

An Audit Report on

Financial Systems at the Office of the Secretary of State

November 2005

Report No. 06-013



Financial Systems at the Office of the Secretary of State

Overall Conclusion

Significant weaknesses in the Office of the Secretary of State's (Office) controls over its revenue processes limit its ability to safeguard revenue that it collects from citizens and businesses for providing various services. Specifically, the Office does not immediately log cash and checks upon receipt, its revenue process is decentralized, and its staff's revenue processing duties are not properly segregated. As a result, the Office has an inadequate system of internal controls. A good system of controls is necessary to ensure that assets that are particularly vulnerable to loss and theft are physically secured and that access to them is limited. Furthermore, in about 38 percent of cases that auditors tested, the Office's Corporations Division did not deposit revenue into the State Treasury within three business days of receipt as required by Texas Government Code, Section 404.094. (See Chapter 1-A for details). The Office's internal auditor's audit of revenue processing in October 2005, as well as an April 1999 State Auditor's Office audit, reported similar findings (see Appendix 2).

Background Information

The Office's mission is to provide a secure and accessible repository for public, business, and commercial records and to receive, compile, and provide information. In addition, the Office is to assure proper conduct of elections, authorize creation and registration of business entities, and publish state government rules and notices. The Office reported collecting \$73 million in appropriation year 2005. Ninety percent of this revenue was deposited into the General Revenue Fund.

The financial system the Office has used for recording and tracking revenue since 2001, the Business Entity Secured Transactions (BEST) system, lacks some of the controls necessary to ensure the integrity of financial data and processes. As a result, Office staff can alter revenue records, and the Office is unable to effectively monitor the revenue collection process. The Office also has not programmed BEST to identify duplicate and potentially fraudulent customer accounts or to close out financial records at the end of an accounting period. These types of weaknesses create process inefficiencies and also make it difficult for Office staff to perform reconciliations and maximize revenue collection.

The Office has well-developed policies and procedures for processing and recording expenditures, and expenditures appear to be made for valid purposes. Although the Office has good procedures in place, it does not always follow them, which increases the opportunity for unauthorized expenditures to be made.



Key Points

Significant weaknesses in the Office's controls prevent it from properly protecting and recording the revenue it receives.

Because of significant weaknesses in the Office's processes, it cannot determine whether all the revenue it receives is deposited into the State Treasury. In addition, inadequate controls in the Office's revenue collection processes make revenue vulnerable to various risks, including theft and fraud.

The financial system used to record and track revenue does not have sufficient controls to ensure financial integrity.

The Office's BEST system does not have sufficient controls to protect the integrity of its financial processes. As a result, Office staff can and have altered revenue records, and the Office is unable to effectively monitor the revenue collection process. Because of limitations in the BEST system, staff have developed inefficient processes over time to manage their duties.

In addition, BEST is not programmed to prevent the deletion of revenue transactions, and auditors identified that 300,000 records had been deleted from BEST. Further, BEST does not generate logs to summarize deleted transactions so that supervisors can detect deletions and determine the cause for them. This lack of records affects the completeness of data in BEST.

The Office's credit policy significantly hinders its ability to collect revenue due to the State.

The Office's current policy states that it "freely extends credit to everyone seeking access to public records in its custody," which significantly hinders the Office's ability to collect revenue due to the State. The Office currently extends credit regardless of whether an individual's or entity's creditworthiness has been verified and asserts that it maintains this practice in the interest of customer service. This practice is contrary to a state agency's responsibility to protect the interests of the State and its taxpayers. It also puts undue stress on the Office's limited resources because revenue collection practices are often ineffective. Furthermore, the Office's current credit policy is inconsistent with Title 1, Texas Administrative Code, Section 71.9(a).

Summary of Management's Response

The Office agrees with our recommendations, and its responses are included in Appendix 3.

Summary of Objective, Scope, and Methodology

The objective of this audit was to determine whether the Office has effective controls for receiving revenue, ensuring expenditures are made for valid purposes, and maintaining accurate and complete accounting and record keeping of revenue and expenditures.

The audit scope included all aspects of the Office's financial processes for fiscal years 2004 and 2005 and the related financial information systems. Our scope also included a review of internal auditor reports and related working papers from the Office's contracted internal audit firm.

As was discussed above, 300,000 records were deleted from the Office's financial system. Because of the missing transactions and because the Office routinely alters transactions, we could not fully validate the completeness of the Office's revenue data.

The audit methodology consisted of collecting information, performing selected tests and other procedures, analyzing and evaluating the results of the tests, and conducting interviews with Office management and staff.

Summary of Information Technology Review

The information technology component of this audit focused on the automated systems the Office uses to record and track financial information. Results of a review of access controls for the Office's users of the Uniform Statewide Accounting System and the Uniform Statewide Payroll/Personnel System indicated that the Office needs to segregate duties and responsibilities. The systems we reviewed include the BEST system and the Expenditures system.

We also reviewed physical security over the Office's computer systems, including its disaster recovery preparedness. See Chapter 2 for detailed results.

Recent SAO Work		
Number	Product Name	Release Date
99-031	1999 Small Agency Management Control Audit	March 1999
99-334	A Management Control Audit of the Office of the Secretary of State	April 1999

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Detailed Results

Chapter 1

Significant Weaknesses in the Office's Controls Limit Its Ability to Safeguard the Revenue It Receives

Significant weaknesses in the Office of the Secretary of State's (Office) controls over its revenue processes limit its ability to safeguard revenue that it collects from citizens and businesses for providing various services (see Table 1). The Office's internal auditor completed an audit of revenue processing in October 2005 that resulted in similar findings. The State Auditor's Office also identified similar issues in a report issued in April 1999. Appendix 2 contains the detailed recommendations from these audit reports.

A good system of internal controls ensures that assets that are particularly vulnerable to loss and theft are physically secured and that access to them is limited. Key controls to safeguard revenue include:

Table 1

Revenue Collected by the Office's Divisions		
Division	Revenue in Appropriation Year 2004	Revenue in Appropriation Year 2005
Corporations	\$56,407,847	\$59,977,928
Uniform Commercial Code	6,148,014	5,846,118
Statutory Documents	4,389,283	4,673,654
Elections	165,173	219,114
Texas Register	69,401	147,906
Other Services	1,645,855	2,217,407
Totals	\$68,825,573	\$73,082,127

Source: Uniform Statewide Accounting System (USAS)

- Having a centralized cash receipt function to handle revenue.
- Logging revenue immediately and depositing it in a timely manner.
- Limiting access to revenue to only the minimum number of people who need access.
- Maintaining proper segregation of duties.

The Office needs to improve its processes and controls in all of these areas.

The Office reported collecting \$68.8 million in appropriation year 2004 and \$73 million in appropriation year 2005 (see Table 1). Ninety percent of appropriation year 2004 revenue was deposited into the General Revenue Fund.

The Office Does Not Have Reasonable Assurances that All Revenue Is Deposited

The controls in the Office's revenue collection process are inadequate, which makes revenue vulnerable to various risks, including theft and fraud. These control weaknesses also make it difficult for the Office to determine whether all revenue it receives is deposited into the State Treasury. Table 2 shows standard cash collection controls described in written guidance provided by authorities in the auditing community and whether the Office uses each control. (For a description of the Office's procedures related to each control, see the text below the table.)

Table 2

Standard Cash Collection Controls	Does the Office Use This Control?
Log revenue and immediately endorse checks and money orders upon receipt.	No
Physically safeguard cash and related items against theft and loss.	No
Limit the number of people with access to revenue.	No
Segregate duties for preparing deposits and recording transactions.	No
Identify, analyze, record, and report shortages.	Yes
Deposit funds within three business days of receipt.	No
Review and approve voids and transactions prior to refunding them.	Yes
Maintain supporting documentation for all deposits.	No

Source: *Internal Control Management and Evaluation Tool*, U.S. Government Accountability Office, Report GAO-01-1008G, August 2001; and *AICPA Audit and Accounting Manual: Nonauthoritative Practice Aids*, American Institute of Certified Public Accountants, Section 4600.190, p. 4,613.

Log revenue and immediately endorse checks and money orders upon receipt

Cash and checks are not immediately logged and date stamped when the Office receives them. Incoming mail goes to the mailroom, where staff open the envelopes; however, the mail is not logged or date stamped in the mailroom. Instead, revenue is recorded later in the process when mailroom staff distribute the mail among the divisions. Because cash and checks are not logged immediately, auditors could not determine how long revenue had been at the Office before it was actually processed.

Physically safeguard cash and related items against theft and loss

Office mail is not sufficiently safeguarded against theft or loss. Auditors observed several instances in which controls were compromised or not in place. For example:

- Auditors observed tubs of documents, cash, and checks that were left unsecured during the day. Office staff placed unprocessed revenue in

locked filing cabinets overnight but left the keys to these cabinets in unlocked desks.

- Individuals other than Office employees had access to keypad codes on doors that were intended to secure revenue areas.
- The safe that the Financial Division used to store daily deposits, as well as paper used to print checks, was left unlocked during the day. Although the door to the office where the safe is housed is secured by a keypad, several people had access to the code for that keypad. Further, auditors observed instances in which the door to the office was left opened and unattended. This is a significant risk because the Office collects an average of about \$200,000 daily.
- The security camera, video recorder, and monitoring system in the Corporations Division's reception area are directly controlled by revenue team personnel.

Limit the number of people with access to revenue

The Office delegates the responsibility for revenue processing to each division, and each division has its own procedures for processing revenue. This decentralized revenue processing function and the number of employees who have access to cash and checks on a daily basis increase the risk of theft and fraud. A recent internal audit report identified 58 employees who have access to cash and checks on a daily basis in the divisions that handle approximately 90 percent of the Office's revenue.

Segregate duties for preparing deposits and recording transactions

Several of the individuals who receive cash and checks are also involved in preparing bank deposits. These functions should be segregated to decrease the opportunity for the manipulation of bank deposits without detection.

Identify, analyze, record, and report shortages

The Office analyzes differences between transactions that have been entered into the Business Entity Secured Transactions (BEST), which is the system that the Office uses to record and track revenue, and the corresponding deposits. However, this may not be an effective control because Office staff can and have directly altered transactions in BEST. For example, staff process insufficient funds checks that are returned to the Office by changing the original transactions in the financial system. These types of alterations to transactions make it difficult for Office staff to reconcile the financial system data to the deposits.

Deposit funds within three business days of receipt

In about 38 percent of cases that auditors tested, the Office's Corporations Division did not deposit revenue into the State Treasury within three business days of receipt as required by Texas Government Code, Section 404.094. The length of time before revenue was deposited and percentage of late deposits could be greater than our testing results indicated because we had to rely on date stamps other than those that should have been recorded at the initial receipt of revenue. This is because (1) mail is not logged immediately upon receipt in the mailroom but instead is sent to divisions for handling and (2) the Corporation Division disposes of envelopes that are stamped with the date it receives them. The Corporations Division's revenue accounted for approximately 82 percent of the revenue the Office collected in appropriation year 2005 to date.

Review and approve voids and transactions prior to refunding them

The overall policies and procedures the Office has in place to process transactions classified as refunds are adequate. This includes the review and approval of transactions prior to issuing a refund. However, the Office has no documented policies and procedures for handling voids. In practice, voids are processed without supervisory review or approval. The Office can determine which employee voided a transaction because BEST requires the employee to enter an explanatory comment for voids. This comment links to the employee's user ID and enables the Office to trace the void back to the employee who processed it.

Maintain supporting documentation for all deposits

The Office does not maintain adequate supporting documentation in its files for daily deposits. As discussed above, it generally does not log revenue, does not consistently maintain support showing when documents are received, and does not keep envelopes that indicate the date revenue is received.

Recommendations

The Office should:

- Ensure that all revenue is deposited in the State Treasury within three business days of receipt as required by statute.
- Develop procedures to mitigate the risk of theft of incoming cash and checks. These procedures should include the following:
 - ◆ Restrict the number of employees who handle cash and checks to the minimum necessary.

- ◆ Cash and checks should be logged, restrictively endorsed, and date stamped immediately on the day the Office receives them.
- ◆ Require two employees be present when the mail is opened.
- ◆ Separate checks from documents when the mail is opened.
- ◆ Safeguard cash and checks by enforcing security controls over doors, cabinets, and safes.
- ◆ Maintain appropriate segregation of duties, such as assigning the cash receipt function and the processing function to separate individuals.

Chapter 1-B

The Office's Credit Policy Limits Its Ability to Collect Revenue Due to the State

The Office's current policy states that it "freely extends credit to everyone seeking access to public records in its custody," which limits the Office's ability to collect revenue due to the State. The Office currently extends credit in the interest of customer service, without verifying an individual's or entity's creditworthiness. However, this practice is contrary to a state agency's responsibility to protect the State's and taxpayers' interests. It also puts undue stress on the Office's limited resources because collection practices are often ineffective.

Furthermore, the Office's current credit policy is inconsistent with some rules and statutes that require that fees and charges be paid prior to providing the transaction or service. For example:

- Title 1, Texas Administrative Code, Section 71.9(a), states that "Fees and charges payable to the secretary of state are required to be paid in advance, that is, at the time of presenting a document for filing or making a request for information for which a fee or charge is payable."
- Texas Government Code, Chapter 405, requires the Office to collect fees on certain transactions, and many of these fees are required to be collected before information is provided.

Table 3 presents selected fees the Office is required to collect in advance of providing services.

Table 3

Services for Which the Office is Required to Collect Fees in Advance	
Type of Service	Reference
Official certificate	Texas Government Code, Section 405.031 (f)
Certified copy of a record	Texas Government Code, Section 405.031 (f)
Certificate of existence or change to entity's organizational documents or certificate for registration or authorization	Texas Government Code, Section 405.031 (f)
Maintenance of a record of the service of any process, notice, or demand authorized to be made on the Secretary of State as agent	Texas Government Code, Section 405.031 (f)
Uncertified copies of records	Texas Government Code, Section 405.031 (f)
Information that is not readily available or in excess of 50 pages	Title 1, Texas Administrative Code, Sections 71.8 (d) and 71.9 (a)
Delivery of requested copies by facsimile transmission or other electronic means	Title 1, Texas Administrative Code, Sections 71.9 (a) and 71.8 (e)

The Office's policy of extending credit freely to customers has affected how it has programmed BEST. Currently, BEST is not helpful in identifying, pursuing, and preventing delinquent accounts because of the following issues:

- BEST does not have adequate controls to assist the Office in actively pursuing delinquent accounts. The Office's current practice is to send a delinquent notice when a bill has been outstanding for 120 days. No other collection efforts are pursued until the end of the fiscal year, when the Office sends a list of bad debts to the Office of the Attorney General. The accounts receivable total and bad debt total were approximately \$424,555 and \$88,000, respectively, as of July 14, 2005. However, weaknesses in the Office's accounting system and financial records create doubt about the accuracy of these amounts, as is described in more detail below.
- Inactive flags can be overridden. BEST has built-in flags to indicate accounts that are 120 days or more past due, which puts these customers in an "inactive" status and prevents them from charging any additional services to their accounts. However, Office management and BEST allow for this control to be overridden. For example, one customer who had a balance of \$775 for three years paid \$20 in order to receive another service on credit. BEST changed this customer's status to "active" and allowed the customer to continue to receive additional services on account, thereby accruing additional debt to the State. As a result, BEST no longer flags this account as past due. This account and others like it were not flagged as delinquent when auditors reviewed the system; therefore, the total amount of bad debt and accounts receivable could be higher than BEST information indicates.

Further, the additional service that was provided to this particular customer on account is a service for which the customer was statutorily required to pay in advance. In other words, the Office should not have allowed this service's cost to be charged.

- Multiple accounts can be created. Many entities and individuals have the ability to open multiple accounts, which makes managing accounts extremely difficult and cumbersome. If an entity or individual has multiple accounts, the Office may not be able to determine the total amount owed by that entity or individual.

The Office's current policies and procedures also allow customers to incur debt to the State even when customers appear to have little or no intent to pay. For example, auditors identified instances in which false accounts had been established to obtain information. In these instances, the Office extended credit to people who had submitted false information and apparently had no intention of paying for the services they received. Furthermore, the Office extended credit to individuals who had already been indebted to the Office for over a year.

To determine whether Office customers agreed with its records of amounts

**Accounts Receivable
Confirmation Letters**

Auditors frequently send customers of an agency or company letters to verify the existence of outstanding debts. These letters are called confirmation letters. The customers are asked to respond and verify that they owe the amount stated on the letter or provide an explanation for why that amount is incorrect or why the debt is nonexistent. This gives auditors some level of assurance regarding the integrity and accuracy of the data in the agency's or company's financial systems.

owed, auditors sent accounts receivable confirmation letters to 293 Office customers (see text box for additional details). The letters asked the customers to confirm the balances they owed. Of 135 customers who responded, approximately 27 percent did not agree with the balances the Office said they owe. Because we took into account timing differences (i.e., time that lapsed between our mailing the confirmation letters and customers' receiving additional services or paying for services) and other such factors, the remaining differences may indicate that the Office's accounts receivable data cannot be relied upon in making management decisions.

The Office's policy to extend credit to customers is not only contrary to some statutes but is also not a common practice among other states we surveyed. To determine the credit policies of similar agencies and compare them with the Office's, auditors contacted 14 other states' secretary of state offices. Twelve (86 percent) required payment in advance for information; two (14 percent) did not. Of those two, one extended credit only to corporations and only after receiving credit approval. The remaining state extended credit to individuals or corporations.

Recommendations

The Office should:

- Re-evaluate its credit policy and ensure that this policy includes consideration of all relevant laws and meets statutory requirements. If the Office intends to continue extending credit, it should consider extending credit only to corporations or businesses that have completed a credit approval process.
- Establish procedures and document the collection of past-due accounts. At a minimum, the procedures should document:
 - ♦ Initial collection steps for overdue accounts.
 - ♦ Timing of collection letters and legal action.
 - ♦ Authorization and the decision process for settlements of bad debt and write-offs.
 - ♦ Process for logging incoming complaint/collection phone calls and documenting the subsequent disposition.
- Regularly monitor receivable accounts to analyze:
 - ♦ Age of receivables.
 - ♦ Turnover of receivables.
 - ♦ Amount of bad debt.
 - ♦ Processing time (collection float).

Performance monitoring and evaluations based on these analyses should be communicated to management.

Chapter 1-C

The Office Is Not Reporting Individuals with Outstanding Debts to the Comptroller's Office as Required by Statute

The Office is not taking advantage of procedures offered by the Office of the Comptroller of Public Accounts (Comptroller's Office) to stop all payments from State of Texas agencies and universities to individuals with outstanding accounts receivable balances. Using these "warrant hold" procedures, which are intended to help the State collect delinquent debts and taxes, would provide those individuals with an additional incentive to pay the Office.

Chapter 403 of the Texas Government Code requires state agencies to report to the Comptroller's Office the names of individuals who are indebted to the State. In addition, it requires agencies to use the procedures offered by the Comptroller's Office to ensure that the State does not make payments to individuals who already owe the State money.

Recommendations

The Office should begin using the warrant hold procedures to provide an additional incentive for individuals to pay their outstanding debts.

The Financial System Used to Record and Track Revenue Does Not Provide Accurate and Complete Accounting Records

The Office's BEST system lacks some of the controls necessary to ensure the integrity of financial processes (see text box for background information on BEST). As a result, Office staff can easily alter revenue records, and the Office is unable to effectively monitor the revenue collection process. The

The BEST System

The Office began using the BEST system in August 2001 primarily as a document management system to track document filings. The accounting function was added later and does not contain all of the necessary controls to ensure the integrity of the data.

Office also has not programmed BEST to identify duplicate and potentially fraudulent customer accounts or to close out financial records at the end of an accounting period. These types of weaknesses create process inefficiencies and also make it difficult for Office staff to perform reconciliations and maximize revenue collection.

Although the Office is generally securing its computer systems, auditors identified certain areas in which physical security, access, and disaster recovery planning could be improved. These are detailed in Table 4 on page 13.

Chapter 2-A

The Office's Financial System Does Not Have Sufficient Controls to Ensure Financial Integrity

BEST does not have sufficient controls to ensure the integrity of the Office's financial data. The reliability of BEST is significantly affected because customers can circumvent system controls, staff can and have altered records without recording a history of actions taken, and records have been deleted. In addition, because of limitations in the BEST system, staff have developed inefficient processes over time to manage their duties. Some of these processes also hinder the use of good controls, such as the ability to properly segregate duties. Specifically, auditors identified the following:

- The Office has not programmed BEST to prevent customers from creating duplicate or false accounts. Auditors identified instances in which customers set up duplicate and false accounts through which they received services on credit. Duplicate and false accounts could be created to circumvent the Office's credit policies and procedures.
- BEST is not programmed to close financial records at the end of an accounting period. As a result, the Office is unable to effectively reconcile BEST with the Uniform Statewide Accounting System (USAS). Instead, it creates a line item (a "plug figure") referred to as "unlocated differences" to force the two systems to reconcile. The Office attempts to reconcile BEST to USAS on a monthly basis. This process takes about 24 hours because the reconciliation must include all transactions since the inception of BEST (instead of just one month).

- Controls are not built in to prevent employees from altering batches from previous accounting periods. Office staff can and have altered original BEST transactions from previous periods (going back to the system's implementation in 2001). This eliminates the audit trail, affects the reliability of historical financial information, and prevents financial staff from being able to conduct effective reconciliations. As a result, the Office has little assurance that account balances in BEST are accurate. In its responses to a recent internal audit report that also identified this issue, management indicated that it intends to develop a task force to consider solutions to this problem.
- Approximately 300,000 records were deleted from BEST. BEST is not programmed to prevent the deletion of records (including revenue transactions), and auditors determined that 300,000 records had been deleted from BEST. Further, BEST does not generate logs to summarize deleted transactions so that supervisors can detect and determine the cause for the deletions. The missing records affect the completeness of data in BEST.
- Monthly accounts receivable billings, which should be processed by accounting staff, are actually processed by information technology (IT) staff. This occurs because extracting the necessary information from BEST to process billings requires extra technical steps. In effect, IT programmers not only have access to live data but are also performing the accounting function, creating a significant lack of segregation of duties and an opportunity to accidentally or intentionally alter financial data.
- The list of customers who receive bills via e-mail is maintained in a separate database that does not interface with BEST. This information is not always transferred to BEST so that it can include complete and accurate information. Maintaining separate systems results in inefficiencies and compromises the accuracy of customer account information in BEST.

Customer responses and questions regarding e-mail billing notifications are directed to an employee's individual e-mail account instead of to a separate account set up specifically for this purpose. The commingling of individual and Office correspondence obscures the accounts receivable audit trail and increases the risk that customer e-mails could be accidentally deleted, moved, or misfiled. As a result, some customers may not receive responses to their e-mails.

Recommendations

The Office should:

- Identify duplicate accounts in BEST and prevent their creation in the future. Management should periodically monitor BEST transactions for inappropriate or questionable activities and follow-up as necessary.
- Program BEST to:
 - ♦ Close out accounting periods monthly.
 - ♦ Prevent employees from altering data from previous accounting periods.
 - ♦ Identify and sequentially number revenue transactions and prevent their deletion.
 - ♦ Generate the monthly e-mail bills to customers.
- Maintain a list of customers who receive bills via e-mail.
- Separate the accounting and IT functions to ensure segregation of duties.
- Direct customer responses and e-mail inquiries to an accounts receivable e-mail account instead of to an individual's e-mail account.

Chapter 2-B

The Office Can Take Further Actions to Improve Controls over Its Automated Financial Systems

While the Office is generally securing its computer systems for revenue and expenditures, auditors identified certain areas in which physical security, access controls, and disaster recovery planning should be improved. See Table 4 for detailed information.

Table 4

Weaknesses in Information System Security	
Type of Control	Weakness
<p>Physical Security Controls Protect computer hardware against physical damage.</p>	<ul style="list-style-type: none"> ▪ The fire-suppression system comprises a few hand-held extinguishers that have not been inspected since 1998.
<p>Access Controls (logical security control) Restrict the access capabilities of users of the system and prevent unauthorized users from accessing the system.</p>	<ul style="list-style-type: none"> ▪ While proper password rules exist at the network level, there is no password change requirement at the application level. Users are unable to change passwords that have been assigned to them in BEST. This weakens password confidentiality and increases the risk of unauthorized access. ▪ Certain users have the ability to create, submit, and release expenditure vouchers to USAS. This increases the risk that unauthorized transactions could be processed without detection. Further, one of the division directors has the ability to directly modify tables and data in BEST. This access is typically limited to IT staff. Management needs to be aware of the risk associated with granting this access to an end-user division manager, who can authorize transactions, as well as bypass application input edit controls.
<p>Disaster Recovery Planning Plan for system recovery in the event of a disaster.</p>	<ul style="list-style-type: none"> ▪ The Office has a disaster recovery plan that it tests periodically. However, the information in the plan is not complete and has not been updated in three years. ▪ The Office relies on a single connection to the Capitol Network (CAPNET), representing a single point of failure to external access. The Office has alternative communication connections to adjacent buildings, which have separate CAPNET connectivity. However, these routes have not been formally established as backup routes to give redundancy for business continuity.

Recommendations

The Office should:

- Ensure that fire extinguishers are routinely inspected.
- Fully implement the password policies outlined in its newly implemented policies and procedures manual and program BEST to prompt users to change their passwords periodically.
- Periodically review users' access rights, limit users' access to what is appropriate for their job duties, and ensure the appropriate segregation of duties.
- Improve its disaster recovery plan by:
 - ♦ Creating and maintaining a prioritized list of computer hardware and specifying the order of restoration.
 - ♦ Considering establishing a redundant or back-up connection to CAPNET.

The Office's Expenditures Appear to Be Made for Valid Purposes

The Office has well-developed policies and procedures for processing and recording expenditures, and expenditures appear to be made for valid purposes. Although the Office has good procedures in place, it does not always follow them, which increases the opportunity for unauthorized expenditures to be made.

Chapter 3-A

The Office Does Not Consistently Follow Its Policies and Procedures for Expenditures

Auditors did not identify any inappropriate expenditures, but testing of vendor payments, travel expenditures, procurement card purchases, and travel advances showed that the Office does not always maintain supporting documentation for expenditures as required by its policies and procedures. The Office also does not always document that expenditures were properly reviewed, approved, and paid in a timely manner. Late payments of expenditures can result in increased cost to the State.

Specifically, tests auditors conducted identified the following:

- 11 percent (11 of 102) of vendor payments and travel expenditures tested did not have adequate supporting documentation and/or proper approval.
- 12 percent (7 of 60) of procurement card purchases tested did not have proper supporting documentation. Further, the Office does not retain its purchase log and approval documentation; therefore, there is no record of who made the purchases and whether they were approved. The Office asserted that it started retaining purchase logs and approval documentation when auditors brought this to its attention.
- 5 percent (5 of 102) of expenditures tested were not processed in a timely manner.

Overall, payroll items tested were appropriate, and items that were lacking the appropriate approval were immaterial.

The Office advances travel funds to employees for election inspections, election monitoring, and conference attendance. The Office made 152 travel advances from September 2003 through July 2005. In an examination of 61 travel advances, 37 of which resulted in reimbursements due from employees, auditors found the following:

- 59 percent (22 of 37) of the reimbursements due from employees (funds that were advanced to the employees but not used during travel) were not

received within 30 days of completion of travel as required by Office policy. The average reimbursement time was 41 days.

- 57 percent (21 of 37) of the reimbursements were not deposited in the bank within three business days as required by Texas Government Code, Section 404.094.
- 8 percent (5 of 61) of the travel advance requests did not include at least one of the required approval signatures.

Recommendations

The Office should:

- Improve its review and approval processes to ensure that proper documentation is included for all expenditures.
- Consistently follow its existing policies and procedures regarding travel advances, the payment of expenditures, and the timely reconciliation of data in its expenditures system.

Chapter 3-B

The Credit Card Transaction Fees the Office Collects Are Not Sufficient to Cover Its Processing Expenses

Auditors reviewed the Office's expenses for processing credit card transactions for fiscal years 2004 through 2005 and found that its expenses for processing these transactions exceeded the fees it collected to cover this cost. For September 2003 through July 2005, the Office's cost of processing credit card transactions exceeded the fees it collected by \$127,543. The Office increased its fees on September 1, 2005, but auditors have not determined whether this fee increase is sufficient to cover costs.

Recommendations

The Office should continue to analyze the cost of processing credit card transactions and compare that cost with the amounts it has collected to ensure that expenses are covered and that there is no excess cost to the State. At a minimum, this analysis should be performed on an annual basis.

Appendices

Appendix 1

Objective, Scope, and Methodology

Objective

The objective of this audit was to determine whether the Office of the Secretary of State (Office) has effective controls for receiving revenue, ensuring expenditures are made for valid purposes, and maintaining accurate and complete accounting and record keeping of revenue and expenditures.

Scope

The audit scope included all aspects of the Office's financial processes for fiscal years 2004 and 2005 and the related financial information systems (the Business Entity Secured Transactions [BEST] and Expenditure systems). Our scope also included a review of internal auditor reports and related working papers from the Office's contracted internal audit firm.

Auditors determined that 300,000 records were deleted from the Office's financial system. Because of the missing transactions and because the Office routinely alters transactions, we could not fully validate the completeness of the Office's revenue data.

Methodology

The audit methodology consisted of collecting information, performing selected tests and other procedures, analyzing and evaluating the results of the tests, and conducting interviews with Office management and staff.

Information collected and reviewed included the following:

- Applicable constitutional and statutory provisions
- Internal audit reports and related working papers
- Agency policies and procedures
- Credit policies of selected states' secretary of state offices
- Organizational charts
- Annual financial reports
- Deposit reports
- Network access documentation for the BEST and Expenditure systems

Procedures and tests conducted included the following:

- Conducted interviews with:
- Agency management and staff
- The Office's contracted internal audit firm
- Sent accounts receivable confirmation letters to 293 Office customers to confirm balances
- Observed various Office financial processes
- Tested the Corporations Division's cash receipts process
- Tested the Office's refund processes
- Tested the Office's travel advance processes
- Tested Office expenditures (procurement card purchases, travel, payroll, and vendor payments)
- Tested network access for the Office
- Performed a limited review of voids processed in BEST

We were able to rely on recent revenue processing work performed by the Office's internal auditor for portions of our audit. Internal audit conducted interviews with knowledgeable Office personnel, obtained and inspected pertinent documentation, and tested revenue processing procedures to determine whether adequate controls and effective procedures were in place for processing revenue agency-wide using BEST. We used the methodology prescribed for auditors' consideration of the internal audit function to assess the competence, objectivity, and effectiveness of the internal auditor's work.¹ References to the internal audit work performed are clearly noted in the body of this report.

Criteria used included the following:

- Texas Constitution, Article 9
- Texas Government Code, Chapters 403, 404, and 405
- Title 1, Texas Administrative Code, Chapter 71
- Office policies and procedures

¹ American Institute of Certified Public Accountants, Statement on Auditing Standards No. 65

- *Internal Control Management and Evaluation Tool*, U.S. Government Accountability Office, Report GAO-01-1008G, August 2001
- *AICPA Audit and Accounting Manual: Nonauthoritative Practice Aids*, American Institute of Certified Public Accountants, Section 4600.190, p. 4,613

Project Information

We conducted the audit from July 2005 through September 2005. The following members of the State Auditor's staff performed this audit:

- Stacey A. Williams, CGAP (Project Manager)
- Mary Wise, CPA (Assistant Project Manager)
- Dean Duan, CISA, Information Systems Audit Team Member
- Harriet A. Fortson, MACC
- Joe Kozak, CPA, CISA, Information Systems Audit Team Member
- Yulia Plakhotnikova
- Bill Vanecek
- Charles P. Dunlap, Jr., CPA (Quality Control Reviewer)
- Sandra Vice, CIA, CGAP, CISA, Assistant State Auditor

Recommendations from Prior Audit Reports

Table 5

Prior Recommendations Issued by the Office's Internal Auditor		
	Recommendation	Management Agrees/ Disagrees
1	Discontinue the practice of re-opening closed batches.	Agree
2	Management should: (1) reduce number of staff in Uniform Commercial Code and Corporations that access revenues, (2) segregate duties, (3) restrictively endorse checks when received, (4) deposit funds in State Treasury in a timely manner.	Disagree
3	Count and sign off on money transfers between divisions.	Agree
4	Close out the Business Entity Secured Transaction (BEST) system on a monthly basis and discontinue changing transactions from closed periods.	Agree
5	Units within the Office using BEST for "Standalone" processing should (a) date stamp documents when received, (b) use date stamped for entry into BEST, (c) maintain cash receipts log, (d) restrictively endorse all checks, and (e) reconcile cash log to BEST on monthly basis.	Agree
6	Modify BEST to allow Citations and Notary Public division to process documents using BEST.	Agree
7	Implement recommendations 1, 2, and 3 for units with Standalone revenue processing.	Agree/Disagree
8	Locate reasons and make adjustments for variances when conducting monthly reconciliation rather than having an "unlocated differences" line item.	Agree
9	Establish standard accounting period; close each period; and use new batches to make prior period adjustments instead of opening batches within closed period.	Agree
10	Develop standard wait time before mailing refund checks to allow the original overpayment checks to clear their financial institutions before sending refund checks to customers.	Disagree
11	If feasible, an automated comparison should be developed to compare refund payees to customer lists in BEST with accounts receivable balances and to the Comptroller's list of NSF checks before refund checks are issued.	Disagree
12	Revise current bad debt collection practice to include: (a) an acceptable dollar threshold, (b) all necessary client contact information, and (c) documentation of collection efforts on standardized form.	Agree
13	Standardize methodology used by BEST to determine when accounts become delinquent and/or bad debt status. The methodology should allow for single, fully funded transactions occurring after becoming delinquent and avoid considering these accounts in an acceptable status because some payment has occurred during the month.	Agree
14	Journal voucher rights should be limited to a few, well-trained staff in each division and specific instructions should be provided by the Financial Management division regarding the maintenance of adequate documentation.	Agree
15	The Office should develop a means by which all imaged document batches have a date of receipt indicated to provide more complete documentation.	Disagree
Prior Recommendations Issued by the State Auditor's Office		
	Recommendation	Management Agrees/ Disagrees
1	The Office should log checks upon receipt, adequately segregate revenue processing duties among the divisions, safeguard unprocessed receipts, and reconcile logged checks to cash deposits.	Disagree
2	The Office should consider centralizing the revenue collecting functions for the smaller divisions.	Not Addressed
3	The Office should comply with the State's three-day deposit rule or determine whether an exemption from the Comptroller would be applicable.	Disagree

Source: *Office of the Secretary of State Internal Audit of Agency-wide Revenue Processing*, October 2005; and *A Management Control Audit of the Office of the Secretary of State*, SAO Report No. 99-334, April 1999.

Management's Response

The State of Texas



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Roger Williams
Secretary of State

November 10, 2005

Sandra H. Vice
Assistant State Auditor
Robert E. Johnson Building
1501 N. Congress Avenue
Austin, Texas 78701

Dear Ms. Vice:

Thank you for the audit work performed by you and your staff. It is advantageous to me, as a still relatively new office holder, to have the perspective of an independent audit report on the Office's operations.

We have reviewed the draft report on financial systems at the Office. Our management responses for each recommendation and issue follow.

Recommendations The Office should:

- Ensure that all revenue is deposited in the State treasury within three business days of receipt as required by statute.
- Develop procedures to mitigate the risk of theft of incoming cash and checks. These procedures should include the following:
 - ◆ Restrict the number of employees who handle cash and checks to the minimum necessary.
 - ◆ Cash and checks should be logged, restrictively endorsed, and date stamped immediately on the day the Office receives them.
 - ◆ Require two employees to be present when the mail is opened.
 - ◆ Separate checks from documents when the mail is opened.
 - ◆ Safeguard checks and cash by enforcing security controls over doors, cabinets, and safes.
 - ◆ Maintain appropriate segregation of duties, such as assigning the cash receipt function and the processing function to separate individuals.

Management's Response

Management agrees.

The agency will seek to improve its compliance with the three-day deposit rule, will more closely monitor the timing of deposits, and improve the timing of delivery of deposits to the State Treasury where possible, not inconsistent with its statutory duties. Recent performance

statistics for the Corporations Section for October 2005 indicate compliance has improved to 91% of checks reconciled to a deposit within three days of receipt.

Prior audit reports have recommended enhancements to internal controls that the agency has implemented. The agency embedded improved internal controls over revenue in the Business Entity Secured Transactions (BEST) document filing system. These internal controls include.

- Each payment and each document is logged into the BEST computer system after the mail is opened and contents removed.
- Checks are restrictively endorsed and unique identifier information is logged into BEST for each payment and each document.
- Logged information includes date of receipt, amount of payment, method of payment, name and address of submitter, and type of document.
- Incoming revenue is tracked from the point of receipt by the section revenue processing unit through deposit, return or refund.
- Logged checks, cash, and other revenue receipts are reconciled with deposits to provide assurance that all revenues received are deposited into the State Treasury.
- Controls exist in the computer system to ensure that the correct statutory fees are collected and deposited when documents are filed or certificates or copies issued.

The majority of fees collected by the Secretary of State are filing fees. By statute, the Secretary of State is charged with the responsibility of determining prior to filing that documents conform to law. Until a determination is made that a document conforms to law, the state has not earned the revenue and is not entitled to retain and deposit the fee. Deposit of the fee on receipt may be construed to be acceptance of the document for filing which may present legal issues regarding the filing of that document. Therefore, a check will remain with a document until the document is reviewed and a filing decision is made. Additionally, the agency asserts that the cost of depositing and refunding fees when documents are not filed substantially exceeds any loss of interest revenue to the state by a slight delay of deposit. In September 2005, the Corporations Section rejected 4,500 documents for failure to comply with the required statutory requirements of law. To have deposited checks and issued refunds related to those rejections, the agency would incur a substantial increase in operational cost and a degradation of customer service standards.

Management will emphasize anew the importance of consistently using security controls over doors, cabinets, and safes. Part of the process will be to review the security policy, modify as necessary, and ensure all employees are aware of agency security objectives. In addition, as funds permit, management will evaluate the installation of more modern security systems such as card access where justifiable.

Within the limitations of resources, the demands of seasonal fluctuations in workload, and consistent with its statutory mandates, office will seek to improve internal control procedures where ever possible.

Recommendations The Office should:

- Re-evaluate its credit policy and ensure that this policy includes consideration of all relevant laws and meets statutory requirements. If the Office intends to continue extending credit, it should consider extending credit only to corporations or businesses that have completed a credit approval process.
- Establish procedures and document the collection of past-due accounts At a minimum, the procedures should document:

- ◆ Initial collection steps for overdue accounts.
- ◆ Timing of collection letters and legal action.
- ◆ Authorization and the decision process for settlements of bad debt and write-offs.
- ◆ Process for logging incoming complaint/collection phone calls and documenting the subsequent disposition.
- Regularly monitor receivable accounts to analyze:
 - ◆ Age of receivables.
 - ◆ Turnover of receivables.
 - ◆ Amount of bad debt.
 - ◆ Processing time (collection float).
- Performance monitoring and evaluations based on these analyses should be communicated to management.

Management's Response

Management agrees.

The Office will thoroughly review its credit policy with the objective of maximizing public access to state records while ensuring adequate controls to protect the state's financial interests. However, the essence of the current policy will be preserved. That is, we will provide public information to our customers when the customer needs it while ensuring any losses to bad debt do not exceed our historical standard of less than one percent. The Office will revise its procedures and documentation as necessary to incorporate the recommendations as fully as possible while not detrimental to the policy of easy and timely access to public information. Implementation of any changes resulting from the credit policy review will require changes to BEST, other databases, and reports. The Director for Administrative Services will be responsible for any changes to policies and procedures. The Director for Information Resources will be responsible for changes to the supporting technology. The Office plans to accomplish these changes by September 1, 2006.

Recommendation The Office should:

- Begin using the warrant hold procedures to provide an additional incentive for individuals to pay their outstanding debts.

Management's Response

Management agrees.

The review of the credit policy will include establishment a policy on when the warrant hold procedure should be invoked. The Office will endeavor to use the warrant hold procedure in a cost effective manner and employ the "best practices" in the state government. The Director for

Administrative Services will be responsible for establishing the warrant hold policy and procedures. The Office plans to implement a warrant hold policy by March 1, 2006

Recommendation The Office should:

- Identify duplicate accounts in BEST and prevent their creation in the future. Management should periodically monitor BEST transactions for inappropriate or questionable activities and follow-up as necessary
- Program BEST to:
 - ◆ Close out accounting periods monthly.
 - ◆ Prevent employees from altering data from previous accounting periods.
 - ◆ Identify and sequentially number revenue transactions and prevent their deletion.
 - ◆ Generate the monthly e-mail bills to customers.
- Maintain a list of customers who receive bills via e-mail.
- Separate the accounting and IT functions to ensure segregation of duties.
- Direct customer responses and e-mail inquiries to an accounts receivable e-mail account instead of to an individual's e-mail account.

Management's Response

Management agrees.

The Office will seek cost effective methods for purging duplicate accounts and preventing their creation. Employee training in techniques to prevent the creation of duplicate accounts is a key factor. The Office will develop a closing process in BEST to create monthly accounting periods. A closing process in BEST will address the issues of data changes, sequential numbering of revenue transactions, and possible deletion of data in a prior period. Delivery of monthly bills by email will be actively promoted and accomplished within BEST as much as possible. In the process of analyzing modifications to BEST, the issues of customer lists, functional segregation, and an accounts receivable email account will be addressed.

The 300,000 records referred to as missing are batch numbers in the submitter batch table. Gaps can easily be explained by failed database operations that result in a rollback of database transactions. This may be caused by errors during a batch operation. This is a common and expected occurrence and should not be characterized as "missing records". Since by design the submitter batch table itself can not be used to store this information, a separate table will be set up for the purpose of sequentially numbering revenue transactions.

The Director for Administrative Services will be responsible for any changes to financial policies and procedures. The Director for Information Resources will be responsible for changes to the supporting technology. The Office plans to accomplish these changes by September 1, 2006.

Recommendations The Office should:

- ◆ Ensure fire extinguishers are routinely inspected.
- ◆ Fully implement the password policies outlined in its newly implemented policies and procedures manual and program BEST to prompt users to change their passwords periodically.
- ◆ Periodically review users' access rights, limit users' access to what is appropriate for their job duties, and ensure the appropriate segregation of duties.
- ◆ Improve its disaster recovery plan by:
 - ◆ Creating and maintaining a prioritized list of computer hardware and specifying the order of restoration.
 - ◆ Considering establishing a redundant or back-up connection to CAPNET.

Management's Response

Management Agrees.

Consistent with best practices, steps will be taken to implement the recommendations. Security policies, including password standards and least privilege standards, will continue to be enhanced and enforced per the agency Information Security Policy. Security measures will be periodically reviewed on a timetable consistent with risk levels. Disaster recovery plans will be reviewed and improved. The Director for Information Resources will be responsible for implementation.

Recommendations The Office should:

- Improve its review and approval processes to ensure that proper documentation is included for all expenditures.
- Consistently follow its existing policies and procedures regarding travel advances, the payment of expenditures, and the timely reconciliation of data in its expenditures system.

Management's Response

Management Agrees.

The Office recognizes that consistent practices contribute to accuracy in financial records and identifying even *de minimus* inconsistencies plays a useful role in an improvement effort. The Director for Administrative Services will be responsible for ensuring compliance with policies and procedures.

Recommendations The Office should

Continue to analyze the cost of processing credit card transactions and compare that cost with the amounts it has collected to ensure that expenses are covered and that there is no excess cost to the State. At a minimum, this analysis should be performed on an annual basis.

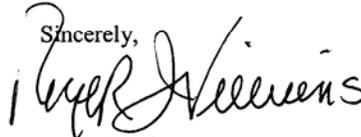
Management's Response

Management Agrees.

Credit card transactions are increasing as the payment method of choice by our customers. The Office's on-going analysis of customer preferences indicated that an increase in the credit card convenience fee was necessary to recover costs. A credit card convenience fee increase to a level predicted to cover processing costs was proposed in June 2005 and became effective on September 1, 2005.

From the private sector I bring my commitment to a retail-oriented philosophy that includes a pro-active, customer-centric and friendly delivery of services to those who depend on our agency. Timely and accurate delivery of public service is good for business and important to establishing a climate that will continue to attract business to Texas. The business changes that will occur as we work toward implementation of many audit recommendations will focus on the enhancement of our ability to serve the public. Please contact me or my General Counsel, Trey Trainor, at 512-463-5570 if you have any questions regarding our responses.

Sincerely,

A handwritten signature in black ink that reads "Roger Williams". The signature is written in a cursive style with a large initial "R".

Roger Williams
Secretary of State

Copies of this report have been distributed to the following:

Legislative Audit Committee

The Honorable David Dewhurst, Lieutenant Governor, Joint Chair
The Honorable Tom Craddick, Speaker of the House, Joint Chair
The Honorable Steve Ogden, Senate Finance Committee
The Honorable Thomas “Tommy” Williams, Member, Texas Senate
The Honorable Jim Pitts, House Appropriations Committee
The Honorable Jim Keffer, House Ways and Means Committee

Office of the Governor

The Honorable Rick Perry, Governor

Office of the Secretary of State

The Honorable Roger Williams, Secretary of State



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