

Office of the
Secretary of State
BISMARCK, NORTH DAKOTA

Audit Report

Two-year Period Ended
June 30, 2016

Office of the State Auditor
Division of State Audit

**LEGISLATIVE AUDIT AND FISCAL REVIEW
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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 4, 2017

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

We are pleased to submit this audit of the Office of the Secretary of State for the two-year period ended June 30, 2016. 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 Krista Lambrecht, CPA. Amanda Westlake and Megan Reis were the staff auditors. 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,

/S/

Joshua C. Gallion
State Auditor

Executive Summary

Introduction

The North Dakota Office of the 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 and 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 40 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 Office of 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 unmodified 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?

Other than our work addressing the Contractor Licensing Process (page 18) there were no indications of lack of efficiency in financial operations and management of the Office of the Secretary of State.

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.*

Yes, a management letter was issued and is included on page 20 of this report, along with management's response.

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, management conflicts of interest, contingent liabilities, 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 Office of 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 Office of the Secretary of State.

Audit Objectives, Scope, and Methodology

Audit Objectives

The objectives of this audit of the Office of the Secretary of State for the two-year period ended June 30, 2016 were to provide reliable, audited financial statements and to answer the following questions:

1. What are the highest risk areas of the Office 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 Office of the Secretary of State and are they in compliance with these laws?
3. Are there areas of the Office of the Secretary of State's operations where we can help to improve efficiency or effectiveness?

Audit Scope

This audit of the Office of the Secretary of State is for the two-year period ended June 30, 2016. We conducted our 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 Office of the Secretary of State's sole location is its Bismarck office which was included in the audit scope.

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.
- Performed a detailed review of the Contractor Licensing Process performed by the Office of the Secretary of State including:
 - Established policies and procedures;
 - Licensing processes;
 - Complaint handling processes;
 - Enforcement processes; and
 - Management analysis processes.

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 Office of the Secretary of State's revenues and expenditures on the legal (budget) basis. They are not intended to be presented in accordance with generally accepted accounting principles (GAAP).

The following management discussion and analysis was prepared by the Office of 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, 2016, operations of the Office 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 filing documents pertaining to over 40 business categories, licensing contractors, registering charitable organizations and lobbyists, commissioning notaries public and filing 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 law, revenue received from the services provided under N.D.C.C. § 54-09-08 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 the services provided.

The revenue generated from the Secretary of State's operations was approximately \$6.1 million for the fiscal year ending June 30, 2016. The combined revenue generated in the 2013-2015 biennium for the general and special funds increased approximately 4% over the previous biennium.

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 periods ending June 30, 2009 and June 30, 2010, the state received three additional HAVA allocations of \$575,000, \$500,000, and \$350,000. In fiscal year 2012, the state received additional funding of \$6,454.

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 is 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. Additionally, it has extended 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, 2016, the balance in the election fund was approximately \$2 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 pollbook 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.

On March 1, 2016, the Secretary of State’s office successfully launched the 100% online 24/7 North Dakota Central Indexing System (NDCIS). All lien documents are now filed and searched online, which include the Uniform Commercial Code (UCC), Central Notice System (CNS) for farm products, agricultural statutory liens and notices, miscellaneous statutory liens, and state and federal tax liens.

To improve its services, the Secretary of State is acquiring a new technology solution for all business and licensing processes, which will replace the outdated AS/400 system. The solution will move the current system from a paper-centric internal data entry environment to a customer self-service online web portal and will also support internal operations.

Analysis of Significant Variances (2013–2015 Biennium)

The unexpended appropriation of \$518,522 in the operating expenses line item is due in part to the fact that the funding for the agency's central indexing software application was included in the operating line. Since the software application was still in progress at the end of the 2013-2015 biennium, the agency requested that \$257,022 be allowed as carryover into the 2015-2017 biennium to continue development of the software application. In addition, according to N.D.C.C. § 54-09-08 and Senate Bill No. 2002 Section 4, the agency requested carryover of \$239,005 to the Secretary of State's General Services Operating fund to be expended during the 2015-2017 biennium.

The unexpended appropriation of \$290,206 in the business process modeling services line item is related to the funding for the agency's business process modeling project. Since the project was still in progress at the end of the 2013-2015 biennium, the agency requested that funding be allowed as carryover into the 2015-2017 biennium for completion of the project.

The significant amount of unexpended appropriation for the election reform line (\$2,132,101) occurred because funding for the 2013-2015 biennium was requested based on the remaining balance of the HAVA funds and the possibility that several of the state's counties would enter into an agreement with the state to purchase electronic pollbooks. Since the counties did not purchase additional electronic pollbooks, a significant portion of the authorization was not used, which caused the appearance of a large unexpended appropriation in the election reform line.

Financial Statements

Statement of Revenues and Expenditures

	<u>June 30, 2016</u>	<u>June 30, 2015</u>
Revenues:		
Licenses and Fees	\$ 6,124,669	\$ 6,141,889
Sales and Services	738,328	352,503
Refunds	280,628	287,433
Revenue from Federal Government	100,000	97,725
Program Income	17,010	42,060
Interest on Investment	1,684	2,285
Total Revenues	\$ 7,262,319	\$ 6,923,895
Expenditures:		
Salaries and Benefits	\$ 2,485,192	\$ 2,336,583
Information Technology	1,668,193	2,286,637
Professional Services	632,016	778,373
Operating Expenses	299,001	69,188
Supplies	207,319	43,202
Printing	116,140	64,510
Equipment	106,720	60,064
Postage	99,754	125,469
Travel	49,365	48,162
Repairs	10,989	37,728
Professional Development	18,102	7,766
Miscellaneous Expenses	10,334	4,247
Total Expenditures	\$ 5,703,125	\$ 5,861,929

Statement of Appropriations

For the Year Ended June 30, 2016

Expenditures by Line Item:	<u>Original Appropriation</u>	<u>Adjustments</u>	<u>Final Appropriation</u>	<u>Expenditures</u>	<u>Unexpended Appropriation</u>
Salaries and Wages	\$ 4,903,514	\$ 208,000	\$ 5,111,514	\$ 2,430,111	\$ 2,681,403
Operating Expenses	5,733,295	(14,972)	5,718,323	1,659,110	4,059,213
Petition Review	8,000		8,000	5,746	2,254
Central Indexing System		290,207	290,207	290,207	
Election Reform	2,703,535		2,703,535	1,106,390	1,597,145
Public Printing-Operating	320,500	(30,455)	290,045	202,611	87,434
Totals	<u>\$ 13,668,844</u>	<u>\$ 452,780</u>	<u>\$ 14,121,624</u>	<u>\$ 5,694,175</u>	<u>\$ 8,427,449</u>
Expenditures by Source:					
General Fund	\$ 10,085,308	\$ 138,774	\$ 10,224,082	\$ 4,254,047	\$ 5,970,035
Other Funds	3,583,536	314,006	3,897,542	1,440,128	2,457,414
Totals	<u>\$ 13,668,844</u>	<u>\$ 452,780</u>	<u>\$ 14,121,624</u>	<u>\$ 5,694,175</u>	<u>\$ 8,427,449</u>

Appropriation Adjustments:

The \$208,000 transfer from the Operating Expenses line to the Salaries and Wages line was approved by the Emergency Commission. This transfer was made to fund temporary personnel hired through HRMS postings to provide staff support during agency's development of its software solution for office operations.

The \$14,972 decrease of the Operating Expenses line consisted of the following adjustments:

- \$378,000 decrease due to the 4.05 percent budget allotment ordered by the governor in February 2016.
- \$257,022 increase authorized by Senate Bill 2002, section 4 of the 2015 Session Laws to allow for funds authorized in subdivision 2 of section 1 of Senate Bill 2023 not to be subject to the provision of NDCC 54-44.1-11. Any unexpended funds from these appropriations are available for completing the central indexing computer project and the business process modeling services contract.
- \$164,006 increase authorized by Senate Bill 2002, section 3 of the 2015 Session Laws to allow any unexpended and unobligated balance remaining in the secretary of state's general services operating fund not be subject to the provisions of section 54-09-08, and any unexpended funds are available and may be expended by the secretary of state, for the database and processing platform migration project.

- \$208,000 decrease due to a transfer from the Operating Expenses line to the Salaries and Wages line was approved by the Emergency Commission.
- \$150,000 increase approved by the Emergency Commission for increased spending to receive additional revenue for the Operating Expenses line associated with the agency's general services operating fund that is generated by the agency's electronic central indexing system and contractor licensing functions.

The \$290,027 increase in the Central Indexing line was authorized by Senate Bill 2002, section 4 of the 2015 Session Laws to allow for funds authorized in subdivision 2 of section 1 of Senate Bill 2023 not to be subject to the provision of NDCC 54-44.1-11. Any unexpended funds from these appropriations are available for completing the central indexing computer project.

The \$30,455 decrease in the Public Printing line was due to the 4.05 percent budget allotment ordered by the governor in February 2016.

Expenditures without Appropriations of Specific Amounts:

The Athletic Advisory Board Fund has a continuing appropriation authorized by NDCC section 53-01-09 (\$8,950 of expenditures during the fiscal year).

Statement of Appropriations

For the Biennium Ended June 30, 2015

Expenditures by Line Item:	<u>Original Appropriation</u>	<u>Adjustments</u>	<u>Final Appropriation</u>	<u>Expenditures</u>	<u>Unexpended Appropriation</u>
Salaries and Wages	\$ 4,263,223	\$ 175,000	\$ 4,438,223	\$ 4,424,831	\$ 13,392
Accrued Leave Payments	82,831	(25,000)	57,831	56,494	1,337
Operating Expenses	2,663,597	2,230,375	4,893,972	4,375,450	518,522
Capital Assets	10,000		10,000	10,000	
Petition Review	8,000	7,000	15,000	15,000	
Business Process Modeling Services		400,000	400,000	109,794	290,206
Election Reform	5,143,115	26,543	5,169,658	3,037,557	2,132,101
Public Printing-Operating	320,500		320,500	258,472	62,028
Totals	<u>\$ 12,491,266</u>	<u>\$ 2,813,918</u>	<u>\$ 15,305,184</u>	<u>\$ 12,287,598</u>	<u>\$ 3,017,586</u>
Expenditures by Source:					
General Fund	\$ 6,646,849	\$ 2,734,578	\$ 9,381,427	\$ 8,772,171	\$ 609,256
Other Funds	5,844,417	79,340	5,923,757	3,515,427	2,408,330
Totals	<u>\$ 12,491,266</u>	<u>\$ 2,813,918</u>	<u>\$ 15,305,184</u>	<u>\$ 12,287,598</u>	<u>\$ 3,017,586</u>

Appropriation Adjustments:

The \$175,000 adjustment to increase the Salaries and Wages line was made up of two adjustments. The first adjustment was a \$25,000 transfer from the Accrued Leave Payments line to the Salaries and Wages line, which was in accordance with the House Bill 1015, section 14 of the 2013 Legislative Session. The second adjustment was a line transfer of \$150,000 from the Operating line to the Salaries and Wages line approved by the Emergency Commission to provide funding for overtime and temporary staff.

The \$25,000 adjustment to decrease the Accrued Leave Payments line was a transfer to the Salaries and Wages line in accordance with House Bill 1015, section 14 of the 2013 Legislative Session.

The \$2,230,375 increase in the Operating Expenses line consisted of the following adjustments:

- \$75,000 – Increase authorized by House Bill 1002, section 3 of the 2013 Session Laws to be carried over to the 2013-2015 biennium for the database and processing platform migration project.
- \$1,355,375 – Increase authorized by House Bill 1002, section 5 of the 2013 Session Laws to be carried over to the 2013-2015 biennium for the completion of the mainframe migration computer project.

- \$950,000 – Increase authorized by Senate Bill 2023, section 1 of the 2015 Session Laws to defray expenses for the period from January 1, 2015 through June 30, 2015.
- \$150,000 – Decrease due to a transfer from the Operating Expenses line to the Salaries and Wages line approved by the Emergency Commission. Transfer was made to provide funding for overtime and temporary staff.

The \$7,000 increase in the Petition Review line was approved by the Emergency Commission to cover costs related to the review of four initiated petitions.

The \$400,000 increase in the Business Process Modeling Services line was authorized by Senate Bill 2023 of the 2015 Legislative Session for the purpose of defraying expenses for the period from January 1, 2015 through June 30, 2015.

The \$26,543 increase in the Election Reform line was approved by the Emergency Commission to reconcile a coding error associated to the state match required for funds received in 2009 from the Help America Vote Act (HAVA).

Expenditures without Appropriations of Specific Amounts:

The Athletic Advisory Board Fund has a continuing appropriation authorized by NDCC section 53-01-09 (\$40,409 of expenditures for this biennium).

Internal Control

In our audit for the two-year period ended June 30, 2016, we identified the following areas of the Office 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 related to payroll.
- Controls effecting the safeguarding of assets.
- Controls relating to compliance with legislative intent.
- Controls surrounding the ConnectND (PeopleSoft) system.
- Controls surrounding the AS400 and Central Indexing information system.
- Controls surrounding the contractor licensing process.

The criteria used to evaluate internal control is published in the publication *Standards for Internal Control in the Federal Government* issued by the Comptroller General of the United States (Green Book, GAO-14-704G). Agency management must establish and maintain effective internal control in accordance with policy of the Office of Management and Budget (OMB Policy 216) and, for programs receiving Federal funds, the Code of Federal Regulation as set forth by the Federal Government (2 CFR 200.303).

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. However, we noted other matters involving internal control that we have reported to management of the Office of the Secretary of State in a management letter dated May 4, 2017.

Compliance with Legislative Intent

In our audit for the two-year period ended June 30, 2016, we identified and tested the Office of the Secretary of State's compliance with legislative intent for the following areas we determined to be significant and of higher risk of noncompliance:

- Proper reporting of credit card usage rates and credit card fees paid (2013 North Dakota Session Laws chapter 1002, section 7).
- 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:
 - Contractor License Fees (NDCC 43-07-07, subsection 2).
 - Contractor Renewal Fees (NDCC 43-07-07, subsection 3).
 - Registered Agent Fees (NDCC 10-01.1-03 subsections 1 and 2).
 - Cooperative Association Fees (NDCC 10-15-54).
 - Lobbyist Registration Fees (NDCC 54-05.1-03).
 - Combative Sports – Mixed Fighting Style License Fees (NDAC 72-02.2-02-04).
 - Professional Mixed Fighting Style Event Fee (NDAC 72-02.2-02-13).
 - Professional Fundraiser Registration Fees (NDCC 50-22-02.1, subsection 1).
 - Fictitious Name Filing Fee (NDCC 45-11-01 subsection 2).
- Proper use of the State Treasurer (State Constitution, article X, section 12).
- Proper authorization for funds used by the Secretary of State.
- Bank of North Dakota used as the credit card processing depository (NDCC 54-06-08.2).
- Compliance with appropriations and related transfers (2013 North Dakota Session Laws House Bill 1002 and 2015 North Dakota Session Laws Senate Bill 2002).
- Compliance with Contractor Licensing Requirements (NDCC 43-07-04).
- Compliance with OMB's Purchasing Procedures Manual.
- Proper authority for investments for HAVA funds and interest being properly deposited into the Election Fund.
- Adequate blanket bond coverage of employees (NDCC section 26.1-21-08).
- Compliance with fixed asset requirements including record-keeping, annual inventory, and surplus property.
- Compliance with payroll-related laws including statutory salaries for applicable elected and appointed positions, and certification of payroll.
- Proper transfer of fees for filing records of a publicly traded corporation to the secretary of state's general services operating fund (NDCC 10-35-33).

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.

While we did not find any items that were required to be reported in accordance with *Government Auditing Standards*, we noted certain inconsequential or insignificant instances of non-compliance that we have reported to management of the Office of the Secretary of State in a management letter dated May 4, 2017.

Operations

Our audit of the Office of the Secretary of State included a review of operations surrounding Contractor Licensing.

Background

North Dakota Century Code chapter 43-07 sets forth the requirement that a person may not engage, in the business nor act in the capacity of a contractor within the state when cost, value, or price per job exceeds the sum of four thousand dollars without first having a license. Any person acting in the capacity of a contractor without a license is guilty of a class A misdemeanor. This chapter of North Dakota Century Code also details the requirements for obtaining a license, reasons the Office of the Secretary of State may refuse to grant a license, reasons for classifying a license as not in good standing, and reasons for denial, suspension, or revocation of license. Additionally, this chapter of North Dakota Century Code outlines the four classes of licenses and the associated fees for each license, the timeframes for the expiration of licenses and requirements to renew a license, and the acts or omissions for which a complaint can be filed.

Our audit procedures were designed and conducted to answer the following objectives:

- Are contractors required to be licensed to certify that certain standards are met for operations within the regulated industry?
- Were complaints handled (through receiving, processing, and investigating) to ensure the contractors operating within the regulated industry follow all applicable requirements and standards?
- Are regulations properly and effectively enforced in accordance with NDCC?

Our audit determined the objectives were met except for the following significant operational improvement noted below.

Inadequate Process for Handling Complaints Filed Against a Contractor (Finding 16-1)

Condition:

The Office of the Secretary of State has an inadequate process for handling complaints filed against a contractor. Issues noted include:

- A letter is sent to the contractor even in workmanship complaints that they have no authority to penalize.
- The letter sent to the contractor states an administrative hearing will be scheduled after a preliminary investigation is done by their office and neither of these are conducted by their office but instead valid complaints are turned over to the Attorney General's office.
- In the letter sent to the contractor it states the contractor is to respond to the complaint within 3 weeks, but nothing is done if they don't respond.
- The complainant does not receive any follow up or acknowledgement of their complaint unless the contractor responds to the letter sent to them.

- Tracking of complaints is not completed so a contractor is not flagged when they have multiple complaints against them so further review can be performed.

In addition, the agency has not developed documented policies and procedures regarding proper and effective handling of complaints for the Contractor Licensing program.

Criteria:

According to "Standards for Internal Control in the Federal Government", management should document internal control responsibilities in policies. Policies are to be documented in the appropriate level of detail to allow management to effectively monitor the control activity. Policies are to be further defined by day-to-day procedures including timing and follow up of corrective actions. Policies and procedures should be communicated to employees so that control activities are implemented for assigned responsibilities. (GAO 14-704G para. 12.01-04)

In addition, best practices are used for this regulatory program as documented in the following publications: Good Practices for Regulatory Inspections: Guidelines for Reformers from international consultants in regulatory reform Jacobs & Associates as prepared for the World Bank, Carrying Out a State Regulatory Program from the National State Auditor's Association, and Best Practice Principles for Regulatory Policy from the Council on Regulatory Policy and Governance. Guidelines from the US Food & Drug Administration (FDA), the US Centers for Disease Control (CDC), and the US Occupational Safety & Health Administration (OSHA) are used.

Cause:

The program is relying on experienced staff to handle complaints in the way they have always been handled instead of developing and documenting proper processes and procedures.

Effect or Potential Effect:

It is likely that the program may not be operating efficiently or the public may not feel that their concerns are not being addressed properly.

Operational Improvement:

We recommend the Office of the Secretary of State develop an adequate complaint process and document policies and procedures regarding proper and effective handling of complaints for the Contractor Licensing program.

Office of the Secretary of State Response:

The Secretary of State will review the applicable laws and will develop written procedures to ensure that processes are in place (including any involvement with the Attorney General's office) to effectively and efficiently administer complaints per Chapter 43-07. The agency will also consider proposing legislative changes to existing laws (some of which were enacted in 2015) as may be needed to augment the process to ensure consumer protection.

Management Letter (Informal Recommendations)

May 4, 2017

The Honorable Al Jaeger
Secretary of State
Office of the Secretary of State
State Capitol
600 E Boulevard Avenue
Bismarck, ND 58505

Dear Mr. Jaeger,

We have performed an audit of the Office of the Secretary of State for the two-year period ended June 30, 2016, and have issued a report thereon. As part of our audit, we gained an understanding of the Office of the Secretary of State's internal control structure to the extent we considered necessary to achieve our audit objectives. We also performed tests of compliance as described in the same report.

Our audit procedures are designed primarily to enable us to report on our objectives including those related to internal control and compliance with laws and regulations and may not bring to light all weaknesses in systems and procedures or noncompliance with laws and regulations which may exist. We aim, however, to use our knowledge of your organization gained during our audit to make comments and suggestions which we hope will be useful to you.

In connection with the audit, gaining an understanding of the internal control structure, and tests of compliance with laws and regulations referred to above, we noted certain conditions we did not consider reportable within the context of your audit report. These conditions relate to areas of general business practice or control issues that have no significant bearing on the administration of federal funds. We do, however, want to present our recommendations to you for your consideration and whatever follow-up action you consider appropriate. During the next audit we will determine if these recommendations have been implemented, and if not, we will reconsider their status.

The following present our informal recommendations.

Informal Recommendation 16-1: We recommend the Office of the Secretary of State follow State procurement policies for all purchases over the procurement levels outlined in State policy.

Informal Recommendation 16-2: We recommend the Office of the Secretary of State establish a control to ensure all transactions entered by other state agencies have been reviewed and approved by their agency.

Informal Recommendation 16-3: We recommend the Office of the Secretary of State document their procedures regarding the process surrounding the issuing and renewal of contractor licenses.

Management of the Office of the Secretary of State agreed with these recommendations.

I encourage you to call me or an audit manager at 328-2241 if you have any questions about the implementation of recommendations included in your audit report or this letter.

Sincerely,

A handwritten signature in black ink that reads "Krista Lambrecht". The signature is written in a cursive style with a large initial 'K'.

Krista Lambrecht
Auditor in-charge

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

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