

STATE OF CONNECTICUT



**AUDITORS' REPORT
SECRETARY OF THE STATE
FOR THE FISCAL YEARS ENDED JUNE 30, 2010, 2011 AND 2012**

AUDITORS OF PUBLIC ACCOUNTS
JOHN C. GERAGOSIAN ❖ ROBERT M. WARD

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AUDITORS OF PUBLIC ACCOUNTS

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December 4, 2013

AUDITORS' REPORT SECRETARY OF THE STATE FOR THE FISCAL YEARS ENDED JUNE 30, 2010, 2011 AND 2012

We have made an examination of the financial records of the Office of the Secretary of the State for the fiscal years ended June 30, 2010, 2011 and 2012. This report on that examination consists of the Comments, Condition of Records, Recommendations and Certification which follow.

Financial statements pertaining to the operations and activities of the Office of the Secretary of the State are presented on a Statewide Single Audit basis to include all state agencies. This audit examination has been limited to assessing the office's compliance with certain provisions of financial related laws, regulations, contracts and grants, and evaluating the Office of the Secretary of the State's internal control policies and procedures established to ensure such compliance.

FOREWORD:

The Secretary of the State is an elected constitutional officer. The duties and responsibilities of the office are set forth by Article Fourth, Section 23, of the Constitution of Connecticut and by various sections, most notably Title 3, Chapter 33, of the General Statutes. The primary functions of the Secretary of the State are:

- Custodian of the state seal, public records and documents, particularly of the acts, resolutions and orders of the General Assembly. Other public documents recorded and filed include state agency regulations, schedules of state boards and commission meetings, town ordinances and acts and the surety bonds of state officers and employees.

- Commissioner of Elections of the state, which includes being the repository of political party rules and campaign finance statements and compiling voter registration statistics.
- Recording various corporate certifications and reports as well as the collection of the appropriate fees.
- Recording commercial transactions and collecting applicable fees in accordance with the Uniform Commercial Code (UCC).
- Appointments of notaries public.
- Publishing the State Register and Manual and other publications.

In addition, Public Act 11-48 amended Section 20-280 subsection (e) of the General Statutes placed the State Board of Accountancy within the Office of Secretary of the State. The board is responsible for licensing and regulating the public accounting profession in this state. Members of the board are appointed by the Governor, and their appointments are coterminous with the Governor's term of office. As of June 30, 2012, the members of the board were:

Thomas F. Reynolds, CPA Chairman
Lee Schlesinger
James S Ciarcia
Philip J. DeCaprio, Jr., CPA
Richard H. Gesseck, CPA
Leonard M. Romaniello, Jr., CPA
Richard L. Sturdevant
Martha S. Triplett, Esq.
Michael Weinshel, CPA

The Office of the Secretary of the State has organized itself into five divisions in order to address its duties and responsibilities: State Board of Accountancy, Commercial Recording, Legislation and Election Administration, Information Technology, and Management and Support Services.

Susan Bysiewicz was elected Secretary of the State in November 1998 and served until January 5, 2011. Denise W. Merrill was elected Secretary of the State in November 2010. She began serving as Secretary of the State on January 5, 2011 and continues to serve. Lesley D. Mara served as Deputy Secretary of the State until January 5, 2011, when James F. Spallone began serving as Deputy Secretary of the State and continues in that capacity.

RÉSUMÉ OF OPERATIONS:**General Fund:**

A comparison of General Fund receipts for the fiscal years under review and the preceding year follows:

| | <u>2008-2009</u> | <u>2009-2010</u> | <u>2010-2011</u> | <u>2011-2012</u> |
|-------------------------------------|---------------------------|----------------------------|----------------------------|----------------------------|
| Commercial Recording Fees | \$5,972,511 | \$20,080,227 | \$26,905,768 | \$25,922,044 |
| State Board of Accountancy | | | | 2,622,875 |
| Penalties - Corporations | 1,224,514 | 1,143,877 | 1,338,036 | 1,297,047 |
| Other Fees - Certificates/Copies | 477,446 | 715,849 | 822,477 | 833,719 |
| Franchise Taxes | 210,194 | 288,771 | 325,648 | 6,543 |
| Notary Public Registrations | 635,247 | 701,390 | 745,381 | 769,651 |
| Sales of Documents and Publications | 236,594 | 123,373 | 161,473 | 96,509 |
| All Other Receipts | <u>242,736</u> | <u>337,910</u> | <u>136,225</u> | <u>32,709</u> |
| Total General Fund Receipts | <u>\$8,999,242</u> | <u>\$23,391,397</u> | <u>\$30,435,008</u> | <u>\$31,581,097</u> |

Receipts consisted primarily of business filing fees and penalties collected by the Division of Commercial Recording and licensing fees by the State Board of Accountancy. Subsequent to fiscal year 2009, the most significant increases in the commercial recording revenues were attributed to the implementation of Public Act 09-3 of the June 2009 Special Session. The public act amended Section 3-99(c) of the General Statutes by requiring all receipts to be deposited in the General Fund and eliminating the commercial recording restricted account effective September 9, 2009. The public act also authorized other fee increases, effective October 1, 2009, which resulted in higher revenues in the remaining accounts. While revenues from franchise taxes fluctuated based on the number of shares issued or amended by domestic corporations, reduction in the printing of legislative publications directly resulted in decreases in publication sales.

A comparison of General Fund expenditures for the fiscal years under review and the preceding year follows:

| | <u>2008-2009</u> | <u>2009-2010</u> | <u>2010-2011</u> | <u>2011-2012</u> |
|--|---------------------------|---------------------------|---------------------------|---------------------------|
| Personal Services & Employee Benefits | \$1,494,942 | \$5,433,722 | \$5,427,459 | \$5,879,770 |
| Purchases and Contracted Services | <u>1,114,113</u> | <u>2,106,743</u> | <u>1,496,170</u> | <u>1,479,037</u> |
| Total General Fund Expenditures | <u>\$2,609,055</u> | <u>\$7,540,465</u> | <u>\$6,923,629</u> | <u>\$7,358,807</u> |

As of June 30, 2012, there were 81 full-time employees who were paid through the General Fund. Increases in the personal services costs subsequent to fiscal year 2009 were mainly a result of transferring the administrative expenses of the Commercial Recording Division from the Commercial Recording Account of the Special Revenue Fund to the General Fund as required by Public Act 09-3 of the June 2009 Special Session. An eight percent increase in the personal services costs in fiscal year 2012, as compared to fiscal year 2011, was attributed to Public Act 11-48, which placed the State Board of Accountancy within the Office of the Secretary of the State effective July 1, 2011.

The most significant categories of expenditures for Purchases and Contracted Services were for information technology services and the printing of materials related to elections. Federal funds for reimbursement to towns for election costs from the Help America Vote Act (HAVA) are only available during a federal election year. Such funds are accounted for in a special revenue fund described below.

Special Revenue Fund - Federal and Restricted Accounts:

A comparison of special revenue fund revenues and expenditures for the fiscal years under review and the preceding year follows:

| | <u>2008-2009</u> | <u>2009-2010</u> | <u>2010-2011</u> | <u>2011-2012</u> |
|------------------------------|----------------------------|---------------------------|---------------------------|---------------------------|
| Revenue: | | | | |
| Commercial Recording Account | \$ 9,768,491 | \$3,310,073 | \$ 0 | \$ 0 |
| Interest Income | 126,327 | 14,750 | 4,812 | 3,187 |
| HAVA Grant | <u>1,362,107</u> | <u>0</u> | <u>1,184,441</u> | <u>921,229</u> |
| Total Revenue | <u>\$11,256,925</u> | <u>\$3,324,823</u> | <u>\$1,189,253</u> | <u>\$ 924,416</u> |
| Expenditures: | | | | |
| Personal Services & Employee | | | | |
| Benefits | \$ 7,012,552 | \$ 103,517 | \$ 82,937 | \$ 2,490 |
| Purchases and Contracted | | | | |
| Services | <u>9,585,244</u> | <u>2,886,248</u> | <u>1,450,144</u> | <u>1,984,824</u> |
| Total Expenditures | <u>\$16,597,796</u> | <u>\$2,989,765</u> | <u>\$1,533,081</u> | <u>\$1,987,314</u> |

Effective September 9, 2009, revenues in the Commercial Recording Account were deposited in the General Fund, as required by Public Act 09-3 of the June 2009 Special Session. The office did not receive any HAVA grant allotments in fiscal year 2010, while allotments in fiscal years 2011 and 2012 were for specific federal projects.

The decreases in expenditures primarily corresponded to the reduction of HAVA grants and the subsequent transfers of expenditures to the General Fund during the audited period. The last employee who worked on the HAVA project retired in December 2010. In addition, expenditures for data services that were previously paid by HAVA grants were absorbed by the General Fund and allocated to the Bureau of Enterprise Systems and Technology.

In addition to the above special revenue fund expenditures, capital equipment purchases totaling \$77,065 were paid from the Capital Equipment Purchase Fund during the audited period.

Connecticut Citizenship Fund:

The Connecticut Citizenship Fund was established as a foundation, pursuant to Section 4-37e of the General Statutes. This organization was created to increase citizen interest and participation in government, particularly state and local government; to increase and improve citizen participation in elections; to stimulate more education of and involvement of Connecticut's school-aged children concerning government; and to engage in any lawful act or activity for which corporations may be formed under said act.

Sections 4-37f through 4-37j of the General Statutes establish certain requirements for foundations affiliated with state agencies. Section 4-37f of the General Statutes sets forth the requirement that any foundation must have a full audit of its books and accounts either annually or every third year, depending on the amount of revenue received each year. The fund's level of revenue required an audit every three years. The last audit was performed for the 2010-2011 fiscal year.

CONDITION OF RECORDS

Our examination of the records of the Office of the Secretary of the State disclosed certain matters of concern requiring agency attention.

Payroll/Personnel Matters:

Criteria:

1. Proper internal control requires procedures to ensure that employees receive accurate leave (vacation, sick, personal) benefits and manual changes to employee personnel records in Core-CT are periodically reviewed for proper authorization.
2. According to the agency's employee handbook, patterns of sick leave used in conjunction with scheduled days off may be an indication of sick leave abuse. Unscheduled absences of nine or more occasions per year would warrant an attendance record review. Additionally, the use of Leave-In-Lieu of Accrual (LILA) time reporting code should be consistent with the Core-CT guide. This temporary time reporting code should be changed to the appropriate leave time when it is posted and available.
3. According to Section 4-87 of the General Statutes, when any specific appropriation becomes insufficient to pay its expenditures, the budgeted agency must obtain the Governor's approval to transfer funds from any other specific appropriation of such budgeted agency. No transfer to and from any specific appropriation of a sum or sums of the lesser of \$50,000 or ten percent of the appropriation shall be made without the consent of the Finance Advisory Committee.

Condition:

1. The leave balances of five new hires were not accurate. Employees received 50 sick leave hours and 19 personal leave hours, more than their leave plans authorized. Also, 38 vacation leave hours were owed to employees. The Core-CT Personnel Actions History Report, which includes manual changes to an employee's job data, was not reviewed during the audited period.
2. Two employees charged sick leave in combination with weekends and holidays in nine or more occasions per year during the audited period. There was no documentation showing that the absence pattern was discussed with the employees. Three employees' leave balances were not adjusted for a total of 24 LILA hours recorded in their attendance records.
3. Appropriations for the Commercial Recording Division were not

properly used. Salaries of employees in the Legislation and Election Administration Division, which were originally charged to Personal Services, were increasingly allocated to the Commercial Recording Division. Such coding of personal services expenditures totaled \$156,181, \$291,520 and \$566,717 for the fiscal years ended June 30, 2010, 2011 and 2012, respectively.

Effect:

The lack of monitoring of leave balances, sick leave usage patterns, LILA time reporting code, and Personnel Actions History Reports could lead to undetected overpayments and unauthorized changes to personnel records in Core-CT.

Transfers of appropriations were not in compliance with statutory requirements.

Cause:

An employee in the Human Resources Office could not run Core-CT personnel reports during the audited period. Staff was not familiar with procedures to assign leave plan benefits and monitor leave balances.

There was a misunderstanding that approval of position funding in Core-CT was sufficient when it came to shifting appropriations in one account to pay for salaries in another account within the General Fund.

Recommendation:

The Office of the Secretary of the State should improve its monitoring of employee leave balances and Core-CT Personnel Actions History Reports and obtain proper authorization to transfer funds between specific appropriations. (See Recommendation 1.)

Agency Response:

“In conjunction with the Office of Policy and Management, Management Support Services has properly assigned staff funding based on their job duties, which will be reflected in the 2014 fiscal year payroll cycle. The coding will be updated by Human Resources in Core-CT to reflect the 2014 fiscal year cycle and other future payroll cycles. This should address the auditor’s concern regarding transfers of appropriations.

The agency recently reorganized the Human Resources office as a separate unit in an effort to create better segregation of duties and accountability regarding payroll and benefits. Errors regarding LILA, leave balances and improper Core-CT data entries were corrected to the auditor’s satisfaction during the month of April 2013. Human Resources personnel have sought and received proper authorization and training to run necessary personnel reports in Core-CT.

Finally, in an effort to further segregate duties and create accountability, the agency has sought to hire a designated payroll officer. In 2011, a vacated clerk typist position was reclassified to a payroll position. Despite continued efforts to fill this newly-created position, it remained vacant due to a combination of economic/budget conditions and a lack of suitable applicants. The agency recently renewed its efforts to fill this position and has hired an experienced payroll clerk who will begin work on August 12, 2013. These measures should satisfy the above recommendation.”

Customer Account Balances:

Background:

The Office of the Secretary of the State utilizes the CONCORD system to process commercial recording transactions. Upon receipt of documents, a uniquely numbered work order is generated and the fee submitted with the work order is recorded and deposited. If it is later determined that the work order cannot be processed due to incomplete information or insufficient fee, the work order will be changed to rejected status and the associated payment is credited to the customer account.

Credit balances are eligible to be refunded or used to pay for subsequent filings upon the customer’s request. Frequent filers may also pay in advance and keep credit balances in order to cut down the need for multiple payments or to ensure that all their filings are fully paid for.

Criteria:

Sound business practice would dictate a regular review of customer accounts and reconciliation procedures to detect data entry errors. Accounts that have been inactive for a lengthy period or contain significant continuing balances should be reviewed to ensure their validity.

Customer account balances represent cash paid in advance by frequent filers or a credit balance provided to customers when a filing is rejected. According to generally accepted accounting principles, cash advances received from customers should be reported as deferred revenues, and credits provided to customers should be reported as liabilities at year-end.

Condition:

We reviewed 30 account balances and noted the following conditions:

As of April 23, 2013, the customer account balance report included 130,525 accounts totaling \$12,835,311. Twenty-five tested

accounts were not accurate, thus overstating the account balances by \$4,433,424, or 35 percent. The data entry errors occurred from November 2000 through December 2012.

The office did not report the customer account balances to the State Comptroller for GAAP reporting purposes during the audited period. Cash paid in advance was not reported as deferred revenue, and credits provided for rejected filings were not reported as a liability at year end.

Effect: The existence of invalid credit balances increases the risk of losses since these amounts could be refunded in error or be used to pay for future filings.

Cause: There was no daily reconciliation between payments received in CONCORD and revenues deposited in Core-CT to identify data entry errors in CONCORD. In addition, most of the account balances have accumulated since as early as 1995, as the office did not periodically escheat the abandoned account balance prior to the elimination of the non-lapsing Commercial Recording Account in July 2009.

It was also explained to us that the office's CONCORD system was originally designed to accommodate business filings without sufficient capacity to handle financial reporting requirements. The system could not separate credits and advance payments within a customer's account. Reconciliation of customer accounts was largely dependent upon the experience and availability of a few staff members in the Commercial Recording Division and Financial Unit.

Recommendation: The Office of the Secretary of the State needs to improve recordkeeping for its customer account balances. (See Recommendation 2.)

Agency Response: "The agency believes that ongoing account balances cited by the auditor are becoming obsolete as more transactions are completed online using credit cards. Overpayments are not permitted in that environment. Elimination of account balances as a policy change is being strongly considered, and the agency is seeking the counsel of the Attorney General to develop a plan of action within the constraints of current law.

The CONCORD application was developed when the Commercial Recording Division had a nonlapsing fund. Resources did not permit the development of advanced accounting tools in an

environment where money was held on account and rolled over year-to-year. The errors noted by the auditor represent an extreme accumulation of data entry typos committed since 1995 and have all been addressed. Most of our filings occur online now, where they are credit card transactions instead of cash transactions. Therefore, the proportion of error that occurred in the past will not occur going forward.

In 2009, the Commercial Recording Division nonlapsing fund was subsumed within the General Fund. Since then, resources have been requested, granted and expended to update CONCORD to include a cash receipts report that will both reconcile cash activity and prevent errant entries from carrying on the books. This module will be operational by the end of July 2013, and from that point forward reconciliation between the payments received in CONCORD and revenues deposited in Core-CT will occur on an ongoing basis. As noted, consideration is being given to eliminating the customer account system for frequent filers in favor of a pay-per-transaction system that will eliminate frequent filer carried balances year-to-year.

Finally, Management and Support Services will complete GAAP reports 4 and 5a so that the Comptroller has an accurate record of the deferred revenue and liabilities associated with customer account balances. These measures have already been planned or implemented and should satisfy this recommendation completely.”

Revenues and Receipts:

Background:

The Financial Unit uses an in-house system called Financial System or FinSys, to record all revenues and receipts. Receipts for public records, business filings and foreign corporation fees are first received by the Commercial Recording Division and entered into the CONCORD system. The receipts are then sent to the Financial Unit to be recorded in FinSys. All other receipts are initially received by the Financial Unit and recorded into FinSys. All receipts are subsequently entered into Core-CT.

Criteria:

1. Separation of duties - Sound internal control procedures dictate that certain duties should not be performed by the same employee.
2. Reconciliation of receipts - Receipts recorded by an agency's in-house accounting system should be regularly reconciled to the state's Core-CT accounting system.
3. Recording of receipts - According to the State Accounting

Manual, internal control over cash receipts shall be established to minimize the risk of loss. An important internal control would be to record the date of cash receipt, name of remitter, amount of receipt, type of receipt, and purpose of the remittance in a cash receipts journal. When receipts are delivered, the person receiving them should verify the amounts and acknowledge delivery of receipts.

4. Accountability reports - In accordance with the State Accounting Manual, accountability reports should be periodically prepared, where feasible. An accountability report compares the recorded receipts with revenues that should have been accounted for, such as the licenses issued or renewed by the State Board of Accountancy.

Conditions:

1. Separation of duties - We continue to note a lack of separation of duties within the Financial Unit. A Financial Unit employee has the ability to receive and record receipts, modify customer account balances and perform daily reconciliation of deposits without supervisory review.

2. Reconciliations of receipts - We note that reconciliations of revenue between the office's in-house system, FinSys, and Core-CT were not performed monthly. The daily reconciliations do not address certain revenue adjustments recorded in Core-CT. Our reconciliation of deposits in June 2012 showed that FinSys reports varied in their total monthly receipts for the same report parameters.

There was also a lack of reconciliation between payments recorded in CONCORD to the deposits recorded in FinSys and Core-CT.

3. Recording of receipts - The office did not have a cash receipts journal as recommended in the State Accounting Manual. The majority of the agency's receipts are generated by the Commercial Recording Division. However, there was no summary or report to show total daily cash receipts by the division that were subsequently forwarded to the Financial Unit for deposit. Thus, we are unable to determine whether all daily cash receipts were completely recorded and deposited.

During the review of the Schedule of Expenditures of Federal Awards for the fiscal year ended June 30, 2012, we found federal receipts totaling \$921,229 mistakenly recorded in a non-federal restricted account.

4. Accountability reports - The office did not prepare an accountability report for the licenses issued and renewed by the State Board of Accountancy in fiscal year 2012.

Effect: Current internal controls over revenues and other receipts do not provide management with reasonable assurance that all receipts are properly accounted for. The lack of segregation of duties, monthly reconciliations, accountability reports, and late deposits increases the risk of undetected losses.

Cause: The lack of segregation of duties and recording deficiencies can be attributed to a lack of available staffing.

We were told that, due to other priorities in improving CONCORD, the office could not implement a new check entry module to interface with FinSys, which was designed to improve receipt recordings and reconciliation.

The recording error of federal fund receipts and lack of accountability reports were an oversight.

Recommendation: The Office of the Secretary of the State should consider other internal control procedures to mitigate the lack of segregation of duties over receipts, completely reconcile its in-house revenues and receipts records to Core-CT, and prepare accountability reports for revenues of the State Board of Accountancy. (See Recommendation 3.)

Agency response: “As noted in the auditor’s comments, the agency lacks available staffing for proper segregation of duties in the Financial Unit. The ongoing fiscal climate indicates this condition may persist. In order to mitigate the lack of segregation of duties, additional cross training will occur. We have also implemented monthly FinSys to Core-CT reconciliation procedures. The Cash Receipts Report Module (active July 2013) mentioned in the agency’s response to the customer account balances section will provide a report to the Financial Unit that will allow for additional reconciliation between CONCORD and the other software.

The State Board of Accountancy is a newly acquired division of the agency that has also undergone a management change. During the merger, an additional transition to the statewide e-License software was underway. Additionally, the State Board of Accountancy and the Financial Unit have already implemented a method to provide a monthly accountability report for the fees collected by the division.

The agency believes the above implementations meet the requirements of this recommendation.”

Administration of Foreign Corporation Investigations and Receivables:

Background: Sections 33-920, 33-1210, 34-38g, 34-223, 34-429 and 34-531 of the General Statutes require foreign corporations, limited liability companies, limited partnerships, and limited liability partnerships to file a certificate of authority or registration with the Secretary of the State before transacting business in Connecticut. A foreign corporation is one that is organized under a law other than the law of Connecticut. Foreign corporations meeting the requirements for a certificate are required to submit an application fee as well as annual reports and the associated fees with the office.

Investigations of unauthorized foreign corporations often begin with a complaint from competing business entities or consumers, or when a foreign corporation submits an application for a certificate of authority indicating that they have transacted business in Connecticut in excess of 90 days, or from analyzing registration of surety bonds of the nonresident contractors.

Criteria: 1. According to the year-end instructions issued by the State Comptroller, receivables are defined as amounts owed to the state for claims against individuals, private organizations, or other governments which arose on or prior to June 30th. When total receivables exceed \$300,000, the agency should complete and submit GAAP Form No. 2 to the Comptroller’s Office.

2. A sound information system should allow management and employees to effectively monitor investigations in their various phases. A report of investigations with open demands status and their receivable ages will allow management to determine the current receivable amount and the appropriate collection step. A reasonable system should also assist in tracking the progress of investigations, including control measures preventing deletion of an open demand investigation without proper authorization.

3. Potential revenue generating events should be promptly reviewed.

Condition: 1. The office did not determine whether they had year-end receivables to be reported to the State Comptroller during the audited period. At the time of our review in May 2013, a report of open investigations showed demands totaling \$1,633,205, which met the definition of receivables for GAAP reporting purposes.

2. The information system used by the Foreign Investigations Unit could not provide management and employees useful tools to monitor investigations in their various phases. There was not a complete report of investigations with open demand status. Our review had to rely on the investigations unit staff to discover which entities were reviewed, not reviewed or whether an open investigation was being further reviewed by a representative from the Office of the Attorney General. When the office entered an installment payment agreement with a foreign corporation, monitoring of the corporation's compliance with the payment plan was also the responsibility of investigations unit staff, as the information system could not generate monthly invoices or aging receivable reports.

3. Potential revenue generating events were not immediately reviewed. In four of twenty closed investigations included in our review, there was a time lag of five to eight months between the date that the office discovered a late registration and the date the office issued demand letters for the penalties and registration fees. As of June 3, 2013, the investigations unit has not been able to start reviewing the next Bond Summary List to discover whether foreign business entities conducting business in Connecticut are without proper registrations.

Effect:

Year-end receivables were not reported to the Comptroller's Office. Without an effective information system to track receivables and ongoing investigations, investigations unit resources were diverted to monitoring receivable activities. Delays in sending demand letters and reviewing registrations of nonresident contractors resulted in delays in collection of revenues.

Cause:

Staff was not aware of the potential existence of year-end receivables. The office also allocated resources to other priorities instead of improving the information system used by the Foreign Investigations Unit as was planned in 2010. Two employees in the investigations unit manually monitored investigation files by batch; therefore, penalty demand letters were grouped and mailed in two or three batches a year to facilitate their manual monitoring activities.

Recommendation:

The Office of the Secretary of the State should review the cost and benefits of allocating additional resources to the Foreign Investigations Unit so that receivables can be effectively managed. (See Recommendation 4.)

Agency Response: “With respect to year-end receivables, the Foreign Investigations Unit will amend its practices and work with the Financial Unit to issue the appropriate year-end GAAP form. The filing will address the outstanding balances remaining on installment agreements and the amount annually claimed as “Open Demands” when each fiscal year closes. (It should be noted that the “Open Demand” report includes amounts that are not likely to be, in fact, receivable due to the nature of collections activity; we nevertheless acknowledge the need to report that sum as “Receivable” for year-end accounting purposes, recognizing that unrealized amounts not received will be reconciled in the subsequent year’s accounting.) The agency will work to focus some resources on upgrading CONCORD to include a Foreign Investigations Module. When some of the tracking and accounting functions of the unit are automated, as the auditor suggests, we can move to a rolling collection model instead of our present batching model and we can move more efficiently through the Contractor Bond lists to completely address this recommendation.”

Inventory Control and Reporting:

Criteria:

1. Section 4-36 of the General Statutes specifies that each state agency shall establish and keep an inventory account in the form prescribed by the Comptroller, and shall, annually, on or before October 1st, transmit to the Comptroller a detailed inventory, as of June 30th, of all of the following property owned by the state and in the custody of such agency: (1) real property, and (2) personal property having a value of one thousand dollars or more.
2. The State Property Control Manual provides guidance on controls for inventory management, including that complete accountability must be maintained over an agency’s physical assets. Assets should be recorded with the correct business unit and location code.
3. Chapter 7 of the manual also establishes the guidelines for maintaining a software inventory. This includes the inventory format and the procedures for conducting an annual physical inventory and preparing an annual inventory report.

Condition:

1. Our review showed that ending balances of three categories in the Asset Management/Inventory Report GAAP Reporting Form (CO-59) were not accurate. Additions to licensed software and equipment categories were misstated by including items with values of less than \$1,000 and not including the amount of a

capital equipment purchase. As of June 30, 2012, the ending balances reported in the CO-59 form was \$2,400,000 greater than the ending balances in Core-CT Cost Activity Report.

2. We randomly inspected 20 items on the office's premises and noted that six items were recorded with incorrect locations or descriptions in the inventory listing.

3. The software inventory record was not accurate and did not include sufficient information as required by the State Property Control Manual.

Effect: Annual inventory reports submitted to the Comptroller were not accurate. Errors in inventory records could result in undetected losses. The office was not in compliance with the State Property Control Manual for software inventory.

Cause: Erroneous additions were caused by an employee's misunderstanding of the state's capital equipment policies. Errors in the ending balances of three asset categories in the CO-59 forms accumulated over the year without being detected. The incomplete software inventory was an oversight.

Recommendation: The Office of the Secretary of the State should abide by the policies and procedures within the State Property Control Manual for software inventory, and ensure that balances in the CO-59 forms are accurate and reconciled to the Core-CT Cost Activity Report. (See Recommendation 5.)

Agency Response: "Management Support Services will run quarterly reports to review data entry information which has been recorded into Core-CT Asset Management. A report will be generated in Core-CT for all software to be given to our Information Technology unit to enter into our Track-IT system to ensure accountability for all software. Documentation has been disseminated to all pertinent staff to review concerning the state's capital equipment policy. An updated CO-59 report will be generated and forwarded to the Comptroller's Office for the 2012 fiscal year along with the 2013 report.

Additionally, under suggestion of the auditor and agreement with the Manager of Management Support Services, the Information Technology Division will begin adding the cost record for all software purchased into our Track-IT inventory system. Items above the \$1,000 limit will continue to be added to the Core-CT system by Management Support Services staff. Track-IT conforms

to all State Property Control Manual requirements for software inventory. These actions should satisfy this recommendation.”

Annual Report Filing Statutes and Missing Fees:

Criteria: Sections 33-953, 33-1243, 34-13e, 34-106, 34-229, 34-420 and 34-431 of the General Statutes require all businesses registered in Connecticut to file an annual report with the Secretary of the State except for Connecticut religious corporations or statutory trusts.

The annual report filing fee is \$150 for a domestic stock corporation, \$435 for an out-of-state stock corporation, \$50 for a non-stock corporation, and \$20 for various partnerships and limited liability companies.

Condition: At the time of our review in April 2013, the office’s business database showed approximately 401,528 business entities that were subject to the annual report filing requirements. We reviewed the annual report filing compliance of 30 corporations and 30 other business entities and the results are as follows:

A. Fifteen (50 percent) of the corporations were not in compliance with the annual report filing statutes, resulting in a loss of \$23,200 in filing fees. The average period of non-compliance was seven years.

B. Twenty-four (80 percent) of the other business entities were not in compliance with the annual report filing statutes, resulting in a loss of \$2,100 in filing fees. The average period of non-compliance was four years.

Effect: The Secretary of the State cannot maintain an accurate business database when business entities do not file annual reports. Revenues associated with filing fees cannot be collected.

Cause: We were told that many registered business entities were no longer active. Active businesses either did not have the legal resource or simply neglected to file their annual reports. Current laws do not provide the Secretary of the State an effective authority to enforce annual filing requirements.

Recommendation: The Office of the Secretary of the State should request the necessary authority to enforce annual report filing requirements to improve collections and the accuracy of its business database. (See Recommendation 6.)

Agency Response: “Until 1995 the agency had the statutory authority to administratively dissolve entities. In 1994 the legislature repealed the administrative dissolution law pertaining to entity annual report filing, leaving the agency with no recourse to enforce or compel filing.¹ Significantly, the high noncompliance rate represents an accumulation of instances of noncompliance since 1995. Many of the noncompliant entities have gone out of business, and many have moved and failed to file, so that we lost the ability to contact them to remind them when their annual report is due.

The agency has implemented a number of initiatives in the absence of the administrative dissolution tool to encourage compliance, including making compliance easier through streamlined and automated annual report filing; requiring entities to provide an email address for contact purposes; actively promoting the annual reporting requirement in many different forums in an effort to educate the public; and sending noncompliance notice letters to 120,000 entities who have outstanding annual filing requirements of more than three years. These efforts have resulted in a 65% increase in annual report filings and a 158% increase in dissolution activities over last year.

The Secretary is reviewing the General Assembly’s 1994 action in order to fully understand the reasoning behind its removal of administrative dissolutions. Based on the findings of this review, the agency may recommend that the General Assembly reinstate administrative dissolutions in order to more fully comply with the auditor’s recommendation.”

¹ Prior to this repeal, dissolved business entities would request that their legislators introduce special acts to reinstate such entities, creating a large volume of requested bills.

RECOMMENDATIONS

Our prior audit contained six recommendations. Five of these have been restated to reflect current conditions and one was resolved. An additional recommendation has been presented as a result of our current review.

Status of Prior Audit Recommendations:

- The office should continue its efforts to establish formal written policies and procedures for all of its functions. This recommendation has been satisfactorily resolved.
- The office should improve its monitoring of leave balances and unpaid absences, ensure a segregation of duties between payroll and personnel functions, and retain proper documentation for FMLA sick leave usage. This recommendation has been modified to remove prior findings that were corrected. (See Recommendation 1.)
- The office needs to improve recordkeeping for its customer account balances. This recommendation is repeated. (See Recommendation 2.)
- The office should improve its segregation of duties over receipts and revenue, ensure that deposits are performed in a timely manner in accordance with Section 4-32 of the General Statutes, and completely reconcile its in-house receipts and revenue records to Core-CT. The State Board of Accountancy should reconcile the number of licenses, permits, and registrations issued to receipts deposited in Core-CT. We still noted deficiencies concerning revenues, which resulted in the repeat of this recommendation in a modified form. (See Recommendation 3.)
- The office should improve documentation for settlements of foreign entity investigations. This recommendation has been modified to remove prior findings that were corrected and to reflect conditions noted in the current review. (See Recommendation 4.)
- The office should abide by the policies and procedures within the State Property Control Manual for software inventory and ensure that perpetual inventory records of merchandise for sale are accurate. We still noted deficiencies concerning software inventory in addition to annual inventory reporting errors, which resulted in the repeat of this recommendation in a modified form. (See Recommendation 5.)

Current Audit Recommendations:

1. **The Office of the Secretary of the State should improve its monitoring of employee leave balances and Core-CT Personnel Actions History Reports and obtain proper authorization to transfer funds between specific appropriations.**

Comment:

Our review found a lack of monitoring of leave balances, LILA time reporting, and changes made to the Personnel Actions History Reports. We also noted a shift in personnel expenditures from the Personal Services account to the Commercial Recording Division account without an approval from the Finance Advisory Committee.

2. **The Office of the Secretary of the State needs to improve recordkeeping for its customer account balances.**

Comment:

We continued to note inaccurate customer account balances.

3. **The Office of the Secretary of the State should consider other internal control procedures to mitigate the lack of segregation of duties over receipts, completely reconcile its in-house revenues and receipts records to Core-CT, and prepare accountability reports for revenues of the State Board of Accountancy.**

Comment:

An employee in the Financial Unit was performing several functions involving receipts that should be segregated. There were no cash receipts journal and no monthly reconciliations between the revenues and receipts recorded in the in-house system and Core-CT. An accountability report was not prepared to compare the fees received by the State Board of Accountancy.

4. **The Office of the Secretary of the State should review the cost and benefits of allocating additional resources to the Foreign Investigations Unit so that receivables can be effectively managed.**

Comment:

Our review showed that the office was not aware of year-end receivables to be reported to the Comptroller. Revenue generating events were postponed for several months as staff manually monitored the demand letters by batch. The information system could not provide complete receivable and aging reports.

5. **The Office of the Secretary of the State should abide by the policies and procedures within the State Property Control Manual for software inventory, and ensure that balances in the CO-59 forms are accurate and reconciled to the Core-CT Cost Activity Report.**

Comment:

We noted that the office lacked a complete software inventory and the annual inventory reports were inaccurate.

6. **The Office of the Secretary of the State should request the necessary authority to enforce annual report filing requirements to improve collections and the accuracy of its business database.**

Comment:

Our review showed that several business entities were not compliant with the annual report filing requirements, resulting in revenue loss to the state and inaccuracies in the Secretary of the State's business database.

INDEPENDENT AUDITORS' CERTIFICATION

As required by Section 2-90 of the General Statutes, we have audited the books and accounts of the Office of the Secretary of the State for the fiscal years ended June 30, 2010, 2011 and 2012. This audit was primarily limited to performing tests of the office's compliance with certain provisions of laws, regulations, contracts and grant agreements and to understanding and evaluating the effectiveness of the office's internal control policies and procedures for ensuring that (1) the provisions of certain laws, regulations, contracts and grant agreements applicable to the office are complied with, (2) the financial transactions of the office are properly initiated, authorized, recorded, processed, and reported on consistent with management's direction, and (3) the assets of the office are safeguarded against loss or unauthorized use. The financial statement audits of the Office of the Secretary of the State for the fiscal years ended June 30, 2010, 2011 and 2012, are included as a part of our Statewide Single Audits of the State of Connecticut for those fiscal years.

We conducted our audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards* issued by the Comptroller General of the United States. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the Office of the Secretary of the State complied in all material or significant respects with the provisions of certain laws, regulations, contracts and grant agreements and to obtain a sufficient understanding of the internal controls to plan the audit and determine the nature, timing and extent of tests to be performed during the conduct of the audit.

Internal Control over Financial Operations, Safeguarding of Assets and Compliance:

Management of the Office of the Secretary of the State is responsible for establishing and maintaining effective internal control over financial operations, safeguarding of assets, and compliance with requirements of laws, regulations, contracts, and grants. In planning and performing our audit, we considered the Office of the Secretary of the State's internal control over its financial operations, safeguarding of assets, and compliance with requirements as a basis for designing our auditing procedures for the purpose of evaluating the office's financial operations, safeguarding of assets, and compliance with certain provisions of laws, regulations, contracts and grant agreements, but not for the purpose of expressing an opinion on the effectiveness of the office's internal control over those control objectives. Accordingly, we do not express an opinion on the effectiveness of the Office of the Secretary of the State's internal control over those control objectives.

Our consideration of internal control over financial operations, safeguarding of assets, and compliance requirements was for the limited purpose described in the preceding paragraph and was not designed to identify all deficiencies in internal control over financial operations, safeguarding of assets, and compliance with requirements that might be significant deficiencies or material weaknesses and therefore, there can be no assurance that all deficiencies, significant deficiencies, or material weaknesses have been identified. However, as described in the accompanying Condition of Records and Recommendations sections of this report, we identified

deficiencies in internal control over financial operations, safeguarding of assets, and compliance with requirements that we consider to be material weaknesses and other deficiencies that we consider to be 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 on a timely basis, unauthorized, illegal or irregular transactions, or breakdowns in the safekeeping of any assets or resource. A *material weakness* is a deficiency, or combination of deficiencies in internal control, such that there is a reasonable possibility that noncompliance which could result in significant unauthorized, illegal, irregular or unsafe transactions and/or material noncompliance with certain provisions of laws, regulations, contracts, and grant agreements that would be material in relation to the Office of the Secretary of the State's financial operations will not be prevented, or detected and corrected on a timely basis. We consider the following deficiency, described in detail in the accompanying Condition of Records and Recommendations sections of this report, to be a material weakness: Recommendation 3 – Revenues and Receipts. There was no receipt journal and reconciliation to ensure that all daily cash receipts were completely recorded and deposited.

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 attention by those charged with governance. We consider the following deficiencies, described in detail in the accompanying Condition of Records and Recommendations sections of this report, to be a significant deficiency: Recommendation 2 – Customer Account Balances.

Compliance and Other Matters:

As part of obtaining reasonable assurance about whether the Office of the Secretary of the State complied with laws, regulations, contracts and grant agreements, noncompliance with which could result in significant unauthorized, illegal, irregular or unsafe transactions or could have a direct and material effect on the results of the office's financial operations, we performed tests of its compliance with certain provisions of laws, regulations, contracts and grant agreements. 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*. However, we noted certain matters, which we reported to the Office of the Secretary of the State's management in the accompanying Conditions of Records and Recommendations sections of this report.

The Office of the Secretary of the State's response to the findings identified in our audit are described in the accompanying Condition of Records section of this report. We did not audit the Office of the Secretary of the State's response and, accordingly, we express no opinion on it.

This report is intended for the information and use of Office of the Secretary of the State's management, the Governor, the State Comptroller, the Appropriations Committee of the General

Assembly and the Legislative Committee on Program Review and Investigations. However, this report is a matter of public record and its distribution is not limited.

CONCLUSION

In conclusion, we wish to express our appreciation for the courtesies and cooperation extended to our representatives by the personnel of the Office of the Secretary of the State during the course of this examination.



William T. Zinn
Principal Auditor

Approved:



John C. Geragosian
Auditor of Public Accounts



Robert M. Ward
Auditor of Public Accounts