

The Office of the Secretary of State

Financial Compliance Audit Fiscal Years 2021 & 2022

Presented by:

Steven Althoff

Senior Financial Compliance Auditor

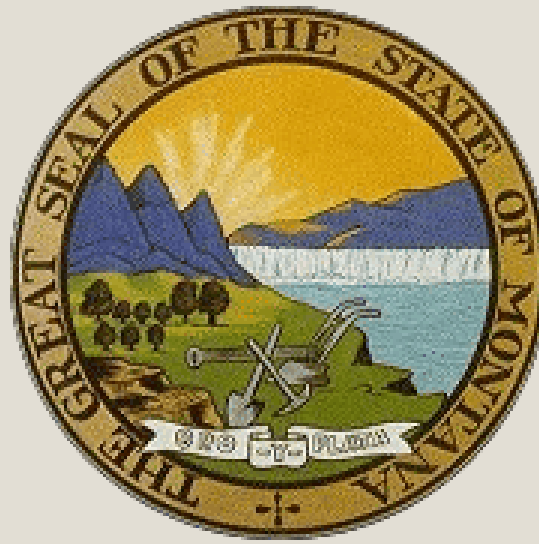
Present from the Office

Angela Nunn

Deputy Secretary of State

Brandi Pierson, CPA

Chief Fiscal Officer



AUDIT RESULTS

Audit Results

OPINIONS

FY21 Financial Schedules – **ADVERSE**

FY22 Financial Schedules – **ADVERSE**

Audit Results

INTERNAL CONTROLS:

Material Weaknesses – 1

Significant Deficiencies – 1

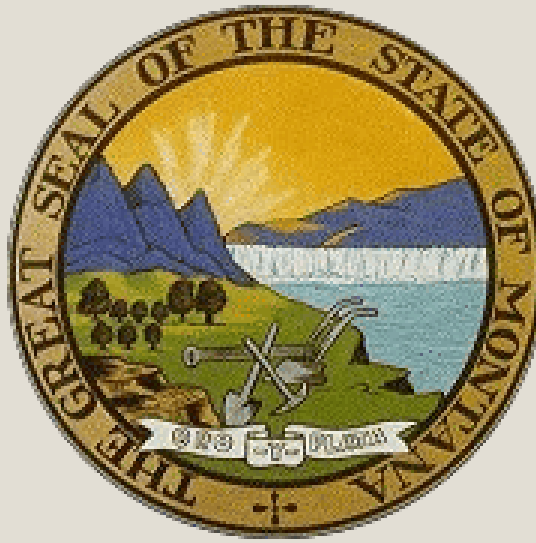
Audit Results

RECOMMENDATIONS:

Accounting and Financial Reporting – 1

Internal Control – 2

State Compliance – 1



FINDINGS AND RECOMMENDATIONS

Recommendation 1

Intangible Assets

Resources that you can't touch, but still have value.

The main intangible assets of the office are computer information systems.

Recommendation 1

Capital Intangible Assets

When intangible assets costs exceed \$500,000, their cost is deferred through capitalization.

Capitalization aligns the costs and benefits of the system on the accounting record.



Recommendation 1

Accounting for Capital Intangible Assets



A. Split Funding

Recording IT projects funded with multiple sources

Recommendation 1

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B. Multiple Modules

Determining when systems with multiple components are “substantially complete”

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Accounting for Capital Intangible Assets



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Determining when systems with multiple components are “substantially complete”



C. Capitalization

Determining what IT project costs should be capitalized

Recommendation 1

Accounting for Capital Intangible Assets



A. Split Funding

Recording IT projects funded with multiple sources



B. Multiple Modules

Determining when systems with multiple components are “substantially complete”



C. Capitalization

Determining what IT project costs should be capitalized



D. Retirement

Ensuring retired assets are removed from the accounting record correctly



Recommendation 1A

Split Funded Capital Intangible Assets

The fund type the asset is recorded to determines how it appears on the financial schedules.



Recommendation 1A

Governmental Funds

Capital intangible assets appear only on the State's ACFR.

- Federal Special Revenue Funds
- Capital Project Funds



Recommendation 1A

Proprietary Funds

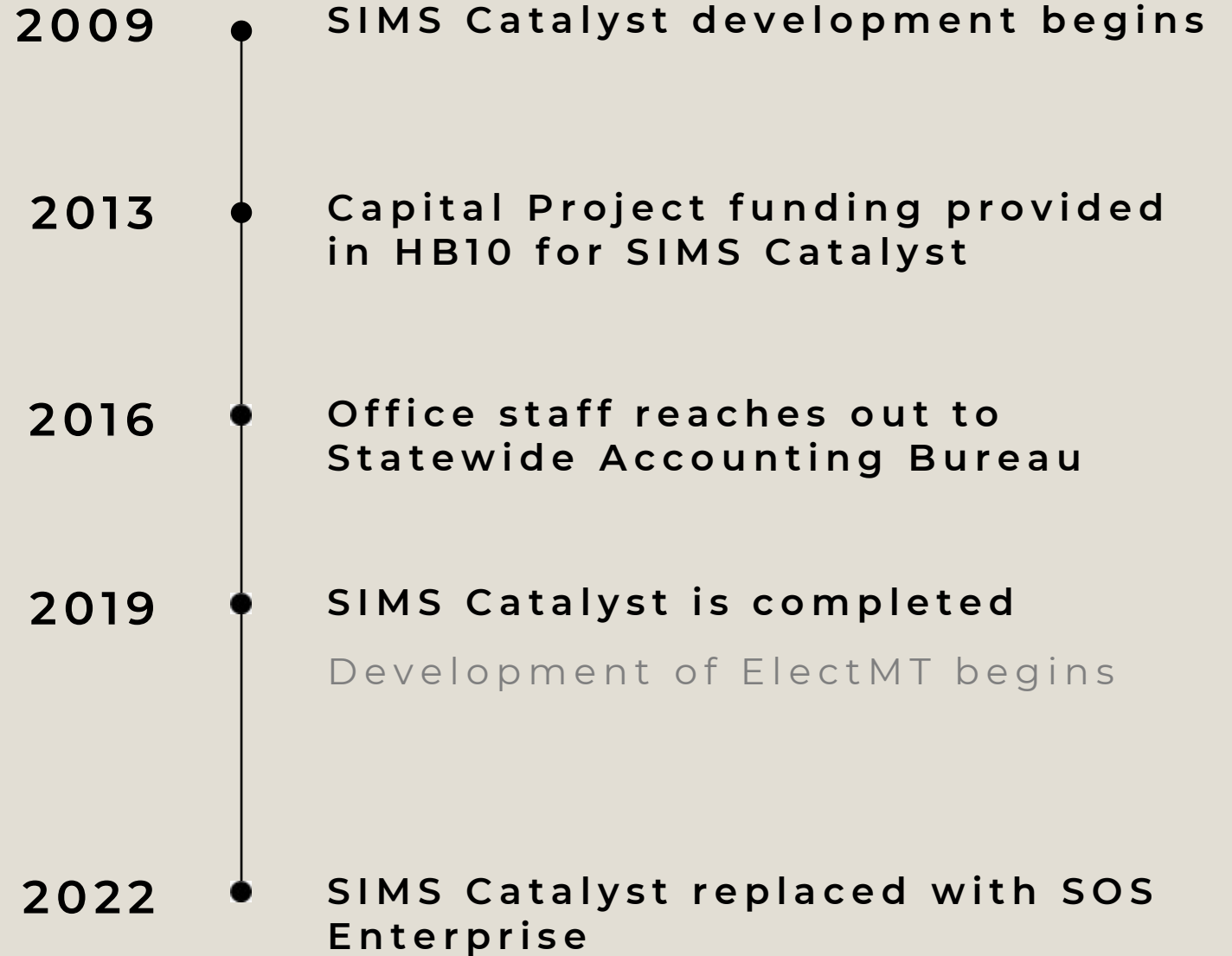
Capital intangible assets also appear on agency financial schedules as a component of fund equity.

- Enterprise Funds

Recommendation 1A

SIMS Catalyst

The system was paid in part by Proprietary funds and in part with Capital Project funds.



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An asset can only be recorded in one fund classification

“

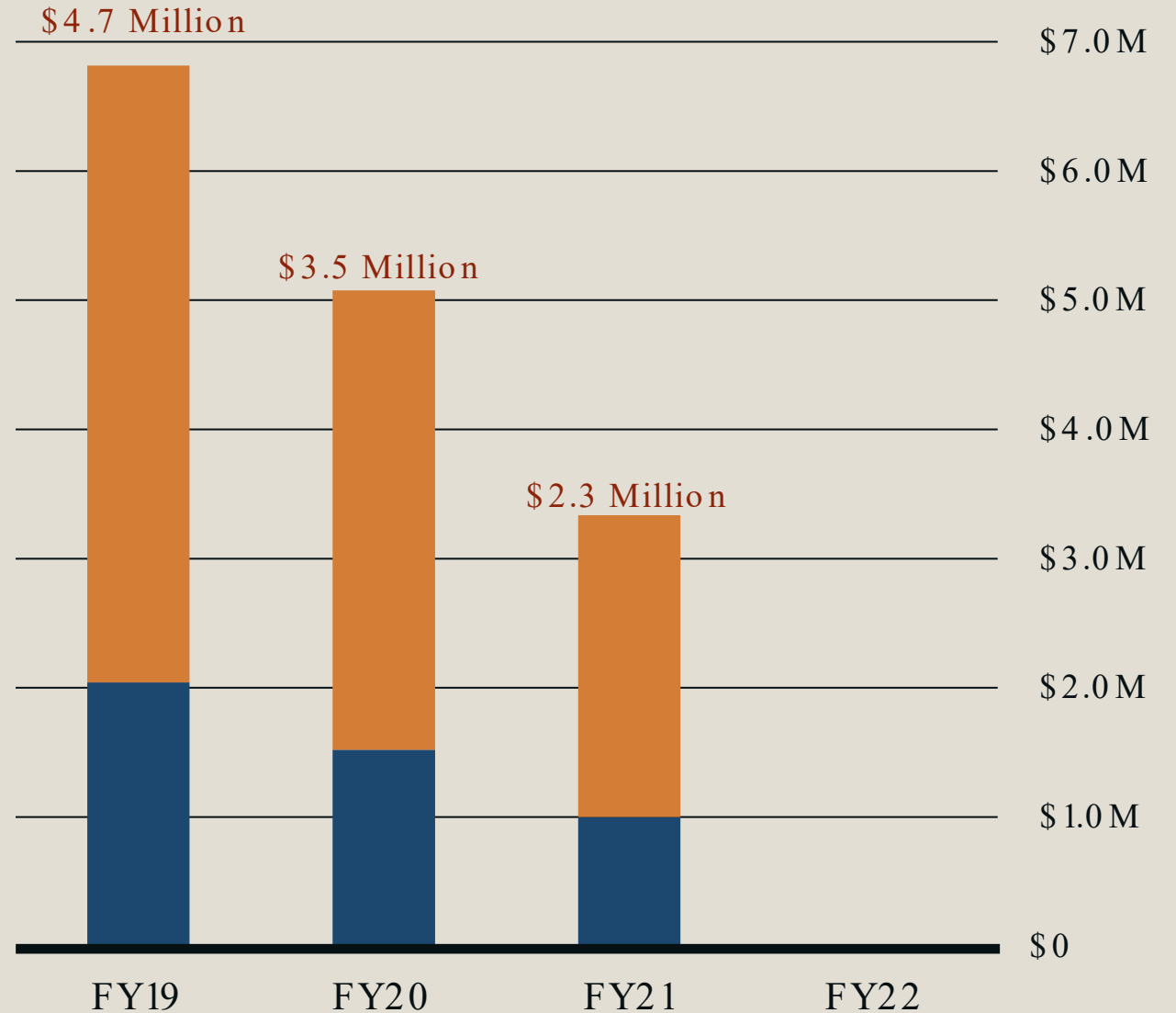
An operating transfer must be recorded from the co-paying fund

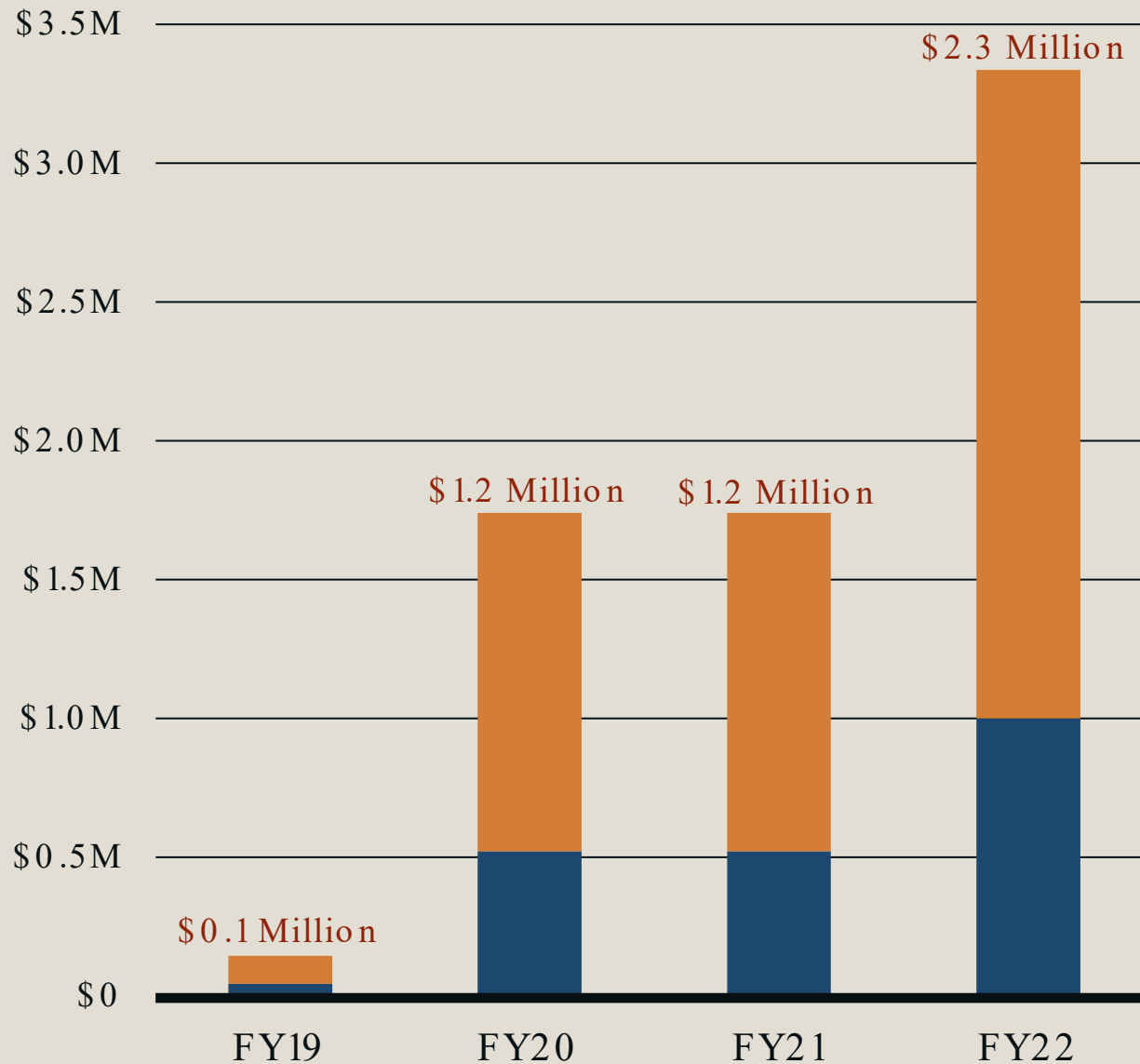
Recommendation 1A

SIMS Catalyst Asset Misstatement

The asset was incorrectly split between the **Enterprise Fund** and the **Capital Projects Fund**.

Capital Project amounts do not appear on the financial schedules and are **misstatements**.





Recommendation 1A

SIMS Catalyst Expense Misstatement

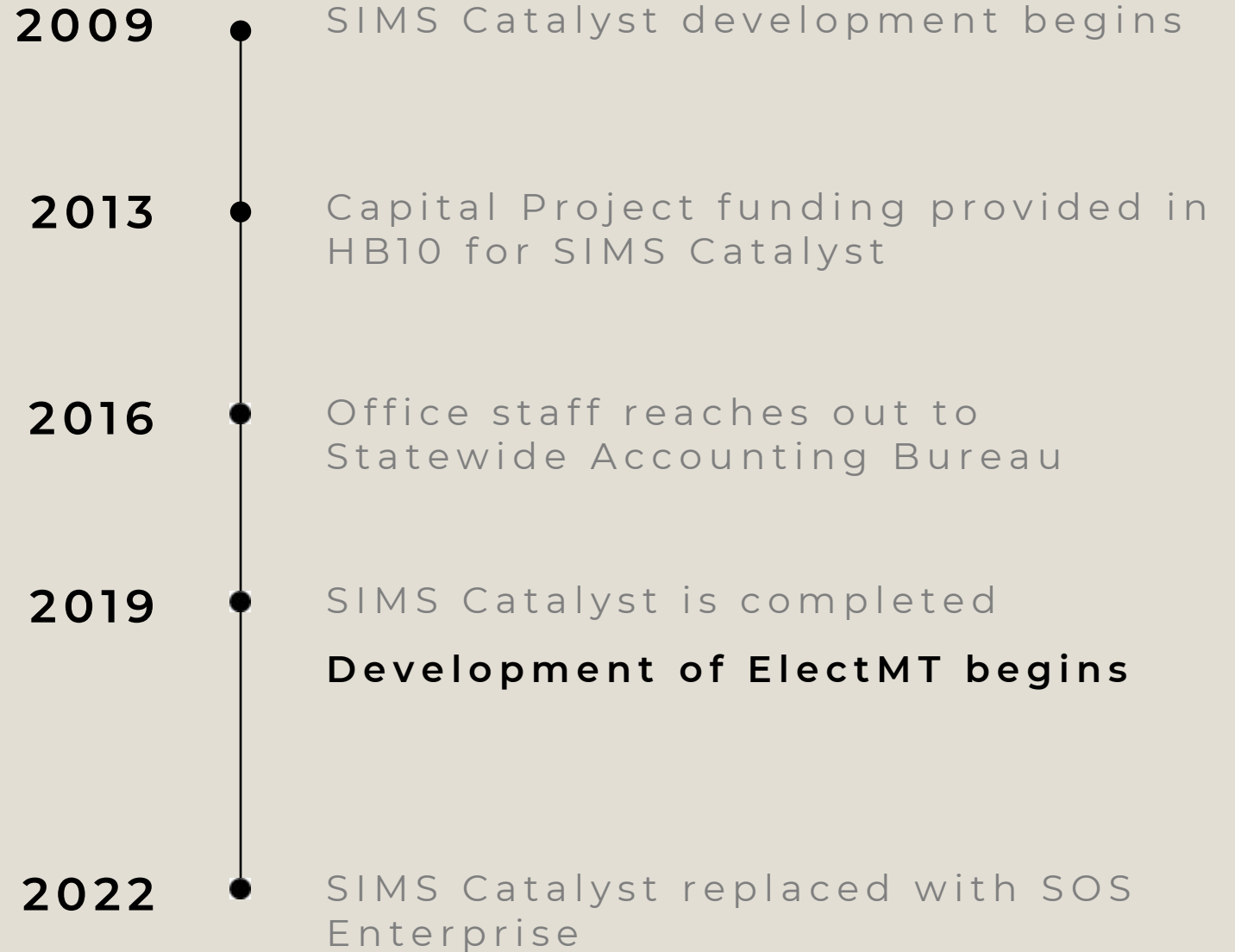
Amortization expenses were also incorrectly split between the **Enterprise Fund** and the **Capital Projects Fund**.

Capital Project amounts do not appear on the financial schedules and are **misstatements**.

Recommendation 1A

ElectMT

The system was paid in part by Proprietary funds and in part with Federal funds.

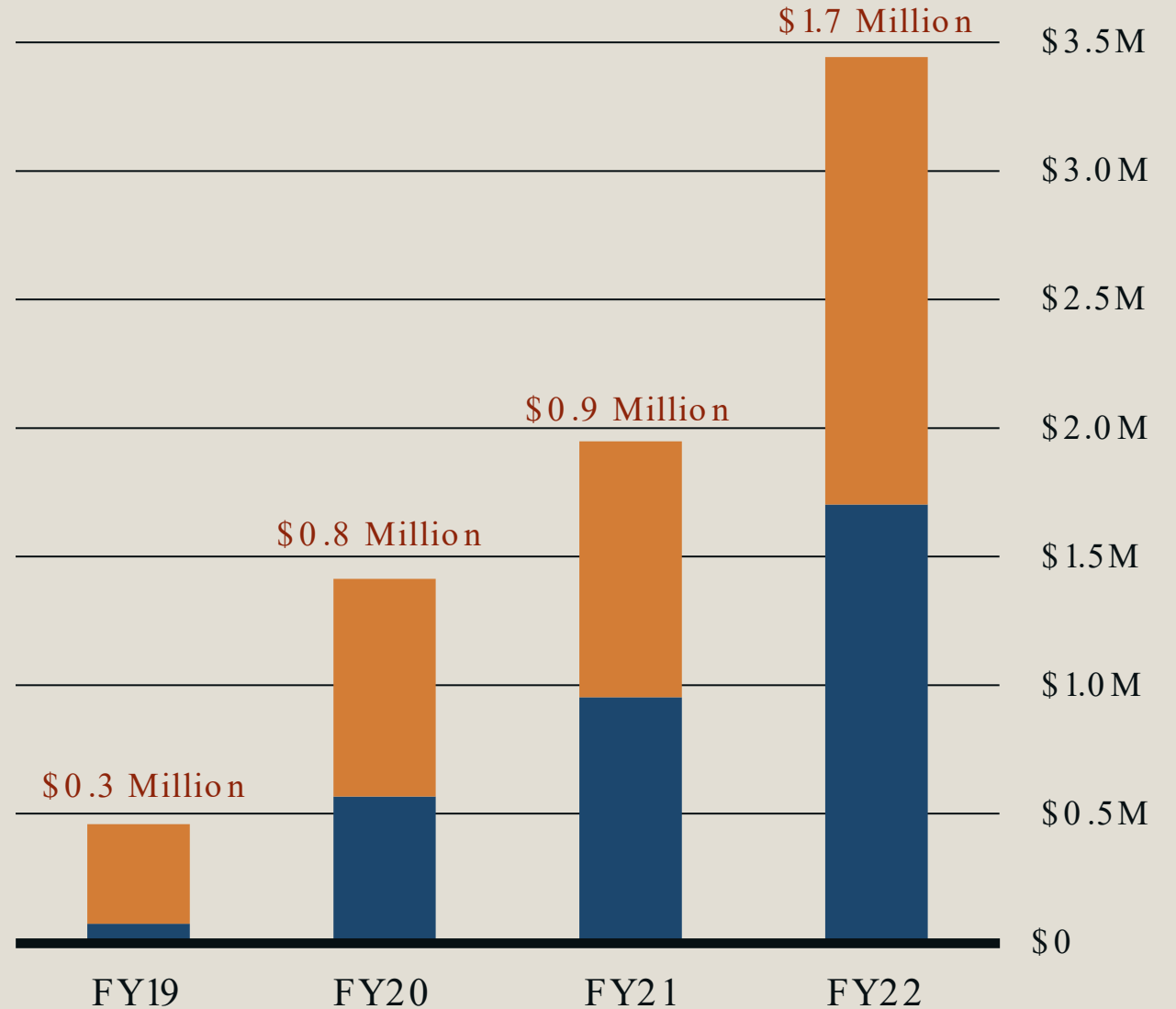


Recommendation 1A

ElectMT Asset Misstatement

The asset was incorrectly split between the **Enterprise Fund** and the **Federal Special Revenue Fund**.

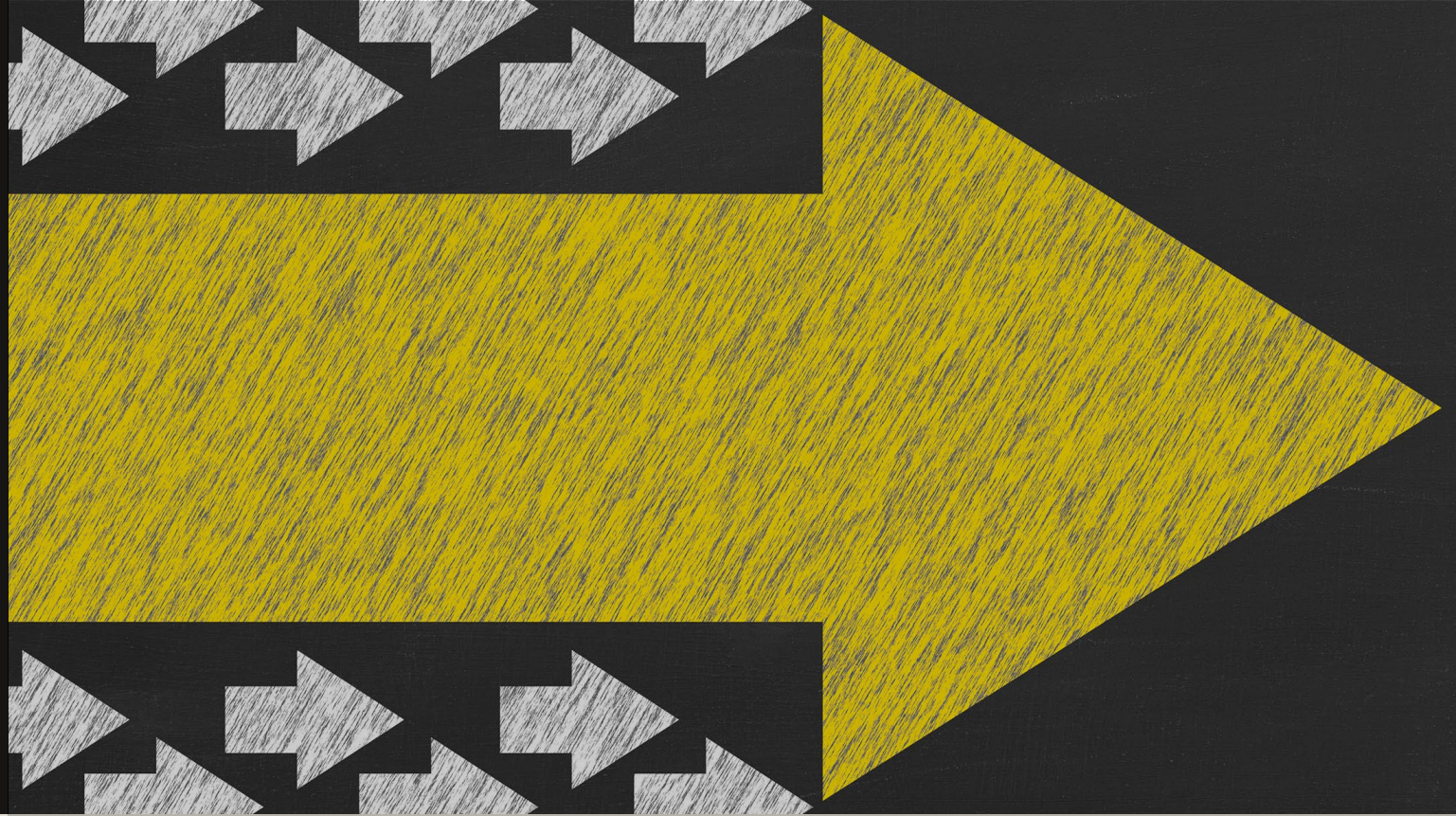
Federal amounts do not appear on the financial schedules and are **misstatements**.



Recommendation
1B

SOS Enterprise System

The SOS Enterprise System is
comprised of three distinct
modules.



**October
2019**

**December
2019**

**December
2020**

**June
2021**

UCC Module
becomes
operational

Notary Module
becomes
operational

Business Module
becomes
operational

System is
Capitalized and
Amortization
begins

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Each upgrade, enhancement, or modification should be treated as a separate asset

“

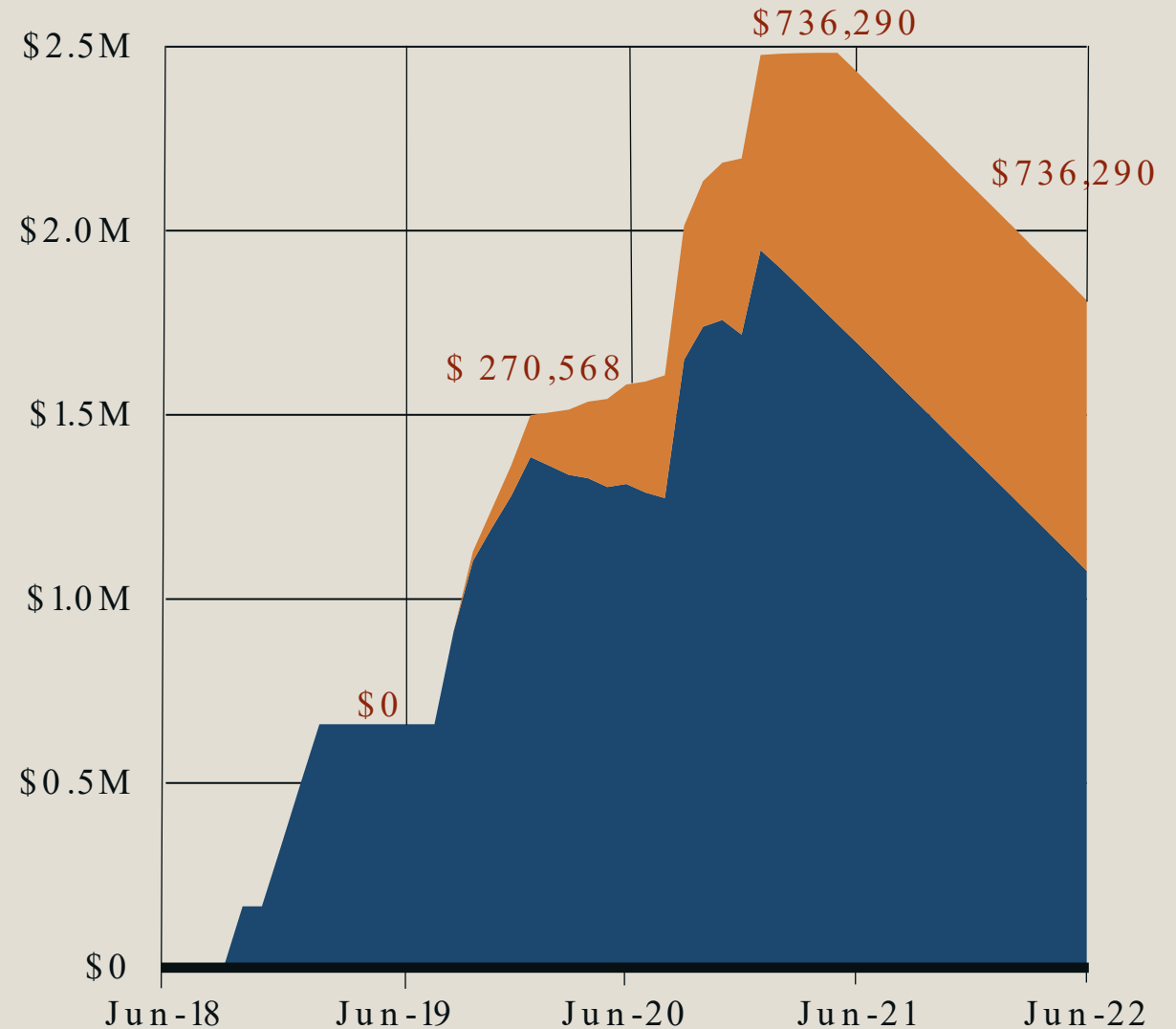
The capitalization of costs should cease once the software is substantially complete and operational.

Recommendation 1B

SOS Enterprise Asset Misstatement

The total asset value of the system **recorded as one asset** versus **if it had been recorded as three modules**.

The **difference** represents a **misstatement** on the financial schedules.



Recommendation 1C

Capitalized Costs

Costs for application, server, & database hosting services were capitalized in ElectMT.

These do not directly contribute to the software development.

Recommendation 1C

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Costs for application, server, & database hosting services were capitalized in ElectMT.

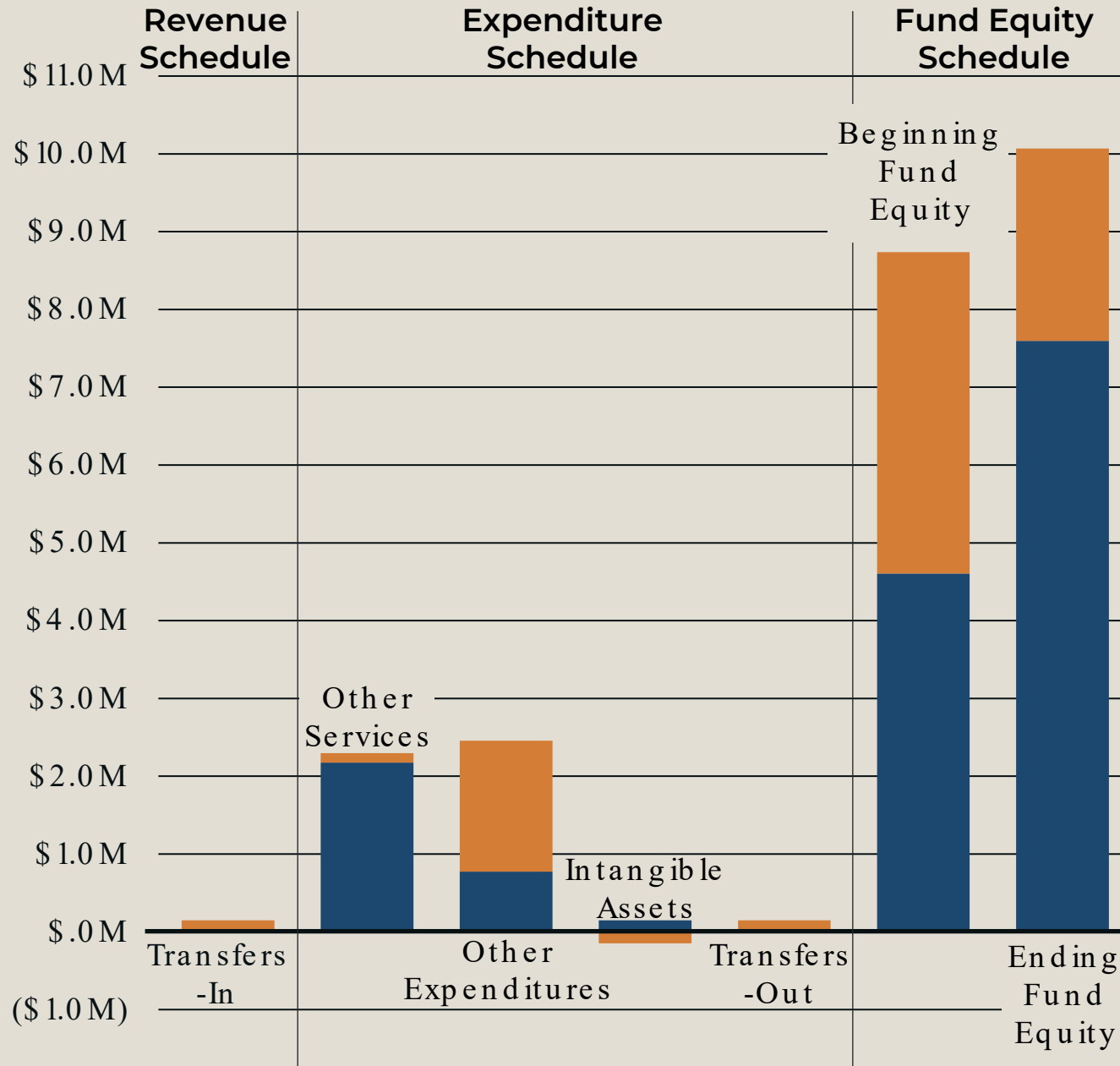
These do not directly contribute to the software development.

Recommendation 1D

Asset Retirement

The retirement of SIMS Catalyst removed more than the value of the asset from the accounting record.

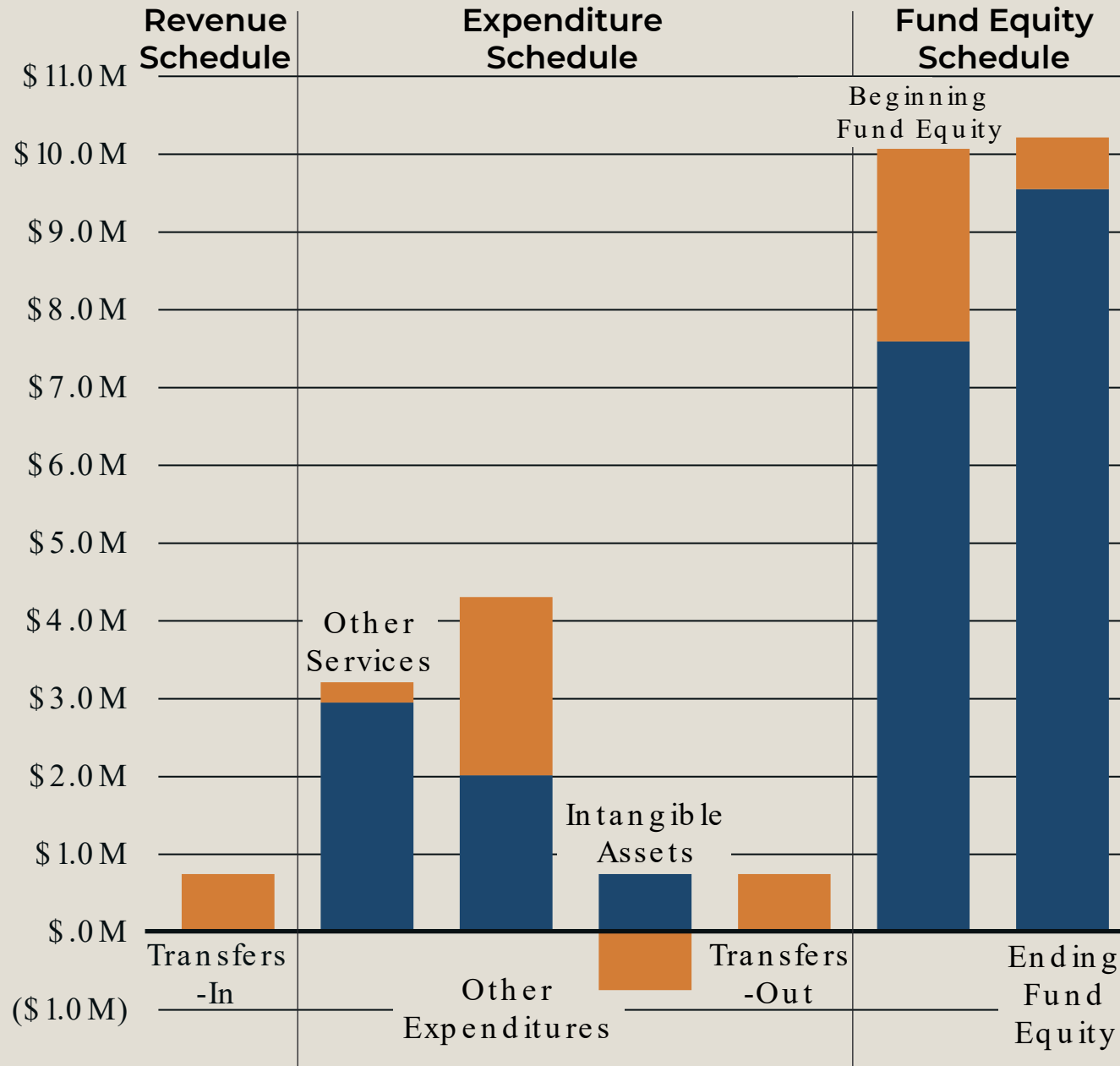
This resulted in a net negative asset value.



Recommendation 1

Fiscal Year 2021

Cumulative misstatements related to intangible capital assets versus reported amounts on the FY21 financial schedules.



Recommendation 1

Fiscal Year 2022

Cumulative misstatements related to intangible capital assets versus reported amounts on the FY22 financial schedules.

Recommendation 1

We recommend the Office of the Secretary of State:

- A. Record split funded assets in only one fund type,
- B. Begin amortizing internally generated software when it is substantially complete,
- C. Capitalize only costs that directly contribute to software development, and
- D. Record asset retirements accurately as state accounting policy requires.

Office Response: CONCUR

Recommendation 2

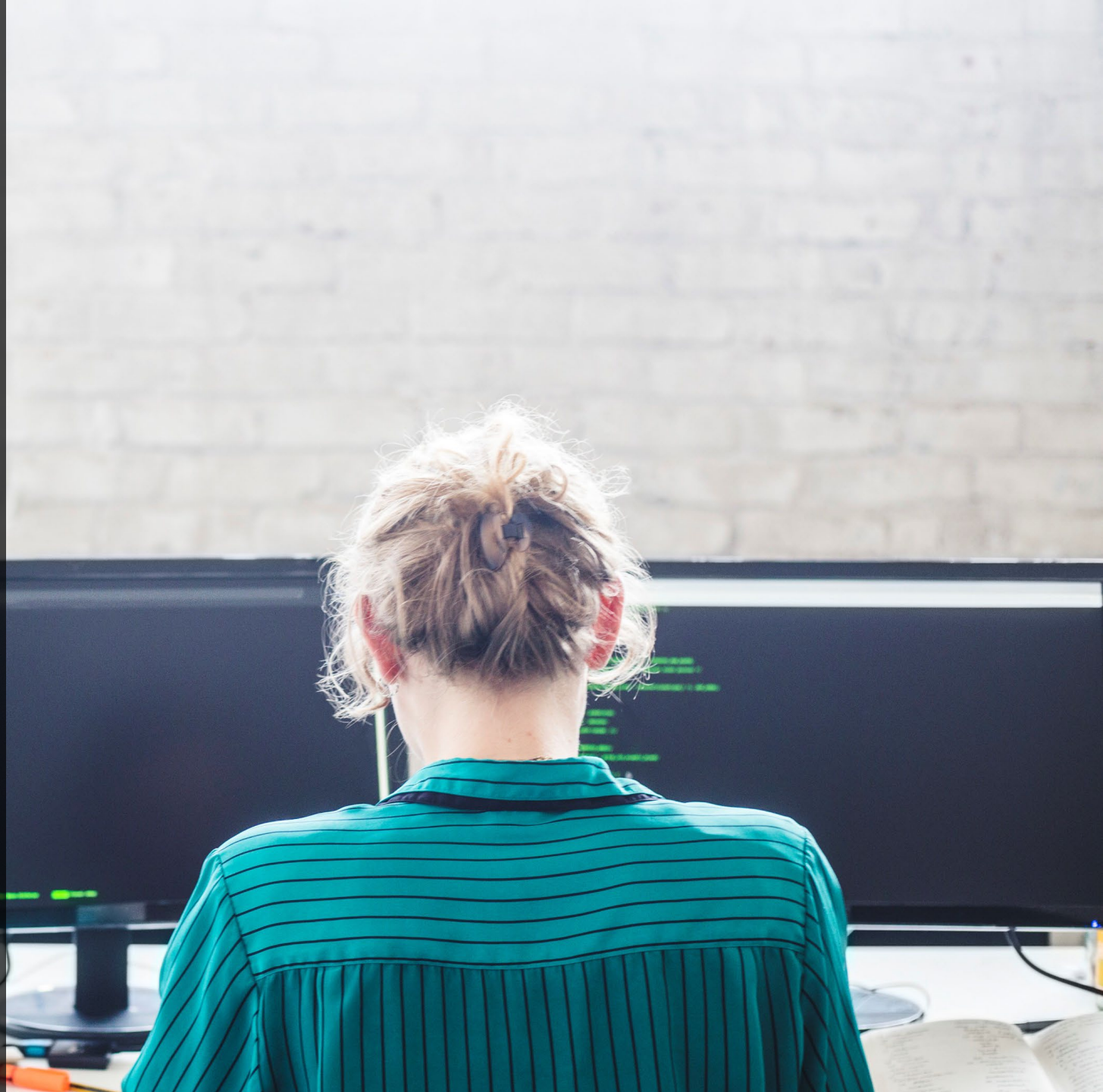
We recommend the Office of the Secretary of State enhance internal controls to ensure capital assets are recorded on the accounting record according to state accounting policy.

Office Response: CONCUR

Recommendation 3

Service Organization Audits

The SOS Enterprise system is supported and maintained by a service organization.





CONTRACT REQUIREMENT

The office's contract requires the service organization to obtain independent security audits.



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TIMEFRAME

The contract with this provision was executed in fiscal year 2019.



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INDEPENDENT AUDITS

The service organization did not receive an independent audit prior to us asking for one.



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SOC REPORT

A common way of obtaining these security assurances is through a SOC 1 type 2 audit.

Recommendation 3

We recommend the Office of the Secretary of State enhance its internal controls to obtain and review independent audit reports as required in the service organization contract.

Office Response: CONCUR

A background image showing a person's hands using a laptop and a credit card. The person is wearing a yellow sweater. The laptop is silver and the credit card is black. The background is a wooden desk.

Recommendation 4

Fees Commensurate With Costs

The office charges fees for the services they provide.

\$9.1 Million

FY21 Fee Revenue

Largest contributor are fees for new business registration and annual report filing.

32%

Increase from FY20

New business registrations increased 28%.

\$9.9 Million

FY22 Fee Revenue

New business registrations increased by 7% from FY21.

“

Fees must be
commensurate with the
overall costs of the
office

“

Fees must reasonably
reflect the prevailing
rates for similar services

Montana Code Annotated 2-15-405



Working Capital

The resources available to spend.

Cash Expenses

Expenses that require resources to be spent.

Operating Cycle

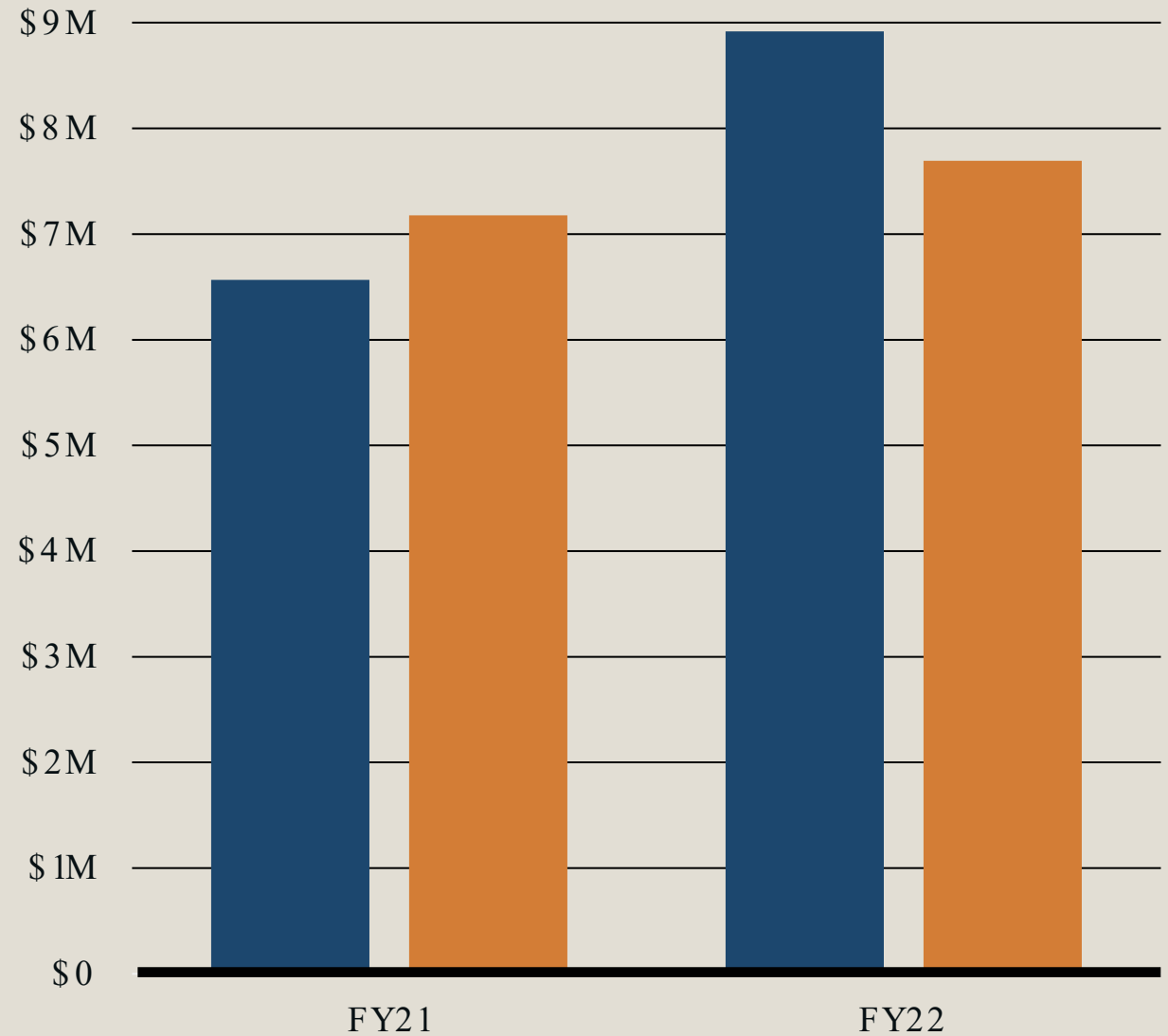
The office does not receive fee revenue evenly throughout the year. They operate with a one-year operating cycle.

Recommendation 4

Fees Commensurate with Costs

At the end of fiscal year 2022,
working capital exceeded **one**
year of cash expenditures.

Working capital was equal to **14**
months of **cash expenditures**.





**April
2022**

● **Administrative Rule Proposal**

The office proposed administrative rule changes to reduce new business filing fees by half.

**July
2022**

● **Rule Effective**

The proposed reduced new business filing fees went into effect.

**June
2023**

● **Fee Holiday Announced**

The office announced that 2024 annual report filing fees will be waived.

**January
-April
2024**

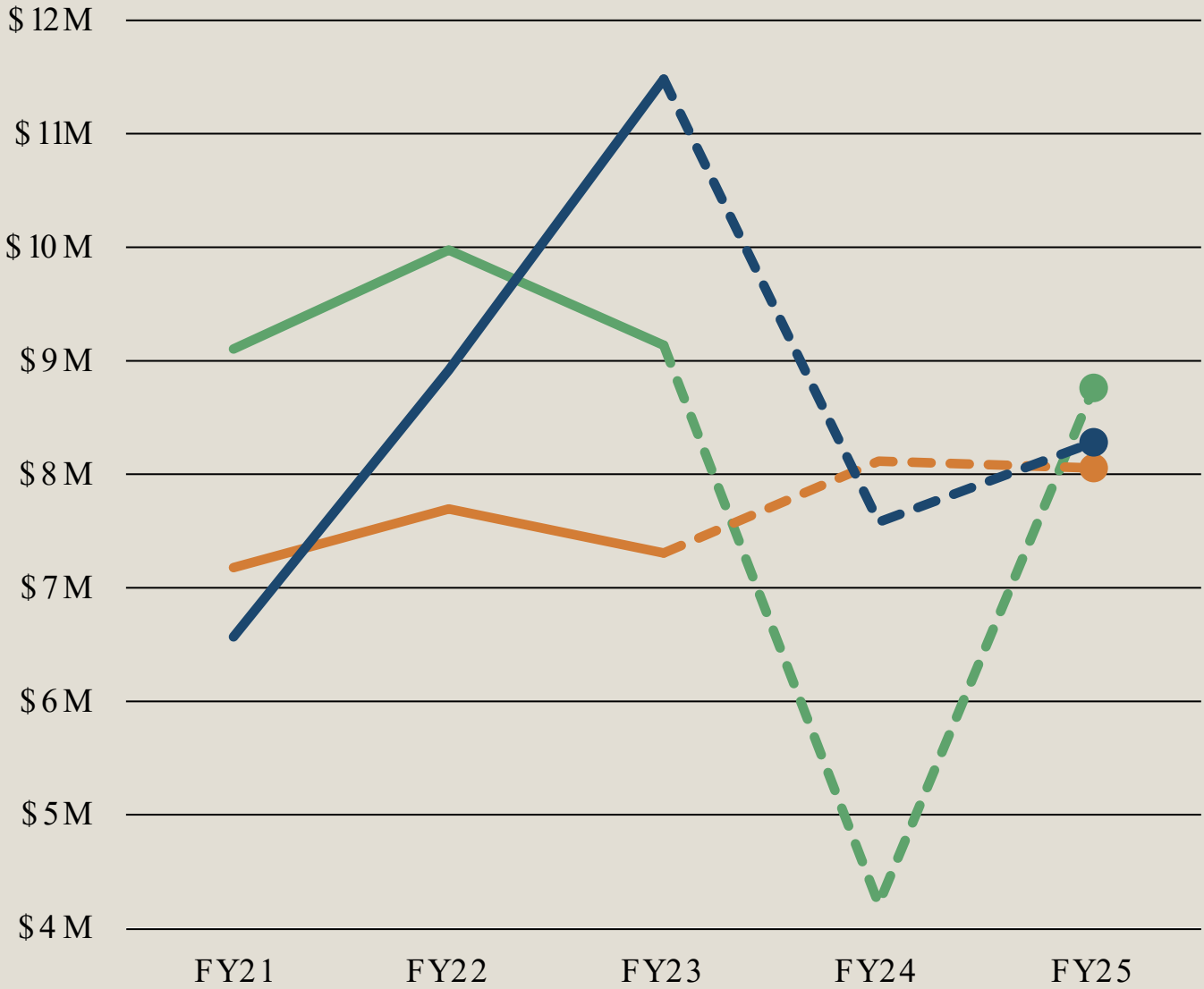
● **Annual Report Fees Waived**

The waiver of fees is effective for annual reports filed during this time.

Recommendation 4

Working Capital Projection

Despite lower **revenues** because of fee reductions, the **working capital** is still projected to exceed one year's **cash expenditures** at the end of fiscal year 2025.



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commensurate with the
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“

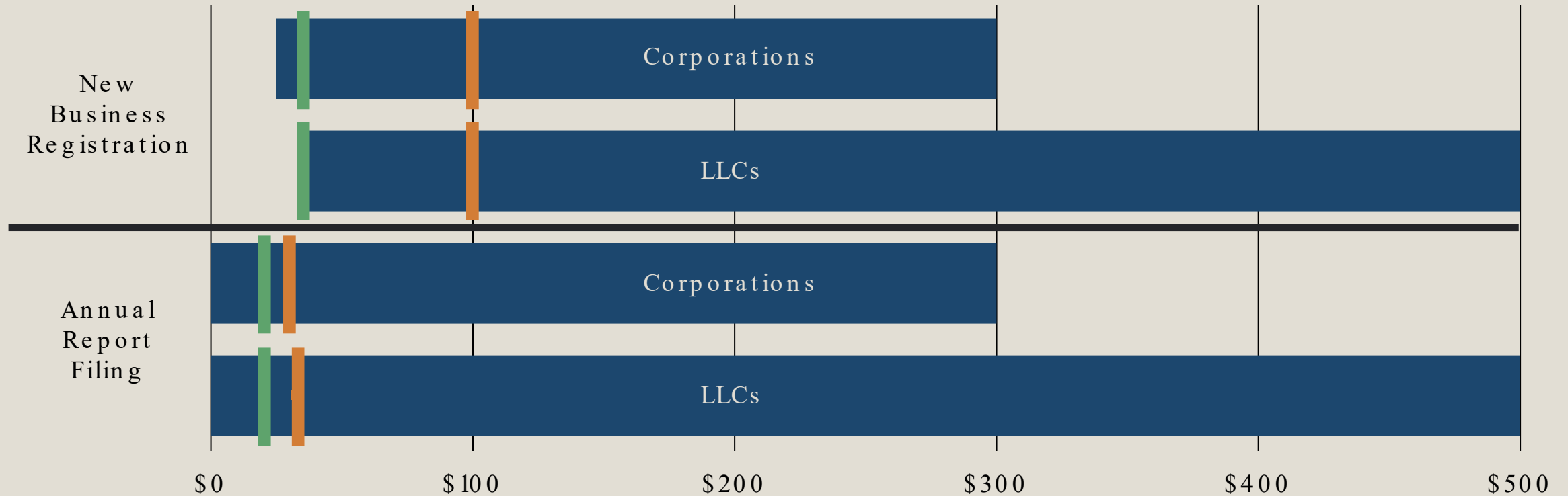
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Recommendation 4

Comparison to Other States

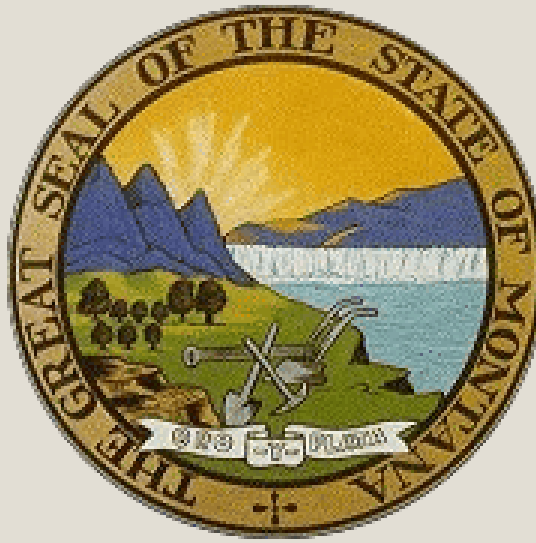
How **Montana** falls within the range of fees charged by other states. **Montana** falls below the **median** for each type of fee evaluated.



Recommendation 4

We recommend the Office of the Secretary of State prepare contingency plans to adjust additional fees as necessary until fees are commensurate with costs as required by state law and working capital has been reduced to a reasonable level.

Office Response: CONCUR



QUESTIONS?