replacement and/or other election related projects or technology upgrades.”

On June 30, 2012, the balance in the election fund was approximately \$5.8 million. This amount included federal funds, interest earned, state matching funds, and other monies received from the state’s counties.

Agency Initiatives

To provide timely services to the public, the effective use of technology is important for the agency’s productivity and the fair administration of state laws, which are clear in their processes and purposes. Therefore, by building on significant advances reported during previous audit periods, the agency continues to place a priority on developing and improving services for its customers, taxpayers, and citizens through a variety of ways.

Through the legislative process, the agency supports and promotes the passage of legislation that clarifies, updates, or repeals obsolete sections of state law as they relate to each of the agency’s administrative functions.

A significant accomplishment is the successful ongoing implementation of the provisions of the Help America Vote Act of 2002 (HAVA). By collaborating with the North Dakota Association of Counties and county election officials, the state achieved a positive working relationship unlike any in the country. It has resulted in elections held without incident.

The agency continues to enhance the Central Voter File, which is a comprehensive poll book of the state’s active voters. The agency also developed, implemented, and launched ND VOICES, which is an election administration tool allowing a single point of entry for all pertinent election data for election officials across the state and providing election results to the public through one portal for every contest listed on any ballot in the state. These two systems working in concert provide valuable information through the Secretary of State’s website to voters, candidates, political parties, and election officials.

To improve its services, productivity, efficiency, and provide electronic on-line filing of business registrations and annual reports, along with related fee payments, the agency is developing in partnership with the state’s Information Technology Department (ITD) a new software application. The new system will replace outdated filing systems on the state’s mainframe and AS/400.

Analysis of Significant Variances

Because of the requirements of state law, nearly all businesses operating within North Dakota have a registration, filing, or licensing requirement with the Secretary of State’s office. Due to the state’s increased economic activity, the agency experienced significant increases in the overall demand for all services provided by the agency. As a result, the agency’s annual revenue increased from \$4,566,175 for the year ended June 30, 2011 to \$5,983,827 for the year ended June 20, 2012, an increase of \$1,417,652 or 31%.

With the assistance of HAVA and the United States Department of Health & Human Services (HHS), the state provided information to individuals with disabilities regarding the accessibility of polling places. In 2011, the agency and the North Dakota Protection and Advocacy Project developed, produced, and distributed to voters with disabilities an educational video and booklet. As a result of this project, the state had increased revenue from federal government for the year ending June 30, 2011.

The 2011 Legislative Assembly appropriated \$3,500,000 to the Secretary of State to develop a comprehensive software application to replace obsolete technology that is over twenty years old. Work on the project with ITD started in July 2011. Therefore, the expenditures allocated to the IT – Data Processing line item increased by \$732,720, from \$828,436 for the year ended June 30, 2011 to \$1,561,156 for the year ended June 30, 2012.

During fiscal year 2012, the agency implemented election system enhancements, paid for license and maintenance of the Central Voter File, and replaced memory cards for voting machines. In addition, one county entered into an agreement with the Secretary of State to purchase electronic poll books. As with previous county agreements, this county will pay back the grant for the electronic poll books to the state election fund. Compared to the previous year, the three items increased expenditures in the grants line by \$936,113.

As a result of the development of the voters with disabilities education video and booklet referenced above, the state had increased expenditures in the Fees – Professional Services line item for the year ending June 30, 2011.

During fiscal year 2011, the state had expenditures in the IT –Consultant/Development line item of \$427,568 compared to \$31,526 in fiscal year 2012. The difference is due to the fact that software and maintenance costs for voting equipment are significantly higher in an election year as opposed to a non-election year.

Financial Statements

Statement of Revenues and Expenditures

	<u>June 30, 2012</u>	<u>June 30, 2011</u>
<u>Revenues and Other Sources:</u>		
Licenses, Permits, & Fees	\$ 5,983,827	\$ 4,566,175
Miscellaneous Refunds	419,380	234,511
Miscellaneous Sales and Services	305,836	283,996
Interest on Investment	27,716	49,917
Program Income	23,520	3,990
Revenue from Federal Government	12,846	303,877
Total Revenues and Other Sources	\$ 6,773,125	\$ 5,442,466
<u>Expenditures and Other Uses:</u>		
Salaries and Benefits	\$ 1,845,743	\$ 1,712,680
IT - Data Processing	1,561,156	828,436
Grants to Counties	1,041,179	105,066
Books	226,184	53,766
Fees - Professional Services	183,638	470,235
Postage	108,895	96,695
Printing	91,056	63,209
Operating Fees and Services	51,455	40,477
Travel	46,750	42,042
Office Equipment and Furniture	45,468	1,018
IT - Communications	42,187	33,534
IT - Consultant/Development	31,526	427,568
Supplies	35,611	31,325
Professional Development	11,410	6,737
Miscellaneous Expenses	12,053	12,938
Rent of Building Space	738	
Other Expenses	200	50
Total Expenditures and Other Uses	\$ 5,335,249	\$ 3,925,776

Statement of Appropriations

For The Fiscal Year Ended June 30, 2012

Expenditures by Line Item:	<u>Original Appropriation</u>	<u>Adjustments</u>	<u>Final Appropriation</u>	<u>Expenditures</u>	<u>Unexpended Appropriation</u>
Salaries and Benefits	\$ 3,423,343	\$ 470,000	\$ 3,893,343	\$ 1,802,059	\$ 2,091,284
Operating Expenses	6,164,989	(367,474)	5,797,515	1,794,552	4,002,963
Petition Review	8,000		8,000	2,215	5,785
Election Reform Technology	6,206,812		6,206,812	1,416,432	4,790,380
Carryover		78,000	78,000	78,000	
Public Printing	310,000		310,000	226,218	83,782
Totals	<u>\$ 16,113,144</u>	<u>\$ 180,526</u>	<u>\$ 16,293,670</u>	<u>\$ 5,319,476</u>	<u>\$ 10,974,194</u>
Expenditures by Source:					
General Fund	\$ 9,326,160	\$ 78,000	\$ 9,404,160	\$ 3,788,146	\$ 5,616,013
Other Funds	6,786,984	102,526	6,889,510	1,531,330	5,358,181
Totals	<u>\$ 16,113,144</u>	<u>\$ 180,526</u>	<u>\$ 16,293,670</u>	<u>\$ 5,319,476</u>	<u>\$ 10,974,194</u>

Appropriation Adjustments:

An increase of \$175,000 in the Salaries and Wages line and a decrease in the Operating Expenses line was approved by the Emergency Commission to allow for payment of temporary staff hired through the services of the Human Resources Management Services division of the Office of Management and Budget rather than through outside staffing firms to handle the increase in demand for agency services and to provide assistance during the agency's mainframe migration project.

An increase of \$295,000 in the Salaries and Wages line and a decrease in the Operating Expenses line was approved by the Emergency Commission to fund the additional positions, overtime, temporary personnel, and salary adjustments to retain essential personnel.

An increase of \$102,526 in the Operating Expenses line is due to Section 4 of Senate Bill 2002 in the 2011 Session Laws which allowed any unexpended and unobligated balance remaining in the Secretary of State's general services operating fund on June 30, 2011 to be available and expended during the biennium ending June 30, 2013, for the database and processing platform migration project.

Expenditures Without Appropriations Of Specific Amounts:

The Athletic Advisory Board Fund has a continuing appropriation authorized by NDCC section 53-01-09 (\$15,773 of expenditures for this fiscal year).

For The Biennium Ended June 30, 2011

Expenditures by Line Item:	<u>Original Appropriation</u>	<u>Adjustments</u>	<u>Final Appropriation</u>	<u>Expenditures</u>	<u>Unexpended Appropriation</u>
Salaries and Benefits	\$ 3,129,509	\$ 132,629	\$ 3,262,138	\$ 3,240,404	\$ 21,734
Operating Expenses	3,207,950	66,500	3,274,450	3,032,348	242,102
Petition Review	8,000		8,000	5,146	2,854
Election Reform	3,400,698		3,400,698		3,400,698
Technology Carryover	8,344,107	368,421	8,712,528	2,561,678	6,150,850
Public Printing	337,000		337,000	292,201	44,799
Totals	<u>\$ 18,427,264</u>	<u>\$ 567,550</u>	<u>\$ 18,994,814</u>	<u>\$ 9,131,777</u>	<u>\$ 9,863,037</u>
Expenditures by Source:					
General Fund	\$ 6,111,588	\$ 68,421	\$ 6,180,009	\$ 6,107,559	\$ 72,450
Other Funds	12,315,676	499,129	12,814,805	3,024,218	9,790,587
Totals	<u>\$ 18,427,264</u>	<u>\$18,427,264</u>	<u>\$ 18,994,814</u>	<u>\$ 9,131,777</u>	<u>\$ 9,863,037</u>

Appropriation Adjustments:

An increase of \$50,000 in the Salaries and Wages line includes increased appropriation allocated by the Office of Management and Budget from the statewide salary equity pool appropriated pursuant to House Bill 1015 of the 61st Legislative Assembly for market equity compensation adjustments.

An increase of \$82,629 in the Salaries and Wages line and \$66,500 in the Operating Expenses line was approved by the Emergency Commission due to increased demand for agency services.

The \$368,421 increase in the Election Reform line includes \$350,000 in federal funds and the 5% state match to obtain federal funds from the Election Assistance Commission for paying election related expenditures. The adjustment was properly approved by the Emergency Commission.

Expenditures Without Appropriations Of Specific Amounts:

The Athletic Advisory Board Fund has a continuing appropriation authorized by NDCC section 53-01-09 (\$30,500 of expenditures for this biennium).

Internal Control

In our audit for the two-year period ended June 30, 2012, we identified the following areas of the Secretary of State's internal control as being the highest risk:

Internal Controls Subjected to Testing:

- Controls surrounding the processing of revenues.
- Controls surrounding the processing of expenditures.
- Controls relating to compliance with legislative intent.
- Controls surrounding the ConnectND (PeopleSoft) system.
- Controls surrounding the AS400 information system.

The criteria used to evaluate internal control is published in the publication *Internal Control – Integrated Framework* from the Committee of Sponsoring Organizations (COSO) of the Treadway Commission.

We gained an understanding of internal control surrounding these areas and concluded as to the adequacy of their design. We also tested the operating effectiveness of those controls we considered necessary based on our assessment of audit risk. We concluded internal control was adequate.

Auditors are required to report deficiencies in internal control that are significant within the context of the objectives of the audit. A deficiency in internal control exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent or detect: (1) misstatements in financial or performance information; (2) violations of laws and regulations; or (3) impairments of effectiveness or efficiency of operations, on a timely basis. Considering both qualitative and quantitative factors, we did not identify any significant deficiencies in internal control.

Compliance With Legislative Intent

In our audit for the two-year period ended June 30, 2012, we identified and tested Secretary of State's compliance with legislative intent for the following areas we determined to be significant and of higher risk of noncompliance:

- Proper use of the following legally restricted funds:
 - Election Fund.
 - Athletic Commission Fund.
 - General Services Operating Fund.
- Application of proper statutory rates relating to revenue.
- Proper use of the State Treasurer (State Constitution, article X, section 12).
- Compliance with appropriations (2009 North Dakota Session Laws chapter 2002).
- Compliance with OMB's Purchasing Procedures Manual.
- Travel-related expenditures are made in accordance with OMB policy and state statute.
- Proper use of petty cash funds.
- Adequate blanket bond coverage of employees (NDCC section 26.1-21-08).
- Compliance with fixed asset requirements including record-keeping, surplus property, lease and financing arrangements in budget requests, and lease analysis requirements.
- Compliance with payroll-related laws including statutory salaries for applicable elected and appointed positions, and certification of payroll.

The criteria used to evaluate legislative intent are the laws as published in the *North Dakota Century Code* and the *North Dakota Session Laws*.

Government Auditing Standards require auditors to report all instances of fraud and illegal acts unless they are inconsequential within the context of the audit objectives. Further, auditors are required to report significant violations of provisions of contracts or grant agreements, and significant abuse that has occurred or is likely to have occurred.

The results of our tests disclosed no instances of noncompliance that are required to be reported under *Government Auditing Standards*. Thus, we concluded there was compliance with the legislative intent identified above.

Operations

This audit did not identify areas of the Secretary of State's operations where we determined it was practical at this time to help to improve efficiency or effectiveness.

You may obtain audit reports on the internet at:

www.nd.gov/auditor/

or by contacting the
Division of State Audit

Office of the State Auditor
600 East Boulevard Avenue – Department 117
Bismarck, ND 58505-0060

(701) 328-2241