

Audit Report

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**Office of the Secretary of State**

October 2008

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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 3, 2008

Senator Verna L. Jones, Co-Chair, Joint Audit Committee  
Delegate Steven J. DeBoy, Sr., 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 September 23, 2005 and ending March 5, 2008. Under the Maryland Constitution and other State statutes, the Secretary of State performs a variety of duties including attests to the Governor's signature on all public papers; registers, regulates, and informs the public about charitable organizations; administers the Notary Public laws; and compiles and publishes all of the State's administrative regulations.

Our audit disclosed that the Office's website did not accurately reflect the compliance status of a number of charities with respect to the registration requirements of the Maryland Solicitations Act. We also noted that the Office had not implemented adequate procedures to identify private foundations affiliated with State agencies.

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

Respectfully submitted,

Bruce A. Myers, CPA  
Legislative Auditor



## **Background Information**

### **Agency Responsibilities**

The Office of the Secretary of State attests to the Governor's signature on all public papers and documents, and is the repository for the Governor's Executive Orders. The Office's 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 2007 totaled approximately \$2.7 million.

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

Our audit included a review to determine the status of the three findings contained in our preceding audit report dated February 2, 2006. We determined that the Office had satisfactorily resolved one of these findings. The remaining two findings are repeated in this report.

## **Findings and Recommendations**

### **Charities**

#### **Finding 1**

**Certain charities were incorrectly listed on the Office's website as being in good standing.**

#### **Analysis**

Certain charities were incorrectly listed on the Office's website as being in good standing, when in fact the charities had not submitted all required registration documents. Our review of 20 charities disclosed 12 charities that, as of March 2008, had not submitted all required registration materials (for example, audit reports) for their 2006 registration year. However, these 12 charities were incorrectly listed on the Office's website as being in compliance with the Maryland Solicitations Act. These 12 charities collected contributions of approximately \$30.6 million for the most recent year reported.

The Maryland Solicitations Act requires that a charitable organization submit an annual report to the Office, which includes certain financial information. By law, the annual reports are due six months after each charitable organization's fiscal year end. Furthermore, the Act provides that the Office is required to inform the public of information that will help the public make informed decisions about charitable contributions to charitable organizations. This same condition was commented upon in our two preceding audit reports dating back to June 2002. According to the Office's records, there were approximately 7,800 charitable organizations registered with the Office during fiscal year 2007.

### **Recommendation 1**

**We again recommend that the Office accurately report the compliance status of all charitable organizations on its website.**

## **Foundations Affiliated with State Agencies**

### **Finding 2**

**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 preceding audit report. In response to that report, the Office stated that, in order 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. The letter would inquire about their knowledge of foundations affiliated with their agency.

Our current audit disclosed that, although the Office revised the registration and renewal forms in March 2007, the forms were not always being used. Our review of 10 registration renewals, which took place after March 2007, disclosed 7 instances in which the revised forms were not used. In addition, we were advised that, although the aforementioned letter to State agencies was developed, such letters had never been sent.

Our limited review of the Office's database of registered charities disclosed one organization that is affiliated with a State agency, but had not been identified as such by the Office. As a result, the Office was unable to ensure that the

organization submitted all required reports. According to the Office's records, the aforementioned organization received charitable contributions of approximately \$128,000 during 2006.

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 2**

**We again recommend that the Office implement procedures to adequately identify foundations affiliated with State agencies. Furthermore, we recommend that the Office ensure that all affiliated foundations submit required reports, including the one organization identified by our review, and review these reports as required.**

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

We have audited the Office of the Secretary of State for the period beginning September 23, 2005 and ending March 5, 2008. 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 State Government Article, Section 2-1221 of the Annotated Code of Maryland, the objectives of this audit were to examine the Office's financial transactions, records and internal control, and to evaluate its compliance with applicable State laws, rules and regulations. 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. 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 does not include any 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 includes findings regarding significant instances of noncompliance with applicable laws, rules, or regulations.

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

## APPENDIX

**STATE OF MARYLAND**  
**EXECUTIVE DEPARTMENT**

**MARTIN O'MALLEY**  
GOVERNOR

**ANTHONY G. BROWN**  
LT. GOVERNOR



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**JOHN P. McDONOUGH**  
SECRETARY OF STATE  
**BRIAN R. MOE**  
DEPUTY SECRETARY OF STATE

September 30, 2008

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

Dear Mr. Myers:

Thank you for providing me with a copy of the draft report to the Members of the Joint Audit Committee concerning the audit of the Office of the Secretary of State for the period beginning September 23, 2005 and ending March 5, 2008. 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. Charitable Organizations

Beginning in July 2008 the Office took steps to improve the accuracy of the information on the website regarding an organizations' status by instituting an internal policy of identifying a charity's compliance status in a more timely fashion. By law, a charity is not delinquent until the 61<sup>st</sup> day from the renewal date. Assessment of delinquent fees begins at that time. Additionally, many organizations are granted extensions by the Internal Revenue Service (IRS) which the State acknowledges. All follow established policies to contact the charity in an effort to obtain required documentation. With adherence to these procedures, the disclosure statement that appears on the website regarding a charity's compliance more accurately reflects that organization's status. The disclosure messages are:

Standard Compliance Statement

*This Organization is in full compliance with the Maryland Solicitations Act.*

Pending Statement

*This organization has applied to register under the Maryland Solicitations Act but has not submitted all of the required information to be registered and in full compliance with the Act and cannot solicit charitable donations.*

This disclosure is primarily for an organization who is registering with the Office for the first time.

Delinquent Statement

*This organization is not in full compliance with the Maryland Solicitations Act because the organization has not submitted all of the information to maintain its registration.*

This disclosure is for an organization that has previously registered with the Office and was previously in full compliance but has not submitted all of the information to *maintain* its registration.

We would also point out that the test sample used by the legislative auditor was not a random sample, but was selected from a “pool” that the auditor had reason to believe might be out of compliance. Thus, the finding of 12 noncompliant charities out of 20 charities does not reflect the level of compliance of charities registered with the Office.

Moreover, by law a charity may request and the Office is required to grant, an extension if the Internal Revenue Service has granted an extension for their tax return. Additionally, some organizations may appear to be out of compliance because of the lack of an audit or accounting review. Before listing an organization as delinquent for this reason, a closer evaluation of the source of income is made to determine whether the office should exercise its discretion under section 6-302(c) of the Act.

Finally, we note that based on the auditor’s recommendations from previous years that the Office made a greater effort to identify organizations that should be registered, the number of registered charities has mushroomed. Unfortunately, the number of staff members to process the registrations has not increased, so it is a continuing challenge to keep the website current.

2. Foundations Affiliated with State Agencies

The Office concurs with the recommendation to develop additional procedures to identify foundations affiliated with State agencies. A question regarding whether a foundation is affiliated with a State agency has been added to the registration for and to the annual renewal form that must be completed by all charitable organizations registered with our Office. During the audit period staff members were using an outdated form. A new form, revised 2/14/08, has replaced all of the previously used forms.

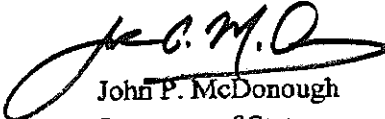
The Office prepared a letter to Secretaries and Financial Officers of various State agencies that inquired about their knowledge of foundations affiliated with their agencies. This letter will be sent on an annual basis beginning this fiscal year.

The information gathered from the addition of the question on the registration forms and the annual letter to State agencies will be checked against our charity database to ensure those foundations required to submit an agreed upon procedures report to our Office have done so.

Agree upon procedures reports submitted to our Office are currently reviewed using an internally developed checklist. Any discrepancies are followed up on with a letter to the foundation. These reviews and follow-up procedures will continue as recommended.

The Office of the Secretary of State appreciates the time and effort taken by the legislative audit staff to conduct our audit. Since our last 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 regulation, as well as to the citizens of Maryland. Should you have any further questions about the audit, please contact my Director of Finance, Frederick Smalls, at 410-260-3853.

Sincerely,



John P. McDonough  
Secretary of State

Cc: Robert Platky  
Director of Financial Administration  
Executive Department

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