



A REPORT
TO THE
MONTANA
LEGISLATURE

FINANCIAL-COMPLIANCE AUDIT

*Office of the
Secretary of State*

*For the Two Fiscal Years Ended
June 30, 2010*

NOVEMBER 2010

LEGISLATIVE AUDIT
DIVISION

10-19

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LEGISLATIVE AUDIT DIVISION

Tori Hunthausen, Legislative Auditor
Monica Huyg, Legal Counsel



Deputy Legislative Auditors
James Gillett
Angie Grove

November 2010

The Legislative Audit Committee
of the Montana State Legislature:

This is our financial-compliance audit report for the Office of the Secretary of State for the two fiscal years ended June 30, 2010. This report contains four recommendations related to an unrecorded capital asset, excess fund balance in the Enterprise Fund, unrecorded expenses, and transaction approval controls. The office's response to the audit recommendations begins on page B-1.

We thank the Secretary of State and her staff for their assistance and cooperation throughout the audit.

Respectfully submitted,

/s/ Tori Hunthausen

Tori Hunthausen, CPA
Legislative Auditor

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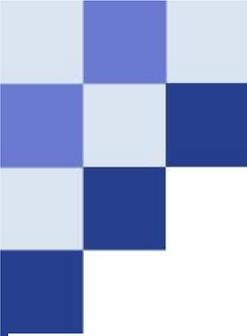
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Harper Lawson, Chief of Staff
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Jorge Quintana, Chief Legal Counsel
Rusty Harper, Deputy for Administrative Rules and Notary
Tana Gormely, Deputy for Business Services
Lisa Kimmet, Deputy for Elections
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MONTANA LEGISLATIVE AUDIT DIVISION

FINANCIAL-COMPLIANCE AUDIT

Office of the Secretary of State

For the Two Fiscal Years Ended June 30, 2010

NOVEMBER 2010

10-19

REPORT SUMMARY

The Office of the Secretary of State (office) is a self-supporting agency that provides diverse services to the public and state agencies. These services include maintaining the official records of the executive branch and the acts of the legislature; reviewing, maintaining, and distributing public-interest records of businesses and nonprofit organizations; filing administrative rules adopted by state departments, boards, and agencies; filing and maintaining records of secured financial transactions, such as liens; and commissioning notaries of public. In addition to these services, the Secretary of State also administers state election laws and oversees elections and serves on the state Board of Land Commissioners, the Board of Examiners, and the Capital Finance Advisory Council.

Context

The office accounts for its expenditures in its Business and Government Services Program. The majority of the office's expenditures are payroll and operating costs. The office received over \$1.6 million in federal grants during the audit period to assist the office with election related activity, but the office's main source of revenue is derived from the fees it charges for the various services it provides. The office received approximately \$4.4 and \$4.7 million in fiscal years 2009 and 2010, respectively, for these types of services. The office also received \$1.5 million from the legislature to begin replacing the office's existing information technology system with a web-based system.

Results

The office implemented three of the four recommendations made in the prior audit report (08-19). The recommendation pertaining to the office's excess fund balance in the Enterprise Fund is addressed again in the current audit report.

Other topics discussed in the report relate to an unrecorded capital asset and unrecorded expenses, which resulted from the office's refusal to pay its allocated share of the Statewide Cost Allocation Plan.

Recommendation Concurrence	
Concur	3
Partially Concur	0
Do Not Concur	1
Source: Agency audit response included in final report.	

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Chapter I – Introduction

Introduction

We performed a financial-compliance audit of the Office of the Secretary of State (office) for the two fiscal years ended June 30, 2010. The objectives of this audit were to:

1. Obtain an understanding of the office's control systems to the extent necessary to support our audit of the office's financial schedules and, if appropriate, make recommendations for improvement in the internal and management controls of the office.
2. Determine if the office has complied with selected laws and regulations.
3. Determine the implementation status of audit recommendations made in the previous audit.
4. Determine whether the office's financial schedules for each of the two fiscal years ended June 30, 2010, fairly present the results of operations in accordance with state accounting policy.

This report contains four recommendations. Areas of concern regarding compliance with laws and regulations and state accounting policy deemed not to have a significant effect on the successful operations of the office's programs are not specifically included in this report, but have been discussed with management. In accordance with §5-13-307, MCA, we analyzed the cost to implement the recommendations and believe the costs are not significant to the office.

Background

Article VI, Section 1, of the Montana Constitution authorizes the Secretary of State as an officer of the executive branch of state government. Section 2-15-401, MCA, sets forth the Secretary of State's duties. In fiscal year 2010, the office was authorized 59.73 FTE (full-time equivalent employees) and currently employs 55.57 FTE in four divisions and an executive office. The office files, stores, maintains, and preserves permanent records of the state and registers businesses and files documents for business entities operating in the state of Montana. The office publishes the Montana Administrative Register (MAR) and the Administrative Rules of Montana (ARM). The office is also responsible for the commissioning of notaries public in Montana. The Secretary of State serves as chief election officer for the state, maintaining uniformity in the application of the election laws and retaining election records through the Elections and Government Services Division. In addition, the Secretary of State serves as a member of the Board of Land Commissioners, the Board of Examiners, and the Capital Finance Advisory Council.

Prior Audit Recommendations

Our previous audit report, covering the two fiscal years ended June 30, 2008, contained four audit recommendations. The office implemented three recommendations and did not implement one recommendation. The recommendation the office did not implement is related to the excess fund balance in the Enterprise Fund discussed on pages 4 and 5.

Chapter II – Findings and Recommendations

Unrecorded Capital Asset

The office did not capitalize its information system asset.

The office is developing a web-based application that will centralize its business functions. The first phase of the project is being funded with a \$1.5 million General Fund appropriation administered through the Long Range Information Technology Program within the Department of Administration and also with the office's Enterprise Fund earnings. If the project is not completed within one fiscal year, state accounting policy requires assets of this type to be capitalized as work-in-progress after the preliminary project stage is complete and until such time as the asset is placed into operation. The preliminary project stage is complete once management has authorized and committed to funding the project, and it is considered probable that the project will be completed and put to its intended use.

The office obtained assistance from the State Procurement Bureau to solicit proposals from contractors through the Request for Proposal (RFP) process. As a result of the RFP process, the contractor was selected on September 4, 2008, the contract signed by the contractor on November 3, 2008, the \$1.5 million General Fund appropriation awarded on May 5, 2009, and the contract signed by the Secretary of State on July 2, 2009. Each of these actions could be considered an authorization and commitment by management, but as of June 30, 2010, the office had not capitalized any portion of its information system asset costs.

During our audit, office personnel stated that they reviewed the expenditures for the project prior to fiscal year-end, but felt state accounting policy was not clear and did not believe that the asset should be capitalized at that point in the project development. More recently, office management stated that the office was aware that the asset should be capitalized, but were unable to obtain clear guidance from the Department of Administration as to the exact date that should be used for capitalization so the office chose not to capitalize the asset. We believe the criteria for capitalizing the project costs was met on September 4, 2008.

We estimate assets and fund balance are understated by \$181,380 and \$1,407,979 at June 30, 2009 and 2010, respectively, and expenditures are overstated in fiscal year 2009 by \$181,380. In addition, because the office did not correctly record the financial activity related to the application having multiple funding sources, in fiscal year 2010, revenues are understated in the Enterprise Fund by \$1,017,859 and the expenditure classification errors exceed \$1 million.

RECOMMENDATION #1

We recommend the office capitalize its web-based application and associated financial activity in accordance with state accounting policy.

Excess Fund Balance in Enterprise Fund

The office is retaining over \$2.6 million in excess profits.

The office charges approximately 100 different fees for services it provides to the public and to state agencies. These services include publishing the Administrative Rules of Montana, registering businesses and filing documents for entities operating in the state of Montana, commissioning notaries of public, and filing and storing the permanent records for the state. Section 2-15-405(2)(a), MCA, states that unless otherwise specified by law, fees must be commensurate with the overall costs of the Office of the Secretary of State. The previous two audit reports contained recommendations regarding the office's excess fund balance in its Enterprise Fund. The excess funds exist because the fees charged in prior years were higher than the office's costs, thus generating a profit. No action was taken to lower fees in subsequent years or otherwise return those profits to the purchasers of the office's services.

The office's response to the prior recommendations was that it was going to use the excess cash to implement its information technology system. However, the office's most recent position is that the excess fund balance is the minimum amount necessary to maintain existing services and have funds for unexpected contingencies.

Office management has also stated that they need to carry a fund balance in order to operate in the first half of the fiscal year because the majority of the office's revenues are received in the second half of the fiscal year. Using data from fiscal year 2007 through fiscal year 2010, we completed an analysis of the revenues and expenses recorded in the first six months of the fiscal year in relation to the liquid assets held by the office at the end of the previous fiscal year. We determined, during those years we analyzed, the office has retained between \$2.6 and \$3.1 million in liquid assets in excess of its operating cash flow needs.

Office management stated that they have not completed an analysis to determine if fees are commensurate with costs, but instead have focused on reducing expenses. The office has reduced its fund balance by approximately \$1.3 million from June 30, 2008,

but management has stated they do not intend for there to be a further decline in the fund balance. As discussed above, the office has more money than necessary to meet its operating needs and should take further steps to comply with state law by establishing fees commensurate with costs, taking into consideration its obligation to return the profits made through the prior years' excessive fee structures to the purchasers of the office's services.

RECOMMENDATION #2

We recommend the Secretary of State return the excess profits collected when its fees were higher than necessary to pay office costs to the purchasers of its services.

Unrecorded Expenses

The office refused to pay its allocated amount of the Statewide Cost Allocation Plan costs.

In order for the state of Montana to obtain reimbursement from the federal government for the costs of central support services, the state develops a Statewide Cost Allocation Plan (SWCAP) that identifies costs the state incurs for central services provided by specific agencies. These costs are then allocated to other state agencies. As outlined in §17-1-105(2), MCA, each agency is required to pay SWCAP costs quarterly, to the Department of Administration, for its share of the liability. In fiscal year 2010, the office only paid \$17,604 of its \$121,958 SWCAP costs, understating the office's expenses and liabilities in its Enterprise Fund by \$104,354.

Office management stated they refused to pay more than the prior year's SWCAP amount because they were unable to obtain an acceptable explanation from the Department of Administration as to why the amount increased so significantly. Through audit work completed during the Department of Administration audit (10-13), we determined the SWCAP allocations were reasonable.

RECOMMENDATION #3

We recommend the office pay its allocated amount of the Statewide Cost Allocation Plan as required by state law.

Transaction Approval Controls

Office internal controls over transaction approvals are not implemented.

State accounting policy requires state agencies to implement internal control procedures to ensure all transactions necessary for compliance with generally accepted accounting principles (GAAP) are recorded in the state's accounting system (SABHRS) before fiscal year-end. This would include ensuring that clear evidence exists to demonstrate transactions have been properly reviewed and authorized before being entered into SABHRS. We identified two types of transactions, as described below, where the office does not consistently review the transactions before they are entered into SABHRS.

- ◆ The office receives approximately \$3.1 million per year in revenue from processing and filing documents required of businesses operating in the state of Montana and approximately \$640,000 per year in revenue for recording lien documents. The revenue is initially recorded in a miscellaneous revenue account and monthly reclassified to the applicable revenue accounts. The monthly reclassification can involve up to 30 different accounts. We reviewed 46 reclassification journals from fiscal years 2009 and 2010, and noted 28 of them contained no evidence of a review prior to the transactions being entered into SABHRS.
- ◆ The office uses state procurement cards for various purchases. During fiscal years 2009 and 2010, the office incurred approximately \$99,000 in expenses using procurement cards. Monthly, the Department of Administration pays the statewide procurement card bill and charges the office's share of the expenses to a default account. Office personnel are responsible for reclassifying the charges from the default account to the proper expense accounts and have only a short timeframe in which to do so. We reviewed all of the procurement card reclassification journals processed by the office from July 2008 to May 2010, and though six of the 23 journals showed that a review of transactions had occurred, office personnel stated that because of current office practices, the transactions were not actually reviewed against supporting documentation to ensure they were coded correctly in SABHRS.

In both types of transactions discussed above, the number of adjustments the office makes varies each month, and because they are manually determined, a higher risk of undetected errors exists. Because office personnel frequently do not perform reviews, there is increased risk that the adjustments are incorrect. Office management stated that control procedures are outlined in office policy, but have not been implemented.

RECOMMENDATION #4

We recommend the office implement its control procedures over transaction approval in accordance with state accounting policy.

Independent Auditor's Report and Office Financial Schedules

LEGISLATIVE AUDIT DIVISION

Tori Hunthausen, Legislative Auditor
 Monica Huyg, Legal Counsel



Deputy Legislative Auditors
 James Gillett
 Angie Grove

INDEPENDENT AUDITOR'S REPORT

The Legislative Audit Committee
 of the Montana State Legislature:

We have audited the accompanying Schedules of Changes in Fund Balances, Schedules of Total Revenues & Transfers-In, and Schedules of Total Expenditures & Transfers-Out of the Office of the Secretary of State for each of the fiscal years ended June 30, 2010, and 2009. The information contained in these financial schedules is the responsibility of the office's management. Our responsibility is to express opinions on these financial schedules based on our audit.

We conducted our audit in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial schedules are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial schedules. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial schedule presentation. We believe that our audit provides a reasonable basis for our opinions.

As described in note 1, these financial schedules are prepared on the basis of Montana state accounting policy, which is a comprehensive basis of accounting other than accounting principles generally accepted in the United States of America. The schedules are not intended to be a complete presentation and disclosure of the office's assets, liabilities, and cash flows.

The office did not properly account for expenditures and the corresponding work-in-progress asset related to the development of its web-based information technology system. As a result, at June 30, 2010, the fund balance is understated by \$1,407,979 in the Enterprise Fund. In addition, Capital Contribution revenues are understated in the Enterprise Fund by \$1,017,859; Other Services expenditures are overstated by \$1,226,599; Other Expenses are understated by \$1,017,859; and Total Expenditures & Transfers-Out are overstated by \$208,740.

In our opinion, except for the effects of the issue discussed in the preceding paragraph, the financial schedules referred to above present fairly, in all material respects, the results of operations and changes in fund balances of the Office of the Secretary of State for each of the fiscal years ended June 30, 2010, and 2009, in conformity with the basis of accounting described in note 1.

Respectfully submitted,

/s/ James Gillett

James Gillett, CPA
Deputy Legislative Auditor

September 2, 2010

SECRETARY OF STATE'S OFFICE
SCHEDULE OF CHANGES IN FUND BALANCES
FOR THE FISCAL YEAR ENDED JUNE 30, 2010

	<u>Federal Special Revenue Fund</u>	<u>Capital Projects Fund</u>	<u>Enterprise Fund</u>
FUND BALANCE: July 1, 2009	\$ <u>2,889,153</u>	\$ <u>0</u>	\$ <u>2,479,684</u>
ADDITIONS			
Budgeted Revenues & Transfers-In	912,080		4,721,092
Nonbudgeted Revenues & Transfers-In	1,143		1,281
Prior Year Revenues & Transfers-In Adjustments			30
Direct Entries to Fund Balance	<u>5,045</u>	<u>1,017,859</u>	
Total Additions	<u>918,268</u>	<u>1,017,859</u>	<u>4,722,403</u>
REDUCTIONS			
Budgeted Expenditures & Transfers-Out	1,024,755	1,017,859	4,857,294
Nonbudgeted Expenditures & Transfers-Out			207,027
Prior Year Expenditures & Transfers-Out Adjustments			<u>(15)</u>
Total Reductions	<u>1,024,755</u>	<u>1,017,859</u>	<u>5,064,306</u>
FUND BALANCE: June 30, 2010	\$ <u>2,782,666</u>	\$ <u>0</u>	\$ <u>2,137,781</u>

This schedule is prepared from the Statewide Accounting, Budgeting, and Human Resources System (SABHRS) without adjustment. Additional information is provided in the notes to the financial schedules beginning on page A-9.

SECRETARY OF STATE'S OFFICE
SCHEDULE OF CHANGES IN FUND BALANCES
FOR THE FISCAL YEAR ENDED JUNE 30, 2009

	Federal Special Revenue Fund	Enterprise Fund
FUND BALANCE: July 1, 2008	\$ <u>3,112,880</u>	\$ <u>3,475,242</u>
ADDITIONS		
Budgeted Revenues & Transfers-In	758,396	4,416,893
Nonbudgeted Revenues & Transfers-In	3,735	4,033
Prior Year Revenues & Transfers-In Adjustments		2,880
Direct Entries to Fund Balance	<u>106,000</u>	<u>3,545</u>
Total Additions	<u>868,131</u>	<u>4,427,351</u>
REDUCTIONS		
Budgeted Expenditures & Transfers-Out	1,091,858	5,196,877
Nonbudgeted Expenditures & Transfers-Out		243,018
Prior Year Expenditures & Transfers-Out Adjustments		<u>(16,986)</u>
Total Reductions	<u>1,091,858</u>	<u>5,422,909</u>
FUND BALANCE: June 30, 2009	\$ <u>2,889,153</u>	\$ <u>2,479,684</u>

This schedule is prepared from the Statewide Accounting, Budgeting, and Human Resources System (SABHRS) without adjustment. Additional information is provided in the notes to the financial schedules beginning on page A-9.

SECRETARY OF STATE'S OFFICE
SCHEDULE OF TOTAL REVENUES & TRANSFERS-IN
FOR THE FISCAL YEAR ENDED JUNE 30, 2010

	Federal Special Revenue Fund	Enterprise Fund	Total
TOTAL REVENUES & TRANSFERS-IN BY CLASS			
Taxes	\$ 279	\$ 449	\$ 728
Charges for Services	3,556	4,535,541	4,539,097
Investment Earnings	9,388	8,659	18,047
Sale of Documents, Merchandise and Property		105,995	105,995
Miscellaneous		71,759	71,759
Federal	900,000		900,000
Total Revenues & Transfers-In	913,223	4,722,403	5,635,626
Less: Nonbudgeted Revenues & Transfers-In	1,143	1,281	2,424
Prior Year Revenues & Transfers-In Adjustments		30	30
Actual Budgeted Revenues & Transfers-In	912,080	4,721,092	5,633,172
Estimated Revenues & Transfers-In	845,200	4,595,550	5,440,750
Budgeted Revenues & Transfers-In Over (Under) Estimated	\$ 66,880	\$ 125,542	\$ 192,422
BUDGETED REVENUES & TRANSFERS-IN OVER (UNDER) ESTIMATED BY CLASS			
Charges for Services	\$ 3,356	\$ 92,925	\$ 96,281
Investment Earnings	(86,476)	(35,137)	(121,613)
Sale of Documents, Merchandise and Property		10,995	10,995
Miscellaneous		56,759	56,759
Federal	150,000		150,000
Budgeted Revenues & Transfers-In Over (Under) Estimated	\$ 66,880	\$ 125,542	\$ 192,422

This schedule is prepared from the Statewide Accounting, Budgeting, and Human Resources System (SABHRS) without adjustment. Additional information is provided in the notes to the financial schedules beginning on page A-9.

SECRETARY OF STATE'S OFFICE
SCHEDULE OF TOTAL REVENUES & TRANSFERS-IN
FOR THE FISCAL YEAR ENDED JUNE 30, 2009

	Federal Special Revenue Fund	Enterprise Fund	Total
TOTAL REVENUES & TRANSFERS-IN BY CLASS			
Charges for Services		\$ 4,251,616	\$ 4,251,616
Investment Earnings	\$ 47,870	51,688	99,558
Sale of Documents, Merchandise and Property		100,956	100,956
Miscellaneous		19,546	19,546
Federal	<u>714,261</u>		<u>714,261</u>
Total Revenues & Transfers-In	762,131	4,423,806	5,185,937
Less: Nonbudgeted Revenues & Transfers-In	3,735	4,033	7,768
Prior Year Revenues & Transfers-In Adjustments		<u>2,880</u>	<u>2,880</u>
Actual Budgeted Revenues & Transfers-In	<u>758,396</u>	<u>4,416,893</u>	<u>5,175,289</u>
Estimated Revenues & Transfers-In	<u>2,191,000</u>	<u>4,963,000</u>	<u>7,154,000</u>
Budgeted Revenues & Transfers-In Over (Under) Estimated	<u>\$ (1,432,604)</u>	<u>\$ (546,107)</u>	<u>\$ (1,978,711)</u>
BUDGETED REVENUES & TRANSFERS-IN OVER (UNDER) ESTIMATED BY CLASS			
Charges for Services		\$ (346,152)	\$ (346,152)
Investment Earnings	\$ (276,865)	(146,345)	(423,210)
Sale of Documents, Merchandise and Property		(34,045)	(34,045)
Miscellaneous	(590,000)	(19,565)	(609,565)
Federal	<u>(565,739)</u>		<u>(565,739)</u>
Budgeted Revenues & Transfers-In Over (Under) Estimated	<u>\$ (1,432,604)</u>	<u>\$ (546,107)</u>	<u>\$ (1,978,711)</u>

This schedule is prepared from the Statewide Accounting, Budgeting, and Human Resources System (SABHRS) without adjustment. Additional information is provided in the notes to the financial schedules beginning on page A-9.

SECRETARY OF STATE'S OFFICE
SCHEDULE OF TOTAL EXPENDITURES & TRANSFERS-OUT
FOR THE FISCAL YEAR ENDED JUNE 30, 2010

PROGRAM (ORG) EXPENDITURES & TRANSFERS-OUT	BUSINESS & GOVERNMENT SERVICES
Personal Services	
Salaries	\$ 2,335,233
Employee Benefits	852,722
Personal Services-Other	33,235
Total	3,221,190
Operating Expenses	
Other Services	2,401,983
Supplies & Materials	131,582
Communications	287,263
Travel	59,421
Rent	234,842
Utilities	2,697
Repair & Maintenance	231,994
Other Expenses	139,537
Goods Purchased For Resale	12,521
Total	3,501,840
Equipment & Intangible Assets	
Equipment	94,657
Intangible Assets	8,292
Total	102,949
Grants	
From State Sources	(1,598)
From Federal Sources	139,578
Total	137,980
Other Post Employment Benefits	
Other Post Employment Benefits	142,961
Total	142,961
Total Expenditures & Transfers-Out	\$ 7,106,920
 EXPENDITURES & TRANSFERS-OUT BY FUND	
Federal Special Revenue Fund	\$ 1,024,755
Capital Projects Fund	1,017,859
Enterprise Fund	5,064,306
Total Expenditures & Transfers-Out	7,106,920
Less: Nonbudgeted Expenditures & Transfers-Out	207,027
Prior Year Expenditures & Transfers-Out Adjustments	(15)
Actual Budgeted Expenditures & Transfers-Out	6,899,908
Budget Authority	10,848,272
Unspent Budget Authority	\$ 3,948,364
 UNSPENT BUDGET AUTHORITY BY FUND	
Federal Special Revenue Fund	\$ 2,722,116
Capital Projects Fund	482,141
Enterprise Fund	744,107
Unspent Budget Authority	\$ 3,948,364

This schedule is prepared from the Statewide Accounting, Budgeting, and Human Resources System (SABHRS) without adjustment. Additional information is provided in the notes to the financial schedules beginning on page A-9.

SECRETARY OF STATE'S OFFICE
SCHEDULE OF TOTAL EXPENDITURES & TRANSFERS-OUT
FOR THE FISCAL YEAR ENDED JUNE 30, 2009

PROGRAM (ORG) EXPENDITURES & TRANSFERS-OUT	<u>BUSINESS & GOVERNMENT SERVICES</u>
Personal Services	
Salaries	\$ 2,514,790
Employee Benefits	878,724
Personal Services-Other	<u>(67,378)</u>
Total	<u>3,326,136</u>
Operating Expenses	
Other Services	1,493,090
Supplies & Materials	105,461
Communications	242,591
Travel	44,197
Rent	235,070
Utilities	1,228
Repair & Maintenance	313,691
Other Expenses	230,770
Goods Purchased For Resale	16,239
Total	<u>2,682,337</u>
Equipment & Intangible Assets	
Equipment	<u>(48,250)</u>
Total	<u>(48,250)</u>
Grants	
From State Sources	4,650
From Federal Sources	342,773
Total	<u>347,423</u>
Benefits & Claims	
Insurance Payments	250
Total	<u>250</u>
Other Post Employment Benefits	
Other Post Employment Benefits	206,871
Total	<u>206,871</u>
Total Expenditures & Transfers-Out	<u>\$ 6,514,767</u>
 EXPENDITURES & TRANSFERS-OUT BY FUND	
Federal Special Revenue Fund	\$ 1,091,858
Enterprise Fund	<u>5,422,909</u>
Total Expenditures & Transfers-Out	6,514,767
Less: Nonbudgeted Expenditures & Transfers-Out	243,018
Prior Year Expenditures & Transfers-Out Adjustments	<u>(16,986)</u>
Actual Budgeted Expenditures & Transfers-Out	6,288,735
Budget Authority	<u>8,628,218</u>
Unspent Budget Authority	<u>\$ 2,339,483</u>
 UNSPENT BUDGET AUTHORITY BY FUND	
Federal Special Revenue Fund	\$ 2,137,735
Enterprise Fund	<u>201,748</u>
Unspent Budget Authority	<u>\$ 2,339,483</u>

This schedule is prepared from the Statewide Accounting, Budgeting, and Human Resources System (SABHRS) without adjustment. Additional information is provided in the notes to the financial schedules beginning on page A-9.

Office of the Secretary of State
Notes to the Financial Schedules
For the Two Fiscal Years Ended June 30, 2010

1. Summary of Significant Accounting Policies

Basis of Accounting

The office uses the modified accrual basis of accounting, as defined by state accounting policy, for its Governmental fund category (Federal Special Revenue and Capital Projects) and certain liabilities of defined benefit pension plans and certain post employment healthcare plans. In applying the modified accrual basis, the office records:

- ◆ Revenues when it receives cash or when receipts are realizable, measurable, earned, and available to pay current period liabilities.
- ◆ Expenditures for valid obligations when the office incurs the related liability and it is measurable, with the exception of the cost of employees' annual and sick leave. State accounting policy requires the office to record the cost of employees' annual and sick leave when used or paid.

The office uses accrual basis accounting for its Proprietary (Enterprise) fund category. Under the accrual basis, as defined by state accounting policy, the office records revenues in the accounting period when realizable, measurable, and earned, and records expenses in the period incurred when measurable.

Expenditures and expenses may include: entire budgeted service contracts even though the office receives the services in a subsequent fiscal year; goods ordered with a purchase order before fiscal year-end, but not received as of fiscal year-end; and equipment ordered with a purchase order before fiscal year-end.

Basis of Presentation

The financial schedule format is in accordance with the policy of the Legislative Audit Committee. The financial schedules are prepared from the transactions posted to the state's accounting system without adjustment.

The office uses the following funds:

Governmental Fund Category

- ◆ **Federal Special Revenue Fund** – to account for activities funded from federal revenue sources. Office Federal Special Revenue Funds include activities related to the Help America Vote Act (HAVA), Election Reform Payments, and Election Assistance for Individuals with Disabilities.

- ♦ **Capital Projects Fund** – to account for financial resources used for the acquisition or construction of major capital facilities, other than those financed by proprietary funds or trust funds. The office uses this fund for activities related to developing the Secretary of State Information Management System (SIMS).

Proprietary Fund Category

- ♦ **Enterprise Fund** – to account for operations (a) financed and operated in a manner similar to private business enterprises, where the Legislature intends that the department finance or recover costs primarily through user charges; (b) where the Legislature has decided that periodic determination of revenues earned, expenses incurred or net income is appropriate; (c) where the activity is financed solely by a pledge of the net revenues from fees and charges of the activity; or (d) when laws or regulations require that the activities' cost of providing services, including capital costs, be recovered with fees and charges rather than with taxes or similar revenues. Office Enterprise Funds include business services, administrative rules, elections filings, management services, information services, and records management services.

2. Direct Entries to Fund Balance

Direct entries to fund balances in the Federal Special Revenue Fund, Capital Projects Fund, and Enterprise Fund include entries generated by SABHRS to reflect the flow of resources within individual funds shared by separate agencies. Corrections of errors that occurred at least two fiscal years prior are also included.

3. Federal Special Revenue Fund

The office received three installments of the HAVA funds in prior years. In fiscal years 2009 and 2010, the office received an additional \$1,594,260 in HAVA funds. The federal special revenue fund balance of \$2,782,666 at June 30, 2010, will be used to replace the hardware and software associated with the statewide voter registration database as well as for providing accessibility grants to counties and voter outreach.

OFFICE OF THE
SECRETARY OF STATE

OFFICE RESPONSE



OFFICE OF THE SECRETARY OF STATE

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OCT 28 2010

LEGISLATIVE AUDIT DIV.

Linda McCulloch
Secretary of State

**TO THE LEGISLATIVE AUDIT COMMITTEE OF THE MONTANA STATE
LEGISLATURE:**

Following is our response to recommendations contained in the Office of the Secretary of State's (SOS) 2009-2010 audit report.

Recommendation #1:

We recommend the office capitalize its web based application and associated financially activity in accordance with state accounting policy.

SOS Response:

We concur. The Secretary of State has already implemented this recommendation and capitalized all unrecorded assets from the ongoing first phase of development for the new office information management system (SIMS).

Recommendation #2:

We recommend the Secretary of State return the excess profits collected when its fees were higher the necessary to pay office costs to the purchasers of those services.

SOS Response:

We do not concur. As an enterprise fund, the Office of the Secretary of State operates solely on fees for services without state general fund monies. This is somewhat unique to state government in Montana, and allows SOS to function much more like a business than a state bureaucracy. As a result, SOS has for the most part not raised its fees for services in the twelve years since becoming an Enterprise funded office. This consistency in fees is due in large part to the existence of the office's fund balance.

The existing fund balance has allowed the office to maintain a consistent fee schedule from year-to-year, despite changes in state and national economic trends, fluctuations in revenue, and increases in fees charged to SOS by other state agencies. For example, in FY 2009, SOS saw a 13% drop in revenue. This decrease was due to the national economic downturn. SOS was able to address the shortfall in revenue by utilizing both the fund balance and cuts in office expenditures. Had a fund balance not been in place,

the office would have been forced to borrow money to maintain operations, as well as raise fees on businesses using SOS services.

Furthermore, the existing fund balance also provides SOS with the ability to implement a long term planning mechanism to prepare for expected and unexpected costs. These costs include, but are not limited to, the elimination of federal HAVA monies that pay for the federally mandated statewide voter file (an annual cost of over \$700,000 a year), the ongoing implementation of a contracted \$5 million office information management system (SIMS) to replace the office's 30 year-old system, increases in state government charges, such as ITSD costs, DOA rent and SWCAP charges, and the average inflationary increase in costs for all expenses that the office incurs as part of day-to-day operations.

We disagree with the recommendation that the Secretary of State liquidate the cash balance of the office's existing fund balance. Such a recommendation unfairly targets Montana taxpayers and businesses operating in Montana by forcing the Secretary of State to implement an erratic and unpredictable fee schedule from year-to-year. Recommending that that SOS reassess fees from year-to-year demonstrates a lack of understanding as to how an agency that interacts with the public has a responsibility to maintain consistent and fair fees for the public.

Compared to other states, Montana has very low business filing fees. The existence of a fund balance has allowed this office to sustain low fees - providing an incentive for businesses wishing to operate in Montana. Our customers appreciate these low fees and they appreciate the fee consistency from year-to-year.

Recommendation #3:

We recommend the office pay its allocated amount of the Statewide Cost Allocation Plan as required by state law.

SOS Response:

We concur. In FY 2009, the Office of the Secretary of State saw its SWCAP bill increase from \$17,603 to \$121,958 - an increase of over 700% in one year. The Secretary of State is committed to paying its share of SWCAP charges, as long as those charges are fair and equally applied throughout state government.

Recommendation #4:

We recommend the office implement its control procedures over transaction approval in accordance with state accounting policy.

SOS Response:

We concur. The Secretary of State has already implemented this recommendation and has added these additional internal controls to existing internal control procedures.

Thank you to the Legislative Auditor and Division Staff for their professional work and interactions with our SOS staff during this fiscal audit process. During my several years of working with the Legislative Audit Division I have enjoyed the expertise and experience they represent.

I believe that all of state government would benefit from guidance the auditors could periodically provide to state agency heads. Often similar recommendations appear in fiscal audits throughout state agencies. It would be helpful and fiscally prudent to issue occasional guidance reflective of those recommendations, including situations that might arise from newly passed legislation. Information sharing is an inexpensive, yet sound practice for improving business practices. We can all get onboard with that!

Sincerely,


Linda McCulloch
Secretary of State