

Audit Report

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**Office of the Secretary of State**

October 2011

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**OFFICE OF LEGISLATIVE AUDITS**  
DEPARTMENT OF LEGISLATIVE SERVICES  
MARYLAND GENERAL ASSEMBLY

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Karl S. Aro  
Executive Director

DEPARTMENT OF LEGISLATIVE SERVICES  
OFFICE OF LEGISLATIVE AUDITS  
MARYLAND GENERAL ASSEMBLY

Bruce A. Myers, CPA  
Legislative Auditor

October 20, 2011

Delegate Guy J. Guzzone, Co-Chair, Joint Audit Committee  
Senator James C. Rosapepe, Co-Chair, Joint Audit Committee  
Members of Joint Audit Committee  
Annapolis, Maryland

Ladies and Gentlemen:

We have audited the Office of the Secretary of State for the period beginning March 6, 2008 and ending March 1, 2011. 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, regulating, and informing the public about charitable organizations; and administering the Notary Public laws. The Office also includes the Division of State Documents, which compiles and publishes all of the State's administrative regulations.

Our audit disclosed that the Office did not adequately monitor revenue contracts to ensure that the appropriate payments were received. We also identified internal control and record keeping deficiencies with respect to the Office's operations, including cash receipts, charitable organizations, equipment, and affiliated foundations.

The Office's response to our findings and recommendations 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,

Bruce A. Myers, CPA  
Legislative Auditor



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\* Denotes item repeated in full or part from preceding audit report

## **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 Charities and Legal Services Division registers, regulates, and informs the public about charitable organizations (including foundations affiliated with State agencies) and professional solicitors. The Division also 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. According to the State's records, the Office's operating expenditures during fiscal year 2010 totaled approximately \$2.4 million.

### **Status of Findings From Preceding Audit Report**

Our audit included a review to determine the status of the two findings contained in our preceding audit report dated October 3, 2008. We determined that the Office satisfactorily addressed one of the findings. The remaining finding is repeated in this report.

## Findings and Recommendations

### Data Licensing Fees

#### **Finding 1**

**The Office did not have adequate procedures to ensure that data licensing fees were received.**

#### **Analysis**

The Office had not established adequate procedures to ensure the appropriate payments were received for the sale of the electronic versions of the Code of Maryland Regulations (COMAR) and the Maryland Register. As a result, approximately \$82,500 remained uncollected. In this regard, a vendor had not remitted the required annual licensing fee of \$7,500 related to the electronic versions of the Maryland Register for calendar years 2001 through 2011. Due to the lack of adequate monitoring procedures, the Office did not notice this until December 2010. On March 15, 2011, the Office of the Attorney General, on behalf of the Secretary of State, sent a letter to the vendor requesting payment of the delinquent annual fees. On May 5, 2011, the Office invoiced the vendor for the delinquent fees.

The Office has data-licensing contracts with two vendors which permit them to offer for sale electronic versions of COMAR and the Maryland Register. Under the terms of the contracts, annual licensing fees for electronic versions of COMAR and the Maryland Register were \$20,000 and \$7,500, respectively, per vendor.

#### **Recommendation 1**

**We recommend that the Office**

- a. establish adequate procedures to ensure the appropriate fees are received from each vendor, and**
- b. collect all delinquent amounts due from the aforementioned vendor.**

### Cash Receipts

#### **Finding 2**

**The Office had not established adequate controls over cash receipts.**

#### **Analysis**

The Office had not established adequate controls over cash receipts. During fiscal year 2010, the Office collected approximately \$2 million. These collections

included charity registration fees, notary commission fees, and sales from publications. Our review of the procedures and controls over these collections disclosed the following conditions:

- Checks received were not restrictively endorsed immediately upon receipt. Instead, checks were often forwarded to at least one other individual for processing prior to the checks being restrictively endorsed.
- Collections were not verified to deposit by an employee independent of the cash receipts process. Specifically, two employees who performed the deposit verification duties also prepared the deposit and recorded cash receipts into the State's accounting records when the employee primarily responsible for these duties was unavailable. Furthermore, one of these employees had access to collections maintained in the safe, including cash and any un-endorsed checks, and had full access to the cash receipts system, which included the capability to perform voids.

The Comptroller of Maryland's *Accounting Procedures Manual* requires that the reconciliation of the initial record of collections to the amount deposited be performed by an employee independent of the cash receipts function. The *Manual* also requires that checks be restrictively endorsed upon receipt.

## **Recommendation 2**

**We recommend that the Office**

- a. ensure checks are restrictively endorsed immediately upon receipt,**
- b. ensure that an employee independent of the cash receipts function verifies that collections are subsequently deposited, and**
- c. ensure access to critical system functions is restricted to only those employees whose job duties require such access and who do not have access to cash receipts.**

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

## Charitable Organizations

### **Finding 3**

**The Office lacked adequate procedures and controls to ensure charitable organizations were in compliance with annual reporting requirements and that the exempt status of charities was proper.**

### **Analysis**

The Office lacked adequate procedures and controls to ensure charitable organizations were in compliance with annual reporting requirements and that the status of exempt charities was proper and accurately recorded in the Office's database. Our review disclosed the following conditions:

- We tested 15 charities that had not submitted the required annual reports and, as of March 1, 2011, had been delinquent for 9 to 37 months. Our test disclosed that, although the Office had properly reported these 15 charities as not in compliance on their website, the Office had not performed any follow-up activity on 10 of these charities for periods ranging from 4 to 27 months. Specifically, for 2 of the 15 charities tested, no monthly delinquency letters were sent at all. For the remaining 13 charities tested, the Office only sent between one and six delinquency letters. In addition, the Office did not refer any of these delinquent charities to its investigator for further follow-up, in accordance with its procedures.
- Our test of an additional 15 charities, designated as exempt in the Office's database, disclosed that the Office improperly assessed the exempt status of 4 charities that did not meet the requirements for exempt status. In addition, independent verifications were not performed to ensure that information was accurately recorded in the charitable organizations database. As a result there was a lack of assurance that database used by the Office to record the exempt status of charities was proper.

Business Regulation Article, Title 6, of the Annotated Code of Maryland requires charitable organizations to register with the State and, thereafter, file annual reports six months after the organization's fiscal year end, unless they meet the criteria for exemption. Exempt organizations include religious organizations, and organizations with less than \$25,000 in annual contributions from the public. Charitable organizations claiming exemption must also submit evidence of exemption to the State.

According to the Office's records, as of March 2011, approximately 10,160 charities were registered with the Office, of which 1,906 are classified as delinquent and 1,939 were classified as exempt.

### **Recommendation 3**

**We recommend that the Office**

- a. ensure that timely and consistent follow-up is performed to obtain annual reports from delinquent organizations, along with timely referral of delinquent organizations to an investigator for further follow-up action; and**
- b. ensure that organizations designated as exempt meet the required exemption criteria and that the exemption is accurately recorded in the charitable organization database.**

## **Equipment**

### **Finding 4**

**Equipment maintained by the Office was not adequately controlled.**

#### **Analysis**

The Office did not comply with the requirements of the Department of General Services' (DGS) *Inventory Control Manual*. According to its records, the value of the Office's equipment totaled approximately \$455,000 as of June 30, 2010. Our review disclosed the following conditions:

- The recordkeeping and physical inventory duties were not adequately segregated. Specifically, the employee who performed the physical inventory had unrestricted access to the automated detail records using an administrator logonid assigned to the employee who maintained the detail records. In addition, a logonid assigned to a former employee who resigned in January 2008, that permitted unrestricted access to the detail records, was still active as of the date of our review in April 2011.
- Although the Office advised us that the most recent physical inventory had been taken in June 2010, adequate documentation of the physical inventory was not maintained. We also noted that the detail equipment records, which are automatically updated during the physical inventory process, indicated that the most recent physical inventory was last conducted in July 2008.

- The Office did not always tag for identification purposes and record equipment purchases in the detail records. Our test of eight equipment purchases totaling approximately \$38,000, that were purchased during the period from June 2008 through August 2010, disclosed that the items related to six of these purchases, totaling approximately \$35,000, were not tagged or recorded in the detail records as of May 2011. In addition, independent detail records maintained by the Office's information technology (IT) Division showed 40 equipment items (including personal computers and monitors) on the IT Division's inventory tracking system that were not recorded on the Office's official detail equipment records.

The DGS *Inventory Control Manual* requires that the duties of recordkeeping, inventory custody, and physical inventory be adequately segregated whenever possible. In addition, the *Manual* requires that periodic physical inventories be conducted and related documentation be retained for audit and verification purposes. The *Manual* also requires that detail records be maintained for all capital equipment items and that the items be tagged for identification and control purposes.

#### **Recommendation 4**

**We recommend that the Office comply with the requirements of the DGS *Inventory Control Manual*.**

### **Affiliated Foundations**

#### **Finding 5**

**The Office had not implemented procedures to identify all foundations affiliated with State agencies.**

#### **Analysis**

The Office had not implemented procedures to identify all foundations affiliated with State agencies to ensure that it received all reporting materials specifically required from such entities. A similar comment was included in our two preceding audit reports. In response to those reports, the Office stated that, to help identify affiliated foundations, a question regarding whether an entity is affiliated with a State agency was added to the registration and the annual renewal forms that must be completed by all charitable organizations registered with the Office. In addition, the Office indicated that a letter would be sent on an annual basis to Secretaries and financial officers of various State agencies to inquire about their knowledge of foundations affiliated with their agencies.

Our current audit disclosed that, although the Office revised the registration and renewal forms in 2008, the revised forms were not always being used by charitable foundations. Our review of 15 registration renewals, which took place after 2008, disclosed 3 instances in which the revised forms were not used by charitable foundations, yet the Office did not contact these charitable foundations to request that the revised form be submitted. In addition, we were advised that, although the aforementioned letter to State agencies was developed, such letters were never sent.

Our limited review of the Office's database of registered charities disclosed three charities that were affiliated with State agencies, but had not been identified as such by the Office. We also identified two additional charities that were not on the Office's database, but were affiliated with State agencies. To the extent the Office does not identify charities affiliated with State agencies, it cannot ensure that the charities submit annual reports, if required to do so.

State regulations require certain private foundations affiliated with a State agency to file audited financial statements and an agreed-upon procedures report annually with the Office. In the agreed-upon procedures report, the auditor must address several items relating to, for example, the foundation's resources, record keeping, and relationship with its affiliated State agency. These reports must be filed if a foundation raises more than \$100,000 from the public and is required to register with the Office as a charitable organization. The Office is required by State regulations to review the auditor's recommendations contained in the agreed-upon procedures report and to make a determination as to whether additional auditing or investigation is necessary.

#### **Recommendation 5**

**We recommend that the Office**

- a. implement procedures to adequately identify foundations affiliated with State agencies (repeat); and**
- b. ensure that all affiliated foundations submit required reports, including the organizations identified by our review, and review these reports as required (repeat).**

## **Audit Scope, Objectives, and Methodology**

We have audited the Office of the Secretary of State for the period beginning March 6, 2008 and ending March 1, 2011. 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 controls, and to evaluate its compliance with applicable State laws, rules, and regulations. We also determined the status of the findings included in our preceding audit report.

In planning and conducting our audit, we focused on the major financial-related areas of operations based on assessments of materiality and risk. The areas addressed by the audit included cash receipts, charitable organizations, affiliated foundations, procurements and disbursements for the Office's operating expenditures, and equipment. Our audit procedures included inquiries of appropriate personnel, inspections of documents and records, and observations of the Office's operations. We also tested transactions and performed other auditing procedures that we considered necessary to achieve our objectives. Data provided in this report for background or informational purposes were deemed reasonable, but were not independently verified.

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.

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 findings regarding significant instances of noncompliance with applicable laws, rules, or regulations. Another less significant finding was communicated to the Office that did not warrant inclusion in this report.

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

**MARTIN O'MALLEY**

GOVERNOR

**ANTHONY G. BROWN**

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**JOHN P. MCDONOUGH**

SECRETARY OF STATE

October 12, 2011

Bruce A. Myers  
Legislative Auditor  
Office of Legislative Audits  
301 West Preston Street  
Baltimore, MD 21201

Dear Mr. Myers:

Thank you for providing me with a draft copy of the audit report to the members of the Joint Audit Committee concerning the audit for the Office of the Secretary of State. This audit covered the period of March 6, 2008 and ending March 1, 2011. The Office of the Secretary of State has cooperated openly and fully with the Department of Legislative Services' 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. Data Licensing Fees*

The Office concurs with your recommendation and has implemented a new database for COMAR and Maryland Register subscriptions that ensures all payments are received in a timely matter. The new system automatically tracks contract expiration dates and invoices are generated up to four months in advance. Safeguards have been built into the database and internal controls have been applied to ensure that payments are received on time. Under terms of new data licensing contracts the licensee will pay a flat annual fee rather than a separate fee for COMAR and a separate fee for the Maryland Register.

The Office also agrees with the recommendation to collect all delinquent amounts due from COMAR/Maryland Register vendor. The Office had conversations with the attorney general as well as a representative from the contractor, and it was determined that the contractor was in default in the amount of \$82,500. A check was received in June 2011 that satisfied the default.

#### *2. Cash Receipts*

The Office concurs with your recommendation and has implemented the necessary procedural changes to ensure all incoming checks are restrictively endorsed immediately after incoming mail is opened. New internal controls changed the mail processing sequence to require incoming checks to be sorted then endorsed.

The independent verification of the cash receipts are performed by the fiscal officer by comparing the recorded logs prepared when checks are processed with the related validated bank deposit ticket on a daily basis.

The Office agrees with the recommendation to restrict access to critical system functions to employees requiring such access. Procedures have been established and the fiscal officer has assigned a staff member who is independent of the cash receipts function to record the daily deposits into the State's accounting system. The procedures ensure the accuracy and proper classification of all transactions posted to the State's system. Internal controls, such as system administrator assigned user login, ensure access to critical system functions are restricted to only staff requiring access.

### 3. Charitable Organizations

The Office agrees with the recommendation regarding follow-up on delinquent organizations. The Division is focusing its efforts on bringing delinquent organizations into compliance with the Maryland Solicitations Act (Title 6 of the Business Regulation Article of the Annotated Code of Maryland) and has assigned the Division Administrator the primary duty of resolving this issue. The Office has developed internal procedures and has redirected its investigative resources to close files or pursue appropriate follow-up action.

Efforts currently include contacting non-compliant organizations to verify their mailing address to forward correspondence describing documentation required, obtaining updated annual reports, and, where appropriate, visiting the organization. Once the contact procedures are exhausted by the Division Administrator, a list of ongoing delinquent organizations will be generated and forwarded to the investigator for further follow-up action. Efforts to contact the delinquent organizations and inform them of their status are continuous.

Finally, we would like to note that based on recommendations from previous audits, the efforts of the Division to identify organizations that should be registered has resulted in the number of registered charities significantly increasing. Unfortunately, the number of staff members to process the registrations has not increased, so it is a continuing challenge to bring non-compliant organizations into compliance with the Maryland Charitable Solicitations Act.

The Office concurs with the recommendation that charitable organizations designated as exempt meet the requirements for that designation. Although proof of an exemption from federal income tax is not required by exempt organizations, the Charities and Legal Services Division currently requires that the organization inform the Division of their tax-exempt status. The Division also requests that the charitable organization provide a copy of the tax determination letter issued by the Internal Revenue Service (IRS). Depending on the type of exemption, additional copies of IRS forms are sometimes required. While these procedures are already in place, we are working with our IT Department to develop an automated process within the Charities Database to capture data entry errors that may provide an erroneous status. Our goal is to increase the use of automation to assist in maintaining data accuracy. Additionally, the Division is performing monthly random assessments of the database to further ensure accuracy. Any inconsistencies entered into the database will be

addressed and corrected.

4. Equipment

The Office agrees with the recommendation and has modified the internal inventory control procedures to ensure accurate inventories in accordance with the Maryland Department of General Services (DGS) Inventory Control Manual. The Office will maintain detailed records of annual physical inventories in accordance with the DGS Inventory Control Manual.

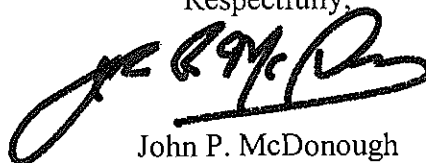
5. Affiliated Foundations

The Office agrees with this recommendation and points out that although the registration and renewal forms were revised to include State Affiliation information, for a brief time obsolete forms continued to be used. Those obsolete forms are no longer in use. The Charities and Legal Services Division has initiated the process of issuing letters to State agencies requesting a list (if any) of all private foundations they may be affiliated with. The letter notes this process will be an annual occurrence in order to keep an accurate account. Although we cannot guarantee 100 percent compliance, we hope that by providing information concerning this requirement to both charities and State agencies, greater compliance will be achieved.

The Charities and Legal Services Division has initiated the necessary procedural changes to ensure that all foundations affiliated with State agencies submit the required reports and that those reports are reviewed with the proper follow-up action. There is now a primary staff person responsible for the accuracy of meeting this requirement each year. Additionally, the staff person reviewing these foundations will provide a quarterly report to the Director of Charities and Legal Services indicating the status of foundation reports and any pending deficiencies.

The Office of the Secretary of State appreciates the time and effort taken by the legislative audit staff to conduct our audit. Since our audit, the Office of the Secretary of State has made tremendous progress discharging its multitude of duties and responsibilities by streamlining operations through improved technology, process analysis, and enhancing the professional capabilities of the staff. We are very proud of our record of providing quality services 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 Director of Administration and Finance, Frederick Smalls, at 410-260-3853. Let me commend your auditors for their professional and courteous conduct during the course of this audit.

Respectfully,

A handwritten signature in black ink, appearing to read "John P. McDonough", written over a horizontal line.

John P. McDonough  
Secretary of State

Cc: Lawrence Myers  
Director of Financial Administration  
Executive Department

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