



A REPORT
TO THE
MONTANA
LEGISLATURE

FINANCIAL-COMPLIANCE AUDIT

*Office of the
Secretary of State*

*For the Two Fiscal Years Ended
June 30, 2022*

NOVEMBER 2023

LEGISLATIVE AUDIT
DIVISION

22-19

FINANCIAL-COMPLIANCE AUDITS

LEGISLATIVE AUDIT COMMITTEE

REPRESENTATIVES

LYN HELLEGAARD

Lyn.Hellegaard@legmt.gov

SJ HOWELL

SJ.Howell@legmt.gov

EMMA KERR-CARPENTER

Emma.KC@legmt.gov

FIONA NAVE

Fiona.Nave@legmt.gov

JERRY SCHILLINGER

Jerry.Schillinger@legmt.gov

LAURA SMITH, VICE CHAIR

Laura.Smith@legmt.gov

SENATORS

JASON ELLSWORTH, CHAIR

Jason.Ellsworth@legmt.gov

PAT FLOWERS

Pat.Flowers@legmt.gov

CHRIS FRIEDEL

Chris.Friedel@legmt.gov

DENISE HAYMAN

Denise.Hayman@legmt.gov

KATHY KELKER

Kathy.Kelker@legmt.gov

FORREST MANDEVILLE

Forrest.Mandeville@legmt.gov

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Financial-compliance audits are conducted by the Legislative Audit Division to determine if an agency's financial operations are properly conducted, the financial reports are presented fairly, and the agency has complied with applicable laws and regulations. In performing the audit work, the audit staff uses standards set forth by the American Institute of Certified Public Accountants and the United States Government Accountability Office. Financial-compliance audit staff members hold degrees with an emphasis in accounting and many staff members hold Certified Public Accountant (CPA) certificates.

The Single Audit Act Amendments of 1996 and the Uniform Administrative Requirements, Cost Principles, and Audit Requirements for Federal Awards require the auditor to issue certain financial, internal control, and compliance reports in addition to those reports required by *Government Auditing Standards*. This individual agency audit report is not intended to comply with these reporting requirements and is therefore not intended for distribution to federal grantor agencies. The Legislative Audit Division issues a statewide biennial Single Audit Report which complies with the above reporting requirements. The Single Audit Report for the two fiscal years ended June 30, 2021, was issued June 21, 2022. The submission deadline for the Single Audit Report for the two fiscal years ended June 30, 2023, is March 31, 2024.

AUDIT STAFF

STEVEN ALTHOFF JESSICA CURTIS
JEANE CARSTENSEN-GARRETT ALISON OBRIEN
MARY CURRIN

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LEGISLATIVE AUDIT DIVISION

Angus Maciver, Legislative Auditor
Deborah F. Butler, Legal Counsel



Deputy Legislative Auditors:
Cindy Jorgenson
William Soller

November 2023

The Legislative Audit Committee
of the Montana State Legislature:

We are pleased to present our financial-compliance audit report for the Office of the Secretary of State (office) for each of the fiscal years ended June 30, 2021, and 2022. This report includes four recommendations related to the recording of intangible assets, use of service organizations, and fees charged by the office. The report contains adverse opinions on the fiscal years 2021 and 2022 financial schedules due to the material and pervasive nature of misstatements related to intangible assets. This means the financial schedules should not be used for decision making purposes.

The office's written response to these recommendations is included in the audit report on page C-1. We thank the Secretary of State and her staff for their cooperation and assistance throughout the audit.

Respectfully submitted,

/s/ Angus Maciver

Angus Maciver
Legislative Auditor

TABLE OF CONTENTS

Figures and Tables.....	ii
Elected, Appointed, and Administrative Officials.....	iii
Report Summary	S-1
CHAPTER I – INTRODUCTION AND BACKGROUND	1
Introduction	1
Financial Activity Summary	1
Background.....	3
CHAPTER II – ACCOUNTING FINDINGS AND RECOMMENDATIONS	5
Intangible Assets	5
Split Funded Intangible Assets	5
State Accounting for Split Funded Assets.....	5
SIMS Catalyst System.....	6
ElectMT System	7
Capitalization of System With Multiple Modules.....	7
Capitalization of Software Development Costs.....	8
Retirement Journal Entries.....	9
Internal Controls Related to Intangible Assets	10
Service Organization Audits	11
Fees Commensurate With Costs.....	12
INDEPENDENT AUDITOR’S REPORT AND OFFICE FINANCIAL SCHEDULES	
Independent Auditor’s Report	A-1
Schedule of Changes in Fund Equity for the Fiscal Year Ended June 30, 2022.....	A-5
Schedule of Changes in Fund Equity for the Fiscal Year Ended June 30, 2021	A-6
Schedule of Total Revenues & Transfers-In for the Fiscal Year Ended June 30, 2022	A-7
Schedule of Total Revenues & Transfers-In for the Fiscal Year Ended June 30, 2021.....	A-8
Schedule of Total Expenditures & Transfers-Out for the Fiscal Year Ended June 30, 2022.....	A-9
Schedule of Total Expenditures & Transfers-Out for the Fiscal Year Ended June 30, 2021	A-10
Notes to the Financial Schedules	A-11
REPORT ON INTERNAL CONTROL AND COMPLIANCE	
Report on Internal Control Over Financial Reporting and on Compliance and Other Matters Based on an Audit of Financial Schedules Performed in Accordance With <i>Government</i> <i>Auditing Standards</i>	B-1
OFFICE RESPONSE	
Office of the Secretary of State	C-1

FIGURES AND TABLES

Figures

Figure 1	Business Filings.....	1
Figure 2	Enterprise Fund Revenues, Cash and Investments, and Fund Equity.....	2
Figure 3	Development Costs of Information Systems	2
Figure 4	Working Capital and Cash Expenditures.....	13
Figure 5	Revenues, Cash Expenditures, and Working Capital.....	14

Tables

Table 1	Information Systems of the Secretary of State.....	5
Table 2	Recording SIMS Catalyst in Capital Project Fund	6
Table 3	Misstatements From Recording ElectMT in Federal Special Revenue Fund	7
Table 4	Misstatements From Not Amortizing SOS Enterprise When Substantially Complete	8
Table 5	Misstatement From Capitalizing Non-Capitalizable Expenses in ElectMT.....	9
Table 6	Misstatements From SIMS Catalyst Retirement.....	9
Table 7	Business Filing Base Fees Nationwide.....	14

ELECTED, APPOINTED, AND ADMINISTRATIVE OFFICIALS

Office of the Secretary of State

Christi Jacobsen, Secretary of State

Administrative Officials

Angela Nunn, Chief Deputy Secretary of State

Julie Lake, Human Resources Director

Sue Ames, Office Manager

Dana Corson, Elections Director

Kellee English, Business Services Director

Richie Melby, Communications Director

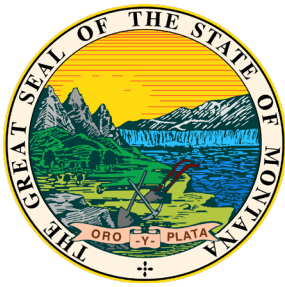
Austin James, Chief Legal Counsel

Brandi Pierson, Chief Fiscal Officer

Andy Ritter, Operations Manager

For additional information concerning the Office of the Secretary of State,
contact:

Angela Nunn
Chief Deputy Secretary of State
Office of the Secretary of State
PO Box 202801
Helena, MT 59620-2801
(406) 444-2034
e-mail: Angela.Nunn@mt.gov



MONTANA LEGISLATIVE AUDIT DIVISION

FINANCIAL-COMPLIANCE AUDIT

Office of the Secretary of State

FOR THE TWO FISCAL YEARS ENDED JUNE 30, 2022

A report to the Montana Legislature

BACKGROUND

The Secretary of State is authorized as an officer of the executive branch of state government. The Secretary of State's duties are diverse including functions such as the administration of elections, publishing administrative rules, and registration of articles of incorporation. In addition, the Secretary of State serves as a member of the Board of Land Commissioners and the Board of Examiners.

The office also interprets state election law and oversees state and federal elections. Nationally, election litigation has been steadily increasing over the last few decades. Consistent with national trends, the Montana Secretary of State's Office has been subject to increasing election litigation.

The office's main funding source is fees, which are recorded as charges for services revenue in the Enterprise Fund. The office also had federal funding during the audit period.

The Office of the Secretary of State developed new information systems to assist in filing documents, collecting fees, and managing voter registration. The office spent \$1.4 million in fiscal year 2021 and \$1.5 million in fiscal year 2022 developing these new systems. New business filings, which are processed by one of these new systems, increased by 28 percent in fiscal year 2021. This contributed to a rise in the office's charges for services revenues of 32 percent, to a total of \$9.1 million in fiscal year 2021. Two of the four recommendations in this report concern the accounting for these assets.

AUDITOR'S OPINION (page A-1): ADVERSE

Due to material and pervasive nature of misstatements identified during the audit period, we issued adverse opinions on the fiscal year 2021 and 2022 financial schedules. This means the reader should not rely on the information presented and the underlying financial records.

For the full context of the office's financial activity, see the financial schedules and notes beginning on page A-5.

RECOMMENDATIONS:

In this report, we issued the following recommendations:

To the office: 4

To the legislature: 0

The prior audit report contained no recommendations.

For the full report or more information, contact the Legislative Audit Division.

leg.mt.gov/lad

Room 160, State Capitol
PO Box 201705
Helena, MT 59620-1705
(406) 444-3122

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RECOMMENDATION #1 (page 10):

Accounting and Financial reporting

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 (page 11):

Internal Control

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 (page 12):

Internal Control

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

Office response: Concur

RECOMMENDATION #4 (page 15):

State Compliance

We recommend the Office of the Secretary of State 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

REPORT ON INTERNAL CONTROL AND COMPLIANCE (page B-1):

In this report, we identified the following:

Material Weaknesses in Internal Control: 1
Significant Deficiencies in Internal Control: 1
Material Non-Compliance: 0
Other Matters: 0

For the full context of this information, including the distinction between the types of items reported, see the report beginning on page B-1.

Chapter I – Introduction and Background

Introduction

We performed a financial-compliance audit of the Office of the Secretary of State (office) for the two fiscal years ended June 30, 2022. The objectives of this audit were to:

1. Determine whether the office’s financial schedules present fairly its results of operations and changes in fund equity.
2. Obtain an understanding of the office’s internal 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.
3. Determine whether the office complied with selected applicable state laws and regulations.

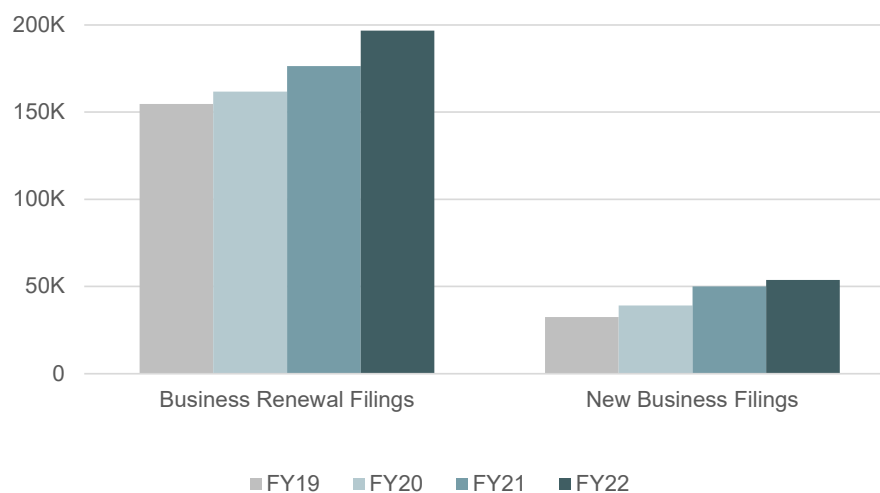
Our primary focus was on the office’s activity related to charges for services, federal revenue, and the recording of the office’s information technology systems assets. We audited this activity by reviewing transactions, analyzing data, and testing the office’s significant internal controls. In addition, we completed testing over significant laws and direct and material regulations.

Financial Activity Summary

Throughout the audit period, the office experienced a large increase in the number of new businesses filing with the office. These filings consist mainly of business names and domestic Limited Liability Company (LLC) articles of organization. The overall number of business renewal filings similarly increased due to the general improvement in economic conditions within the state.

Figure 1
Business Filings
Fiscal Years 2019-2022

Business renewal filings and new business filings both increased in recent years.

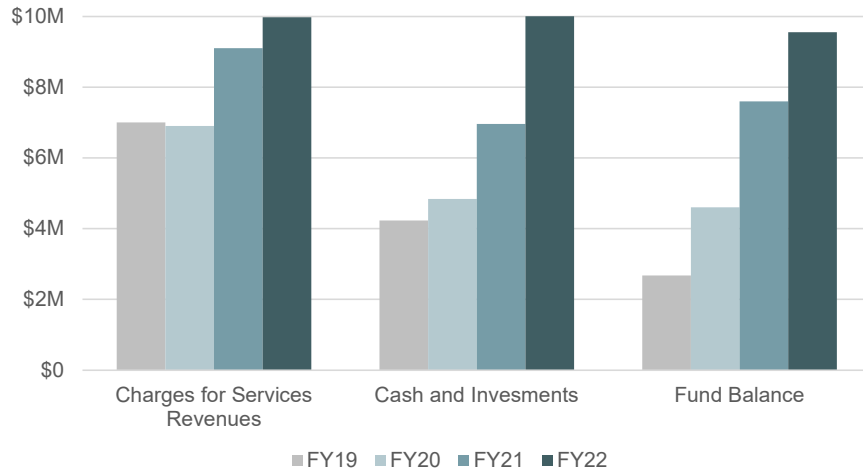


Source: Compiled by the Legislative Audit Division from Secretary of State records.

Each filing has an associated fee, which is recorded as a Charges for Services revenue. The increase in filings increased revenues, along with a corresponding increase in cash and investments and the fund equity of the office.

Figure 2
Enterprise Fund Revenues, Cash and Investments, and Fund Equity
Fiscal Years 2019-2022

Revenues increased in recent years, resulting in higher cash and fund equity balances.

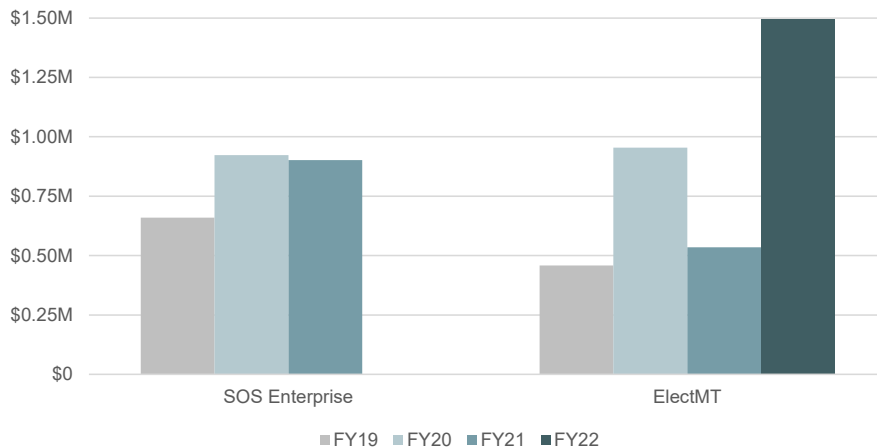


Source: Compiled by the Legislative Audit Division from unadjusted records.

Office expenditures in recent years included the development of new information systems. Of the three major systems of the office during the audit period, two had development costs in fiscal years 2021 and 2022.

Figure 3
Development Costs of Information Systems
Fiscal Years 2019-2022

Development costs for systems occur over several fiscal years and accumulate to the recorded asset value.



Source: Compiled by the Legislative Audit Division.

Background

The Office of the Secretary of State provides various services to the public including the following five functional areas described below.

Administrative Rules of Montana publishes the administrative rules promulgated by state agencies. The administrative rules process requires state agencies to notify the public when they wish to adopt, amend, or repeal administrative rules. The notices are compiled in the Montana Administrative Register. Once adopted, administrative rules have the force of law.

Business Services tracks the registration, renewal, amendment, and cancellation of businesses and trademarks in Montana. The division also tracks Uniform Commercial Code and Effective Financing Statement filings and liens. In addition, it processes the required annual reports for all Montana corporations and LLCs, due each year before April 15th.

Notary Services is the primary resource for commissioning, informing, and educating Montana's notaries public and providing authentication services for those needing documents certified for use in foreign countries.

Elections and Government assists election administrators and the general public on voter registration and elections issues, interprets state election laws, and oversees state and federal elections. The division also provides resources to election officials and updates election results as the precincts report to the Secretary of State's Office on election night.

Records and Information Management is responsible for storing, accessing, scanning, preserving, and disposing of public documents generated by state and local government. This management of essential information helps to ensure continuity and accountability in government.

Chapter II – Accounting Findings and Recommendations

Intangible Assets

Intangible assets are resources lacking physical substance, such as computer systems, software licenses, and easements. The primary intangible assets of the Office of the Secretary of State are information technology computer systems used to carry out the duties and responsibilities of the office. All the systems have been customized for the office's needs and are classified as internally generated computer software. The information systems used by the office during the audit period are summarized in Table 1 below.

Table 1
Information Systems of the Secretary of State

Name	<u>SIMS Catalyst</u>	<u>SOS Enterprise</u>	<u>ElectMT</u>
Purpose	Assist in the electronic filing of records and documents.	Assist in the electronic filing of records and documents.	Assist in the management of voter registration for elections.
Funding Source	Capital Projects fund & Enterprise fund	Enterprise fund	Federal Special Revenue fund & Enterprise fund
Development Began	Fiscal Year 2009	Fiscal Year 2019	Fiscal Year 2019
Amortization Began	Fiscal Year 2019	Fiscal Year 2021	N/A
Current Status	Retired in Fiscal Year 2022	In Use	In Development
Total Cost of Development	\$6.96 million	\$2.48 million	\$3.44 million through Fiscal Year 2022

Source: Compiled by the Legislative Audit Division from Secretary of State records.

When internally generated software costs exceed \$500,000, state accounting policy (policy) requires the software to be capitalized. As information systems are developed, the office must spend cash on services and materials used to develop the system before it can be used for its intended purpose. Capitalization is an accounting process that re-classifies these costs from expenditures to an intangible asset. This allows the system development costs to be recognized as expenditures throughout the system's useful life. Also known as amortization, this better aligns expenditures with the benefits the system provides or is expected to provide. Just as costs for internally generated software accumulate, any misstatements related to the software development also accumulate over time.

Split Funded Intangible Assets

The office did not record two split funded intangible assets in one fund as required by state accounting policy.

State Accounting for Split Funded Assets

Capital assets are reported differently based on which fund they are recorded in. Capital project funds and federal special revenue funds only reflect near-term financial information and do not

report long-term assets, such as intangible assets, on the financial schedules. Assets recorded in these funds appear in the government-wide statements in the Annual Comprehensive Financial Report (ACFR) for the State of Montana. By contrast, enterprise funds reflect both near and long-term financial information, so all long-term assets are reported as an element of fund equity on the financial schedules. When multiple funding sources contribute to system development, policy requires the office to transfer money from contributing funds to the fund that will record the capital asset.

SIMS Catalyst System

In 2016, office management updated and corrected the asset records of the office. They observed that the incomplete SIMS Catalyst system was recorded only in the office's enterprise fund, even though it was funded partially through a capital projects fund. Per office management, they sought advice from the Statewide Accounting Bureau (SAB) at the Department of Administration on whether the asset should be recorded in multiple funds to reflect the multiple funding sources. SAB personnel advised the office that, until the system was completed, they should record it in multiple funds.

This advice contradicts state accounting policy, which requires capital assets, complete or incomplete, to be recorded in only one fund type, regardless of the funding source. Office management recognized that this advice appeared contrary to state accounting policy but heeded SAB's advice and recorded the incomplete asset in multiple funds.

During our audit for fiscal year 2015 and 2016, office management disclosed to the audit team that the incomplete asset had been recorded incorrectly. The audit team at the time reviewed policy and held additional discussions with SAB. Based on the work performed, the audit team did not take issue with the error as communicated by the office. However, because the incomplete asset was recorded in multiple funds, it was recorded contrary to state policy.

In the advice provided by SAB, they also recommended that the asset be transferred to one fund type upon completion of the system. However, when the system's development was finished in fiscal year 2019, the office recorded the completed asset in two fund types, contrary to this advice and state policy. Since intangible assets in the capital projects fund are not reported on the financial schedules of the office, the portion of the asset and its subsequent amortization recorded in the capital projects fund does not appear on the financial schedules. This resulted in the following misstatements, one component of the total misstatements summarized in the Independent Auditor's Report on page A-1.

Table 2
Misstatements From Recording SIMS Catalyst in Capital Project Fund

	Fiscal Year 2021 <i>Over(Under)stated</i>	Fiscal Year 2022 <i>Over(Under)stated</i>
Enterprise Fund		
Beginning Fund Equity	(\$3,554,547)	(\$2,335,845)
Other Expenses	(\$1,218,702)	(\$2,335,845)
Ending Fund Equity	(\$2,335,845)	

Source: Compiled by the Legislative Audit Division.

ElectMT System

Office management stated that when the development of the ElectMT system began in 2019, they followed the guidance provided by SAB in 2016, as discussed above. The office recorded the incomplete asset in multiple funds to reflect the multiple funding sources. We discussed this with SAB personnel, and based on those discussions, we determined there is criteria in state accounting policy stating split funded assets, even incomplete assets, should be recorded in only one fund type.

Since the office recorded a portion of the ElectMT system in a federal special revenue fund, the financial schedules of the office do not report this portion. This resulted in the following misstatements, one component of the total misstatements summarized in the Independent Auditor's Report on page A-1.

Table 3
Misstatements From Recording ElectMT in Federal Special Revenue Fund

	Fiscal Year 2021 <i>Over(Under)stated</i>	Fiscal Year 2022 <i>Over(Under)stated</i>
Enterprise Fund		
Beginning Fund Equity	(\$846,000)	(\$994,463)
Transfers-In	(\$148,463)	(\$746,100)
Ending Fund Equity	(\$994,463)	(\$1,740,563)
Federal Special Revenue Fund		
Intangible Asset Expense	\$148,463	\$746,100
Transfers-Out	(\$148,463)	(\$746,100)

Source: Compiled by the Legislative Audit Division.

While the office may receive advice and guidance on accounting matters, the responsibility for management decisions rests solely with the office. Compliance with policies, rules, and regulations is a continuous process. The office should consider current circumstances and policies when capitalizing assets. Policies can change over time and projects may have unique parameters that require unique considerations. The advice provided on one project may not apply to similar projects.

Capitalization of System With Multiple Modules

The office did not amortize software once substantially complete and operational, as required by state accounting policy.

The completed SOS Enterprise System has three modules: the Universal Commercial Code module, which became operational in October 2019; the Notary module, which became operational in December 2019; and the Business module, which became operational in December 2020. Each module relies on core system functionality and is not independent of the other modules.

Once an information system is substantially complete, state accounting policy requires the amortization of capitalized system development costs to begin. Enhancements to the system are treated as separate assets per policy and separately amortized because they benefit the office over a different period than the rest of the system.

As each module became operational, it was used by the office for its intended purpose. Therefore, the core system was substantially complete upon implementing the first module, with subsequent modules increasing the system's functionality. State accounting policy requires the assets to be placed into service when they are substantially complete and modifications that increase system functionality to be capitalized as separate assets. The office did not capitalize each module separately. Instead, it capitalized the costs for all three modules into one intangible asset because they believed the system was a single, inseparable system that should be capitalized as a single asset.

The office began amortizing the intangible asset in June 2021—six months after completing the final module. As a result, there were periods in which the system benefited the office, but the costs of the system were not recognized. This caused the following financial schedule misstatements, one component of the total misstatements summarized in the Independent Auditor's Report on page A-1.

Table 4
Misstatements From Not Amortizing SOS Enterprise When Substantially Complete

	Fiscal Year 2021 <i>Over(Under)stated</i>	Fiscal Year 2022 <i>Over(Under)stated</i>
Enterprise Fund		
Beginning Fund Equity	\$270,568	\$736,290
Other Expenses	(\$465,722)	
Ending Fund Equity	\$736,290	\$736,290

Source: Compiled by the Legislative Audit Division.

Large information technology projects tend to have development costs throughout their lives. These costs may include adding new functionality, enhancing existing features, or performing maintenance on the system. If amortization does not begin until these costs cease, it may not occur until the system is no longer in use. Without amortization, fund equity overstates the system's value and understates expenditures in the years the system is in use.

Capitalization of Software Development Costs

The office capitalized costs state accounting policy does not allow.

State accounting policy requires that only the services and materials directly consumed in the development of the system be capitalized. In fiscal years 2021 and 2022, costs for server, database, and application hosting services were tracked as capitalizable expenses and capitalized as part of the ElectMT intangible asset. Hosting services do not directly contribute to software development, so

per state accounting policy, they should not be included in capitalized expenditures. This caused the following financial schedule misstatements, one component of the total misstatements summarized in the Independent Auditor's Report on page A-1.

Table 5
Misstatement From Capitalizing Non-Capitalizable Expenses in ElectMT

	Fiscal Year 2021 <i>Over(Under)stated</i>	Fiscal Year 2022 <i>Over(Under)stated</i>
Enterprise Fund		
Beginning Fund Equity		\$121,061
Other Services	(\$121,061)	(\$260,442)
Ending Fund Equity	\$121,061	\$381,503

Source: Compiled by the Legislative Audit Division.

Retirement Journal Entries

The office recorded asset retirement journal entries that did not accurately remove the asset from the accounting record.

Once an information technology system is no longer used, it is retired, or removed from the accounting record. If the system is retired before the end of its useful life, policy requires the remaining asset value to be recorded as a loss expense on the accounting records.

When the office retired the SIMS Catalyst system, the state's accounting system automatically calculated the accounting entries necessary to remove the intangible asset from the state's accounting record, including the associated loss expense. However, due to an extra period of amortization recorded at the beginning of the fiscal year, the system did not calculate the asset value correctly at retirement. The office detected the excess amortization earlier in the fiscal year, but no corrections were made because they believed it would correct itself later in the year. The asset was retired before the extra amortization could correct itself, and the office did not detect the incorrectly generated retirement loss expense. This caused the following financial schedule misstatements, one component of the total misstatements summarized in the Independent Auditor's Report on page A-1.

Table 6
Misstatements From SIMS Catalyst Retirement

	Fiscal Year 2022 <i>Over(Under)stated</i>
Enterprise Fund	
Other Expenses	\$43,458
Ending Fund Equity	(\$43,458)

Source: Compiled by the Legislative Audit Division.

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.*

Internal Controls Related to Intangible Assets

The Office of the Secretary of State’s internal controls were insufficient to ensure that intangible assets were recorded according to state accounting policy. This resulted in a material control weakness and pervasive material misstatements on the financial schedules.

As discussed in more detail in Recommendation #1 above, the office did not comply with state accounting policy because they did not record intangible assets in one fund or amortize intangible assets when substantially complete and operational. They also recorded asset capitalization and retirement journal entries that did not comply with policy. This resulted in numerous accounting errors and material misstatements on the state’s accounting records and the office’s financial schedules. As a result, we determined the office’s internal controls were insufficient to ensure intangible assets were recorded in compliance with state accounting policies. We consider this a material weakness in the internal controls of the office in our Report on Internal Control and Compliance on page B-1. The Independent Auditor’s Report on page A-1 summarizes the resulting financial schedule misstatements.

These misstatements are material and pervasive to the fiscal year 2021 and fiscal year 2022 financial schedules. They are the basis of the adverse opinions issued on each year’s financial schedules in the Independent Auditor’s Report on page A-1.

State accounting policy makes office management responsible for establishing and maintaining an effective internal control system. An effective internal control system should detect and correct errors and noncompliance with relevant policies timely. The office should confirm compliance with the relevant policies, especially for infrequent transactions.

Due to the nonroutine nature of capital asset transactions, the office should consider adding additional layers of review to ensure they are recorded correctly. These additional reviews may include reviews of state accounting policy or reviews for accuracy and completeness. Someone proficient in state accounting for capital assets should perform these reviews. Due to the small size of the office’s

accounting staff, the office may need to utilize resources outside of the office for the reviews to be effective.

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.

Service Organization Audits

The Office of the Secretary of State did not obtain contractually required independent audit reports from a key service provider.

The office contracts an outside service organization to maintain and support its SOS Enterprise information system. This system is used to process nearly all the office's revenues. It also processes and stores sensitive data of the people and entities required to file information with the office.

The contract between the office and the service organization contains a requirement for the service organization to provide reasonable proof, through independent audit reports, that the system meets or exceeds state security requirements. The contract provision outlines the security standards that must be met, the audit report format, the frequency of the independent audits, and which office personnel they should deliver the reports to.

These independent audits are important because they help the service organization and the office identify potential control deficiencies and security vulnerabilities in the system. If control deficiencies or security vulnerabilities go undetected and uncorrected, there is a risk that sensitive data could be compromised. There is also a risk the financial activity processed by the SOS Enterprise system could be incorrect. State accounting policy makes management responsible for establishing and maintaining an effective control system, which includes controls to comply with contract provisions.

Office management was unaware of the provision in the contract, executed in fiscal year 2019. As of the end of fiscal year 2022, no independent audit report had been requested by the office or delivered to the office. The service organization did not obtain an independent audit. The office did obtain information about the service organization's security in 2021 and again in 2023, but this was all self-reported information, which the office felt was sufficient at the time.

Self-reported assessments provide a different level of assurance than an independent audit. Independent audits focus on compliance and are performed by a team without bias. The office eventually requested

an independent audit report, but only after we asked if one was available. We consider this a significant deficiency in internal controls of the office in our Report on Internal Control and Compliance on page B-1.

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.

Fees Commensurate With Costs

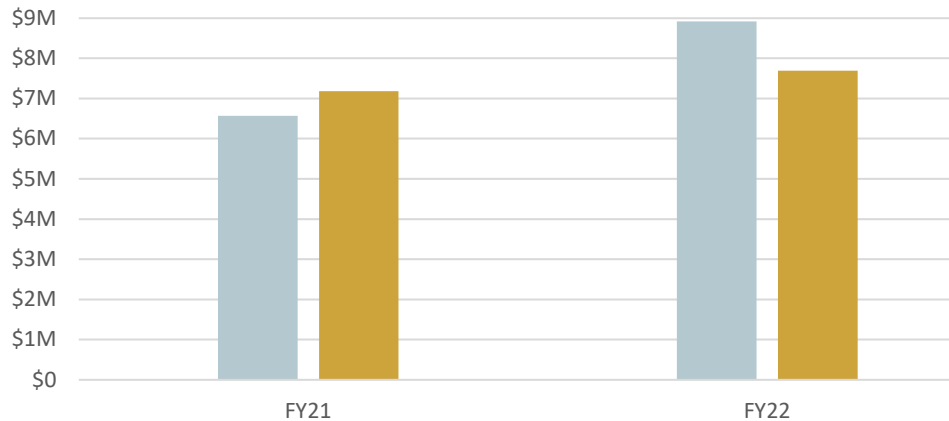
The fees charged by the Office of the Secretary of State were not commensurate with costs in fiscal year 2022, as required by state law.

The office charges small fees for the various filings they collect and the services they provide. The office sets these fees in administrative rule as required by state law. The proceeds from the fees fund the operations of the office. The fees are deposited in the office's Enterprise Fund. The Enterprise Fund is not an internal service fund, so it is not limited to 60 days of working capital. However, §2-15-405(2), MCA, requires the fees charged by the office, unless otherwise specified in law, to be commensurate with the overall costs of the office.

There is no clear criteria stating how to measure whether the fees charged by the office are commensurate with the overall costs of the office. Our evaluation began with the methodology for evaluating internal service funds and we adjusted it to reflect the office's unique business cycle. We compared the office's working capital at fiscal year-end to cash expenditures. Working capital measures the assets available to spend, and cash expenditures are the expenses that require the office to spend assets. Since the office receives revenues from business filings that occur once a year, we considered fees commensurate with costs if working capital is less than a year's cash expenditures.

Figure 4
Working Capital and Cash Expenditures
 Fiscal Years 2021 and 2022

Working capital exceeded a year's worth of **cash expenditures** in fiscal year 2022



Source: Compiled by the Legislative Audit Division.

At the end of fiscal year 2022, the working capital amount was enough to cover approximately 14 months of cash expenditures. To put this into context, the office could choose not to collect any fees for an entire year and still be able to operate normally and pay all their bills. When working capital exceeds expenditures, it means that consumers, primarily Montana businesses, are paying more for services than the office requires to operate.

The accumulation of working capital resulted primarily because of increased revenues and decreased expenses. Fiscal years 2021 and 2022 saw a large increase in the number of new businesses filing with the office, and the office experienced a corresponding increase in the revenues from these filings. The office has also found operational efficiencies that have reduced operating costs in recent years, which resulted in the office needing less money to perform their duties.

The office has already reduced and eliminated some fees in response to the accumulation of working capital. Effective fiscal year 2023, new business filing fees were cut in half and various other fees were eliminated. The office has also eliminated fees for 2024 annual report filings. The rule-making process required to change fees can take up to six months to complete. Since the long rule-making process makes it difficult for the office to quickly raise revenues if needed, the office has been carefully trying to reduce fees without creating the need to raise them in the near future. A situation like this would also result in fees not being commensurate with costs. Still, the fees reduced to date by the office did not go into effect quickly enough to prevent the accumulation of working capital shown in Figure 4 above.

In addition to requiring fees to be commensurate with the overall costs of the office, §2-15-405(2), MCA, requires that fees reasonably reflect the prevailing rates charged in the public and private sectors for similar services. After reducing fees, the office has the lowest overall new business registration fees in

the country. The office’s base annual report fees also rank in the top third of states. This demonstrates the efficiency with which the office operates compared to their peer organizations in other states.

Table 7
Business Filing Base Fees Nationwide
Fiscal Year 2023

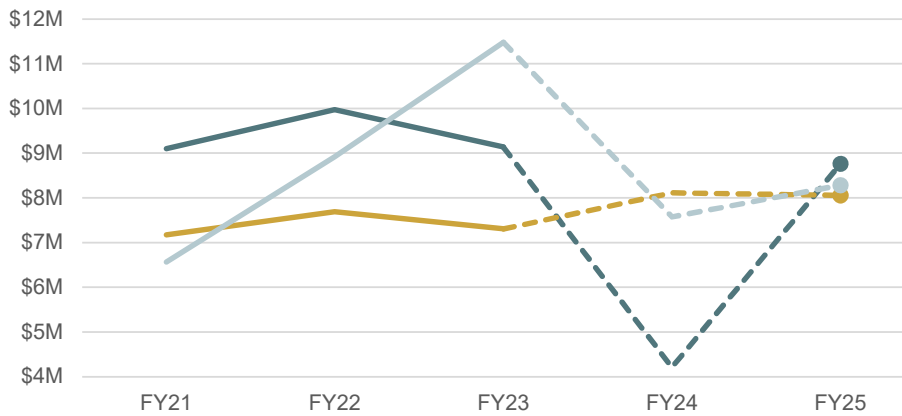
	Domestic For-Profit Corporation		Domestic LLC	
	Registration	Annual Report Filing	Registration	Annual Report Filing
Montana’s Fee	\$35	\$20	\$35	\$20
Montana’s Rank	2	14	1	16
Lowest Fee Nationally	\$25	\$0	\$35	\$0
Highest Fee Nationally	\$300	\$300	\$500	\$500
Median Fee Nationally	\$100	\$30	\$100	\$32.50

Source: Compiled by the Legislative Audit Division from Secretary of State records.

At the office’s request, we reviewed their projected revenues and expenses for the 2025 biennium. We also reviewed the unaudited fiscal year 2023 financial data. Using the office’s projected and historical data, we projected cash expenditures for the 2025 biennium. This allowed us to evaluate the impact the fee reductions made to date will have on the office’s working capital.

Figure 5
Revenues, Cash Expenditures, and Working Capital

Projections show that, while fee waivers reduce **revenues**, **working capital** is still projected to exceed one year's worth of **cash expenditures** in fiscal year 2025.



Source: Compiled by the Legislative Audit Division from Secretary of State records.

While the 2024 annual report filing fee waiver is expected to reduce working capital by approximately one-third, working capital is still projected to be approximately one year's worth of cash expenditures at the end of fiscal year 2025. This indicates that the actions taken by the office to date may be insufficient to reduce working capital to a reasonable level. If the office continues to find cost efficiencies in its operations, they will benefit from developing contingency plans to further reduce fees. This will allow the office to better manage its working capital.

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.

Independent Auditor's Report and Office Financial Schedules

Angus Maciver, Legislative Auditor
Deborah F. Butler, Legal Counsel



Deputy Legislative Auditors:
Cindy Jorgenson
William Soller

INDEPENDENT AUDITOR'S REPORT

The Legislative Audit Committee
of the Montana State Legislature:

REPORT ON THE AUDIT OF FINANCIAL SCHEDULES

Opinions

We have audited the financial schedules of the Office of Secretary of State, which are comprised of the Schedules of Changes in Fund Equity, Schedules of Total Revenues & Transfers-In, and Schedules of Total Expenditures & Transfers-Out for each of the fiscal years ended June 30, 2022, and 2021, and the related notes to the financial schedules.

Adverse Opinions on Regulatory Basis of Accounting

In our opinion, because of the significance of the matters discussed in the “Basis for Adverse Opinions on Regulatory Basis of Accounting” paragraph, the accompanying financial schedules for the fiscal years ended June 30, 2022, and 2021 do not present fairly the results of operations and changes in fund equity for each of the fiscal years ended June 30, 2022, and 2021, in conformity with the basis of accounting described in Note 1.

Adverse Opinions on U.S. Generally Accepted Accounting Principles

In our opinion, because of the significance of the matter discussed in the “Basis for Adverse Opinions on U.S. Generally Accepted Accounting Principles” section of our report, the financial schedules referred to above do not present fairly, in accordance with accounting principles generally accepted in the United States of America, the financial position of the office as of June 30, 2022, and June 30, 2021, or changes in financial position for the years then ended.

Basis for Adverse Opinions on Regulatory Basis of Accounting

The intangible assets of the office contained multiple misstatements, including those outlined below:

- ◆ The office recorded intangible assets in multiple fund classifications based on their funding source. State accounting policy requires capital assets to be recorded in only one fund classification. The portion of intangible assets recorded in governmental funds are recorded on the ledger supporting the state’s Annual Comprehensive Financial Report, which is not presented on the financial schedules. This resulted in an understatement of fund equity and amortization expenses (Other Expenses).
- ◆ The office did not place one intangible asset into service when it was substantially complete. The office placed it into service several months after all planned modules were substantially complete instead of capitalizing each module separately as required by state accounting policy. This resulted in an understatement of amortization expense (Other Expenses) and an overstatement of fund equity.

- ◆ The office incorrectly capitalized certain expenses. This resulted in an understatement of system maintenance expenses (Other Services Expense) and an overstatement of fund equity.
- ◆ When one capital intangible asset was retired, the loss expense was recorded incorrectly, resulting in the asset having a negative book value. This resulted in an understatement of fund equity and an overstatement of loss expense (Other Expenses).

We consider the resulting misstatements on the fiscal year 2021 and 2022 financial schedules to be material and pervasive. See the tables below for a summary of the resulting errors on the financial schedules.

Schedule of Revenues and Transfers-In

	Fiscal Year 2021		Fiscal Year 2022	
	Reported	Error	Reported	Error
	Enterprise Fund		Enterprise Fund	
Transfers-In	\$0	\$(148,463)	\$0	\$(746,100)
Nonbudgeted Revenues & Transfers-In	\$8,632	\$(148,463)	(\$14,252)	\$(746,100)

Schedule of Expenditures and Transfers-Out

	Fiscal Year 2021		Fiscal Year 2022	
	Reported	Error	Reported	Error
	Business & Government Services Program		Business & Government Services Program	
Other Services Expense	\$2,174,152	\$(121,061)	\$2,952,835	\$(260,442)
Other Expenses	\$772,384	\$(1,684,424)	\$2,016,004	\$(2,292,388)
Intangible Assets Expense	\$148,463	\$148,463	\$746,100	\$746,100
Transfers-Out	\$0	\$(148,463)	\$0	\$(746,100)
Non-Budgeted Expenditures & Transfers-Out	\$(903,234)	\$(1,657,023)	\$455,278	\$(1,806,729)
Actual Budgeted Expenditures & Transfers-Out	\$7,979,929	\$(148,462)	\$8,979,922	\$(746,100)

Schedule of Changes in Fund Equity

	Fiscal Year 2021		Fiscal Year 2022	
	Reported	Error	Reported	Error
	Enterprise Fund		Enterprise Fund	
Beginning Fund Equity	\$4,605,295	\$(4,129,979)	\$7,595,218	\$(2,472,956)
Nonbudgeted Revenues & Transfers-In	\$9,288,724	\$(148,463)	\$(14,252)	\$(746,100)
Budgeted Expenditures & Transfers-Out	\$7,169,090	\$(148,462)	\$7,682,959	\$(746,100)
Non-Budgeted Expenditures	\$(903,234)	\$(1,657,023)	\$455,278	\$(1,806,729)
Ending Fund Equity	\$7,595,218	\$(2,472,957)	\$9,550,712	\$(666,227)

We conducted our audit in accordance with auditing standards generally accepted in the United States of America (GAAS) and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States. Our responsibilities under those standards are further described in the Auditor's Responsibilities for the Audit of the Financial Schedules section of our report. We are required to be independent of the office and to meet our other ethical responsibilities, in accordance with the relevant ethical requirements relating to our audits. We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinions.

Basis for Adverse Opinions on U.S. Generally Accepted Accounting Principles

As described in Note 1 of the financial schedules, the financial schedules are prepared by the Office of Secretary of State from the transactions posted to the state's primary accounting system without adjustment, in the regulatory format prescribed by the Legislative Audit Committee. This is a basis of accounting other than accounting principles generally accepted in the United States of America. The financial schedules are not intended to, and do not, report assets, deferred outflows of resources, liabilities, deferred inflows of resources, and cash flows.

The effects on the financial schedules of the variances between the regulatory basis of accounting described in Note 1 and accounting principles generally accepted in the United States of America, although not reasonably determinable, are presumed to be material and pervasive.

Responsibilities of Management for the Financial Schedules

Management is responsible for the preparation and fair presentation of these financial schedules in accordance with the regulatory format prescribed by the Legislative Audit Committee, based on the transactions posted to the state's accounting system without adjustment; this responsibility includes recording transactions in accordance with state accounting policy; and designing, implementing, and maintaining internal controls relevant to the preparation and fair presentation of the financial schedules that are free from material misstatement, whether due to fraud or error.

In preparing the financial statements, management is required to evaluate whether there are conditions or events, considered in the aggregate, that raise substantial doubt about the office's ability to continue as a going concern for twelve months beyond the financial statement date, including any currently known information that may raise substantial doubt shortly thereafter.

Auditor's Responsibility for the Audit of the Financial Schedules

Our objectives are to obtain reasonable assurance about whether the financial schedules as a whole are free from material misstatement, whether due to fraud or error, and to issue an auditor's report that includes our opinion. Reasonable assurance is a high level of assurance but is not absolute assurance and therefore is not a guarantee that an audit conducted in accordance with GAAS and *Government Auditing Standards* will always detect a material misstatement when it exists. The risk of not detecting a material misstatement resulting from fraud is higher than for one resulting from error, as fraud may involve collusion, forgery, intentional omissions, misrepresentations, or the override of internal control. Misstatements are considered material if there is a substantial likelihood that, individually or in the aggregate, they would influence the judgment made by a reasonable user based on the financial schedules.

In performing an audit in accordance with GAAS and *Government Auditing Standards*, we:

- ◆ Exercise professional judgment and maintain professional skepticism throughout the audit.
- ◆ Identify and assess the risks of material misstatement of the financial schedules, whether due to fraud or error, and design and perform audit procedures responsive to those risks. Such procedures include examining, on a test basis, evidence regarding the amounts and disclosures in the financial schedules.
- ◆ Obtain an understanding of internal control relevant to the audit in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an

opinion on the effectiveness of the office's internal control. Accordingly, no such opinion is expressed.

- ◆ Evaluate the appropriateness of accounting policies used and the reasonableness of significant accounting estimates made by management, as well as evaluate the overall presentation of the financial statements.
- ◆ Conclude whether, in our judgment, there are conditions or events, considered in the aggregate, that raise substantial doubt about the office's ability to continue as a going concern for a reasonable period of time.

We are required to communicate with those charged with governance regarding, among other matters, the planned scope and timing of the audit, significant audit findings, and certain internal control-related matters that we identified during the audit.

REPORT ON OTHER LEGAL AND REGULATORY REQUIREMENTS

Other Reporting Required by Government Auditing Standards

In accordance with *Government Auditing Standards*, we have also issued our report dated July 13, 2023, on our consideration of the office's internal control over financial reporting and on our tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements and other matters. The purpose of that report is solely to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing, and not to provide an opinion on internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* in considering the office's internal control over financial reporting and compliance.

Respectfully submitted,

/s/ Cindy Jorgenson

Cindy Jorgenson, CPA
Deputy Legislative Auditor
Helena, MT

July 13, 2023

SECRETARY OF STATE'S OFFICE
SCHEDULE OF CHANGES IN FUND EQUITY
FOR THE FISCAL YEAR ENDED JUNE 30, 2022

	General Fund	Federal Special Revenue Fund	Enterprise Fund
FUND EQUITY: July 1, 2021	\$ <u>0</u>	\$ <u>129,396</u>	\$ <u>7,595,218</u>
ADDITIONS			
Budgeted Revenues & Transfers-In		1,206,919	10,112,479
Nonbudgeted Revenues & Transfers-In		(4,196)	(14,252)
Prior Year Revenues & Transfers-In Adjustments		(301)	5,852
Direct Entries to Fund Equity	<u>100,000</u>	<u>3,384</u>	<u>4,542</u>
Total Additions	<u>100,000</u>	<u>1,205,806</u>	<u>10,108,622</u>
REDUCTIONS			
Budgeted Expenditures & Transfers-Out	100,000	1,196,963	7,682,959
Nonbudgeted Expenditures & Transfers-Out			455,278
Prior Year Expenditures & Transfers-Out Adjustments			<u>14,891</u>
Total Reductions	<u>100,000</u>	<u>1,196,963</u>	<u>8,153,128</u>
FUND EQUITY: June 30, 2022	\$ <u>0</u>	\$ <u>138,239</u>	\$ <u>9,550,712</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-11.

SECRETARY OF STATE'S OFFICE
SCHEDULE OF CHANGES IN FUND EQUITY
FOR THE FISCAL YEAR ENDED JUNE 30, 2021

	Federal Special Revenue Fund	Enterprise Fund
FUND EQUITY: July 1, 2020	\$ <u>(103,245)</u>	\$ <u>4,605,295</u>
ADDITIONS		
Budgeted Revenues & Transfers-In	1,056,197	9,288,724
Nonbudgeted Revenues & Transfers-In	(9,506)	8,632
Prior Year Revenues & Transfers-In Adjustments	(3,212)	(34,926)
Direct Entries to Fund Equity		<u>(640)</u>
Total Additions	<u>1,043,480</u>	<u>9,261,790</u>
REDUCTIONS		
Budgeted Expenditures & Transfers-Out	810,839	7,169,090
Nonbudgeted Expenditures & Transfers-Out		(903,234)
Prior Year Expenditures & Transfers-Out Adjustments		<u>6,011</u>
Total Reductions	<u>810,839</u>	<u>6,271,867</u>
FUND EQUITY: June 30, 2021	\$ <u><u>129,396</u></u>	\$ <u><u>7,595,218</u></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-11.

SECRETARY OF STATE'S OFFICE
SCHEDULE OF TOTAL REVENUES & TRANSFERS-IN
FOR THE FISCAL YEAR ENDED JUNE 30, 2022

	Federal Special Revenue Fund	Enterprise Fund	Total
TOTAL REVENUES & TRANSFERS-IN BY CLASS			
Charges for Services		\$ 9,975,415	\$ 9,975,415
Investment Earnings	\$ 5,459	13,205	18,664
Sale of Documents, Merchandise and Property		73,672	73,672
Federal Indirect Cost Recoveries		39,258	39,258
Miscellaneous		2,529	2,529
Federal	1,196,963		1,196,963
Total Revenues & Transfers-In	1,202,422	10,104,079	11,306,501
Less: Nonbudgeted Revenues & Transfers-In	(4,196)	(14,252)	(18,448)
Prior Year Revenues & Transfers-In Adjustments	(301)	5,852	5,551
Actual Budgeted Revenues & Transfers-In	\$ 1,206,919	\$ 10,112,479	\$ 11,319,398

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-11.

SECRETARY OF STATE'S OFFICE
SCHEDULE OF TOTAL REVENUES & TRANSFERS-IN
FOR THE FISCAL YEAR ENDED JUNE 30, 2021

	<u>Federal Special Revenue Fund</u>	<u>Enterprise Fund</u>	<u>Total</u>
TOTAL REVENUES & TRANSFERS-IN BY CLASS			
Charges for Services		\$ 9,104,731	\$ 9,104,731
Investment Earnings	\$ 2,127	8,721	10,848
Sale of Documents, Merchandise and Property		92,956	92,956
Federal Indirect Cost Recoveries		64,957	64,957
Miscellaneous		(8,935)	(8,935)
Federal	1,041,353		1,041,353
Total Revenues & Transfers-In	<u>1,043,480</u>	<u>9,262,430</u>	<u>10,305,910</u>
Less: Nonbudgeted Revenues & Transfers-In	(9,506)	8,632	(874)
Prior Year Revenues & Transfers-In Adjustments	(3,212)	(34,926)	(38,138)
Actual Budgeted Revenues & Transfers-In	<u>\$ 1,056,197</u>	<u>\$ 9,288,724</u>	<u>\$ 10,344,922</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-11.

SECRETARY OF STATE'S OFFICE
SCHEDULE OF TOTAL EXPENDITURES & TRANSFERS-OUT
FOR THE FISCAL YEAR ENDED JUNE 30, 2022

	Business & Government Services	Total
PROGRAM (ORG) EXPENDITURES & TRANSFERS-OUT		
Personal Services		
Salaries	\$ 2,189,098	\$ 2,189,098
Employee Benefits	535,476	535,476
Personal Services-Other	53,475	53,475
Total	2,778,049	2,778,049
Operating Expenses		
Other Services	2,952,835	2,952,835
Supplies & Materials	181,729	181,729
Communications	120,253	120,253
Travel	58,987	58,987
Rent	87,633	87,633
Utilities	184	184
Repair & Maintenance	409,674	409,674
Other Expenses	2,016,004	2,016,004
Total	5,827,298	5,827,298
Equipment & Intangible Assets		
Intangible Assets	746,100	746,100
Total	746,100	746,100
Grants		
From Federal Sources	399,292	399,292
Total	399,292	399,292
Debt Service		
Total		
Post Employment Benefits		
Other Post Employment Benefits	42,695	42,695
Employer Pension Expense	(343,343)	(343,343)
Total	(300,648)	(300,648)
Total Expenditures & Transfers-Out	\$ 9,450,091	\$ 9,450,091
EXPENDITURES & TRANSFERS-OUT BY FUND		
General Fund	\$ 100,000	\$ 100,000
Federal Special Revenue Fund	1,196,963	1,196,963
Enterprise Fund	8,153,128	8,153,128
Total Expenditures & Transfers-Out	9,450,091	9,450,091
Less: Nonbudgeted Expenditures & Transfers-Out	455,278	455,278
Prior Year Expenditures & Transfers-Out Adjustments	14,891	14,891
Actual Budgeted Expenditures & Transfers-Out	8,979,922	8,979,922
Budget Authority	12,798,674	12,798,674
Unspent Budget Authority	\$ 3,818,753	\$ 3,818,753
UNSPENT BUDGET AUTHORITY BY FUND		
Federal Special Revenue Fund	\$ 3,324,945	\$ 3,324,945
Enterprise Fund	493,807	493,807
Unspent Budget Authority	\$ 3,818,753	\$ 3,818,753

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-11.

SECRETARY OF STATE'S OFFICE
SCHEDULE OF TOTAL EXPENDITURES & TRANSFERS-OUT
FOR THE FISCAL YEAR ENDED JUNE 30, 2021

	Business & Government Services	Total
PROGRAM (ORG) EXPENDITURES & TRANSFERS-OUT		
Personal Services		
Salaries	\$ 2,249,461	\$ 2,249,461
Employee Benefits	627,169	627,169
Personal Services-Other	46,280	46,280
Total	2,922,910	2,922,910
Operating Expenses		
Other Services	2,174,152	2,174,152
Supplies & Materials	130,527	130,527
Communications	112,603	112,603
Travel	337	337
Rent	83,155	83,155
Utilities	271	271
Repair & Maintenance	306,445	306,445
Other Expenses	772,384	772,384
Total	3,579,875	3,579,875
Equipment & Intangible Assets		
Intangible Assets	148,463	148,463
Total	148,463	148,463
Grants		
From Federal Sources	501,358	501,358
Total	501,358	501,358
Debt Service		
Capital Leases	432	432
Total	432	432
Post Employment Benefits		
Other Post Employment Benefits	24,735	24,735
Employer Pension Expense	(95,067)	(95,067)
Total	(70,331)	(70,331)
Total Expenditures & Transfers-Out	\$ 7,082,706	\$ 7,082,706
EXPENDITURES & TRANSFERS-OUT BY FUND		
Federal Special Revenue Fund	\$ 810,839	\$ 810,839
Enterprise Fund	6,271,867	6,271,867
Total Expenditures & Transfers-Out	7,082,706	7,082,706
Less: Nonbudgeted Expenditures & Transfers-Out	(903,234)	(903,234)
Prior Year Expenditures & Transfers-Out Adjustments	6,011	6,011
Actual Budgeted Expenditures & Transfers-Out	7,979,929	7,979,929
Budget Authority	14,495,841	14,495,841
Unspent Budget Authority	\$ 6,515,912	\$ 6,515,912
UNSPENT BUDGET AUTHORITY BY FUND		
Federal Special Revenue Fund	\$ 6,316,713	\$ 6,316,713
Enterprise Fund	199,200	199,200
Unspent Budget Authority	\$ 6,515,912	\$ 6,515,912

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-11.

Office of the Secretary of State
Notes to the Financial Schedules
For the Two Fiscal Years Ended June 30, 2022

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 (General Fund and Federal Special Revenue). 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 the full accrual basis of 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.
- ◆ expenses in the period incurred when measurable.

Expenditures 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 was adopted by 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

- ◆ **General Fund** – The 2021 Legislature provided the Secretary of State with \$100,000 in general fund as a restricted, biennial, one-time-only appropriation for consulting and professional services associated with litigation related to elections.
- ◆ **Federal Special Revenue Fund** – to account for activities funded by federal revenue received from the U.S. Election Assistance Commission.

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. The Office of the Secretary of State provides elections administration, registration and document filing of Montana businesses and publication of administrative rules, ensures the proper management and safeguarding of public records, notary, and certification services, and provides operational support for the office.

2. Direct Entries to Fund Equity

- ◆ **Fiscal Year 2021**
 - ◇ Enterprise Fund
 - » Direct entries to fund equity were made in accordance with the Montana Operations Manual Policy 311, Section VIII for corrections to transactions that occurred in a previous period that occurred at least two fiscal years prior to the current fiscal year. The direct entries to fund equity resulted in a net decrease of (\$640).
- ◆ **Fiscal Year 2022**
 - ◇ General Fund
 - » A direct entry to fund equity of \$100,000 was made. This entry was generated by SABHRS to reflect the flow of resources within an individual fund shared by separate agencies.
 - ◇ Federal Special Revenue Fund
 - » A direct entry to fund equity of \$3,384 was made as part of the Fund 03715 close-out process. All remaining funds had been spent in Fiscal Year 2021.
 - ◇ Enterprise Fund
 - » A net decrease of \$480 in direct entries were made to fund equity in accordance with the Montana Operations Manual Policy 311, Section VIII for corrections to transactions that occurred in a previous period that occurred at least two fiscal years prior to the current fiscal year.
 - » Direct entries to fund equity of \$5,022 were made resulting from the buy-out of leased copiers.

3. Unspent Budget Authority

The Schedule of Total Expenditures presents unspent budget authority for the Federal Special Revenue and Enterprise Funds.

Federal Special Revenue Fund

- ◆ The schedule presents unspent budget authority in the amount of \$6.3 million in FY2021 and \$3.3 million for FY2022 which is comprised of recent grant awards that were only partially spent during each of the fiscal years.
 - ◇ In Fiscal Year 2018, the U.S. Election Assistance Commission awarded the Montana Office of the Secretary of State \$3.0 million for the purpose of improving security and administration of elections for Federal office. At the end of Fiscal Year 2021, \$1.7 million of the award remained unspent. At the end of Fiscal Year 2022, \$871,979 of the award remained unspent.
 - ◇ In Fiscal Year 2020, the U.S. Election Assistance Commission awarded the Montana Office of the Secretary of State an additional \$3.1 million for the purpose of improving security and administration of elections for Federal office. At the end of Fiscal Year 2021, \$1.9 million of the award remained unspent. At the end of Fiscal Year 2022, \$1.5 million of the award remained unspent.
 - ◇ In Fiscal Year 2021, \$2.7 million in unexpended CARES funds were returned to the U.S. Election Assistance Commission.
 - ◇ In Fiscal Year 2022, the U.S. Election Assistance Commission awarded the Montana Office of the Secretary of State an additional \$1 million for the purpose of improving security and administration of elections for Federal office. At the end of Fiscal Year 2022, the \$1 million award remained unspent.

Enterprise Fund

- ◆ The schedule presents unspent budget authority in the amount of \$199,200 for Fiscal Year 2021 and \$493,807 for Fiscal Year 2022. The unspent authority is the result of operational efficiencies and personal services savings. Through modernizing and streamlining our systems and processes along with finding and implementing efficiencies and innovative solutions, the Office of the Secretary of State has been able to realize a savings in both operating expenses and personal services.

4. Expenditures

Historically, the Secretary of State has incurred litigation costs. The 2021 Legislature appropriated a \$100,000 biennial, restricted, one-time-only general fund appropriation for potential litigation related to elections. Due to an unprecedented number of lawsuits filed, the Secretary of State had expended the entire appropriation for consulting and professional services associated with litigation related to elections in February 2022. As a result, the Secretary of State's Office paid subsequent litigation expenditures in FY 2022 using proprietary funds.

5. Subsequent Events

On April 29, 2022, the Secretary of State published Montana Administrative Register (MAR) Notice No. 44-2-257 proposing to amend rules to reduce new business filing fees by 50.0%. The adoption notice was published on June 10, 2022, and effective July 1, 2022. The Secretary of State's Office estimates that approximately 35,000 small businesses will have their fees reduced and estimates it will save the small businesses over \$1.1 million.

In addition, on July 22, 2022, the Secretary of State proposed MAR Notice No. 44-2-260 to reduce several additional business filing fees. These rule changes were adopted on September 9, 2022, and effective on September 10, 2022, and are estimated to save 5,000 businesses over \$124,000 annually.

In Fiscal Year 2023, the U.S. Election Assistance Commission awarded the Montana Office of the Secretary of State an additional \$1 million for the purpose of improving security and administration of elections for Federal office.

Report on Internal Control and Compliance

LEGISLATIVE AUDIT DIVISION

B-1

Angus Maciver, Legislative Auditor
Deborah F. Butler, Legal Counsel



Deputy Legislative Auditors:
Cindy Jorgenson
William Soller

REPORT ON INTERNAL CONTROL OVER FINANCIAL REPORTING AND ON COMPLIANCE AND OTHER MATTERS BASED ON AN AUDIT OF FINANCIAL SCHEDULES PERFORMED IN ACCORDANCE WITH GOVERNMENT AUDITING STANDARDS

The Legislative Audit Committee
of the Montana State Legislature:

We have audited, in accordance with the auditing standards generally accepted in the United States of America and the standards applicable to the financial audits contained in *Government Auditing Standards* issued by the Comptroller General of the United States, the Schedules of Changes in Fund Equity, Schedules of Total Revenues & Transfers-In, and Schedules of Total Expenditures & Transfers-Out of the Office of Secretary of State for each of the fiscal years ended June 30, 2022, and 2021, and the related notes to the financial schedules, and have issued our report thereon dated July 13, 2023. Our report includes adverse opinions on the financial schedules for both fiscal years 2022 and 2021.

Internal Control Over Financial Reporting

In planning and performing our audit of the financial schedules, we considered the office's internal control over financial reporting as a basis for designing audit procedures that are appropriate in the circumstances for the purpose of expressing our opinions on the financial schedules, but not for the purpose of expressing an opinion on the effectiveness of the office's internal control. Accordingly, we do not express an opinion on the effectiveness of the office's internal control.

Our consideration of internal control was for the limited purpose described in the preceding paragraph and was not designed to identify all deficiencies in internal control that might be material weaknesses or significant deficiencies and therefore, material weaknesses or significant deficiencies may exist that were not identified. However, as described below, we identified certain deficiencies in internal control that we consider to be material weaknesses and significant deficiencies.

A *deficiency in internal control* exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent, or detect and correct, misstatements on a timely basis. A *material weakness* is a deficiency, or a combination of deficiencies, in internal control such that there is a reasonable possibility that a material misstatement of the entity's financial schedules will not be prevented, or detected and corrected, on a timely basis. We consider the deficiency described below to be a material weakness.

- ◆ As described in Recommendation #2, the office's controls were not sufficient to ensure that capital intangible assets were recorded according to state accounting policy.

A *significant deficiency* is a deficiency, or a combination of deficiencies, in internal control that is less severe than a material weakness, yet important enough to merit the attention by those charged with governance. We consider the deficiency described below to be a significant deficiency.

- ◆ As described in Recommendation #3, the office's internal controls were not sufficient to obtain independent audit reports from a key service provider as required by the office's contract with the service provider.

Compliance and Other Matters

As part of obtaining reasonable assurance about whether the office's financial schedules are free from material misstatement, we performed tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements, noncompliance with which could have a direct and material effect on the financial schedules. However, providing an opinion on compliance with those provisions was not an objective of our audit, and accordingly, we do not express such an opinion. The results of our tests disclosed no instances of noncompliance or other matters that are required to be reported under *Government Auditing Standards*.

Office of the Secretary of State's Response to Findings

Government Auditing Standards requires the auditor to perform limited procedures on the office's response to the findings identified in our audit as described on page C-1 of this report. The office's response was not subjected to the auditing procedures applied in the audit of the financial schedules and, accordingly, we express no opinion on it.

Purpose of this Report

The purpose of this report is solely to describe the scope of our testing of internal control and compliance and the results of that testing, and not to provide an opinion on the effectiveness of the office's internal control or on compliance. This report is an integral part of an audit performed in accordance with *Government Auditing Standards* in considering the office's internal control and compliance. Accordingly, this communication is not suitable for any other purpose.

Respectfully submitted,

/s/ *Cindy Jorgenson*

Cindy Jorgenson, CPA
Deputy Legislative Auditor
Helena, MT

July 13, 2023

OFFICE OF THE
SECRETARY OF STATE

OFFICE RESPONSE



CHRISTI JACOBSEN
MONTANA SECRETARY OF STATE

RECEIVED
OCT 31 2023
LEGISLATIVE AUDIT DIV.

October 31, 2023

Mr. Angus Maciver, Legislative Auditor
Legislative Audit Division
PO Box 201705
Helena, MT 59620-1705

Dear Mr. Maciver,

Re: Response to Financial-Compliance Audit 21-22

Thank you for the opportunity to respond to the Financial-Compliance audit report for the Secretary of State's Office for the two fiscal years ending June 30, 2022. The four recommendations included in the audit report were reviewed with responses provided below.

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.

SOS Response: Concur

The Secretary of State's Office maintains an extensive Internal Control Evaluation and Monitoring Plan. The Plan is currently under review, and it will be enhanced to address the items identified in the audit. SOS will complete this review, implement the revisions, and train appropriate staff by February 1, 2024.

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.

SOS Response: Concur

The Secretary of State's Office maintains an extensive Internal Control Evaluation and Monitoring Plan. The Plan is currently under review, and it will be enhanced to address the items identified in the audit. SOS will complete this review, implement the revisions, and train appropriate staff by February 1, 2024.

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.

SOS Response: Concur

While the Secretary of State's Office did not receive an independent audit report from the vendor during the audit period, SOS did receive other security assurances. Additionally, during Fiscal Year 2023, SOS enhanced internal controls and processes to ensure the annual request and review of vendors' independent audit reports.

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.

SOS Response: Concur

The Secretary of State has proven commitment to serving the state with fiscal responsibility. Over the last two years, the Secretary of State has eliminated fees, waived fees, and implemented several fee reductions. With these changes, Montana has the lowest overall new business registration fees in the country. As the Legislative Auditor noted, "This demonstrates the efficiency with which the office operates compared to their peer organizations in other states."

The Office of the Secretary of State continually monitors the projected revenue and expenses and is currently analyzing fiscal forecasts to ensure adequate working capital is available to fund several system enhancement projects anticipated over the next several years. Upon completion of the analysis, the Secretary of State is committed and looking forward to proposing additional fee reductions to ensure fees are commensurate with costs and that Montana businesses benefit from the efficiency with which the Office operates.

Thank you to you and your staff for the professional work and interactions with our staff during this fiscal audit process and the willingness of the auditors to discuss recommendations and responses to our questions. The Secretary of State's Office regards the audit process as an opportunity to improve the agency's operations and performance.

Regards,

A handwritten signature in black ink that reads "Christi Jacobsen". The signature is written in a cursive style with a large, looping initial "C".

Christi Jacobsen
Secretary of State