

INTERNAL CONTROL STUDY
OF THE
WEST VIRGINIA SECRETARY OF STATE'S OFFICE
FOR THE PERIOD
FEBRUARY 28, 1994 - MARCH 9, 1994

WEST VIRGINIA LEGISLATURE
Joint Committee on Government and Finance

**Legislative Post Audit Division
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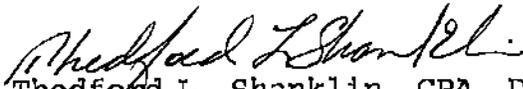
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The Joint Committee on Government and Finance:

We were asked by the West Virginia Secretary of State, the Honorable Ken Hechler, to perform a study of his office's internal control structure and to make recommendations on how the structure could be strengthened. Our study covered the period February 28, 1994 through March 9, 1994. The results of our study are set forth on the following pages of this report.

Respectfully submitted,


Thedford L. Shanklin, CPA, Director
Legislative Post Audit Division

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**INTERNAL CONTROL STUDY OF THE
WEST VIRGINIA SECRETARY OF STATE'S OFFICE**

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SECRETARY OF STATE

EXIT CONFERENCE

We held an exit conference on November 10, 1994 with a Deputy Secretary of State, and the Chief of Staff of the Secretary of State's Office. All deficiencies and recommendations were reviewed and discussed. The Secretary of State's Office responses are included in the Appendix section of this report.

**INTERNAL CONTROL STUDY OF THE
WEST VIRGINIA SECRETARY OF STATE'S OFFICE
INTRODUCTION**

The Legislative Post Audit Division was asked by the West Virginia Secretary of State, Mr. Ken Hechler, to perform a study of the procedures in his office and to make recommendations that would improve the efficiency and strengthen the internal controls over the operations of the office.

Secretary Hechler, having some concerns over procedures used in his office to deposit certain collections, had asked the Legislature's Commission on Special Investigations to investigate the conditions within his office and issue a report. The report acknowledged that certain state monies had been deposited into state accounts not authorized to receive the money. The report also stated that it appeared that no personal gain had resulted to any individual in the Secretary of State's Office, however, the internal controls over the operations in the office would not have allowed the personal gain to be discovered if it did occur. Secretary Hechler released the Commission on Special Investigations' report to the personnel in his office and to the news media.

As a result of the Commission on Special Investigation's report, Secretary Hechler requested that the Legislative Post Audit Division study the office procedures and make recommendations. Secretary Hechler stressed to his staff that the auditors were not conducting an audit or an investigation, and that they should

openly discuss their job duties and concerns with the auditors.

PURPOSE OF AN INTERNAL CONTROL STRUCTURE IN GOVERNMENT

A governmental entity's internal control structure is defined as the policies and procedures established to provide reasonable assurance that specific entity objectives will be achieved. An internal control structure consists of three elements: 1. the control environment which denotes the agency's overall attitudes, actions and awareness concerning the emphasis and importance of controls; 2. the accounting system which is the agency's method of recording and processing transactions; and 3. the control procedures which are the specific methods designed to develop a system of checks and measures to ensure ACCOUNTABILITY.

A governmental entity is accountable to the public and to other levels and branches of government for the resources provided to administer government programs and services. The resources provided to that particular governmental entity should be administered in accordance with applicable laws and administrative regulations. The resources should be applied efficiently, economically and effectively.

An effective internal control structure for a governmental entity should ensure that goals and objectives of the agency are met, resources are safeguarded, laws and regulations are followed and that reliable data are obtained, maintained and fairly disclosed.

METHODOLOGY

Information concerning the procedures was collected through personal interviews with individual staff members in the Secretary of State's Office. The interviews were begun on February 28, 1994 and continued through March 9, 1994.

We questioned the staff and took notes concerning their job procedures, in particular the handling of money, either checks or cash. We wrote the procedures based upon our interpretation of the individual staff members explanations. Then we gave his/her description of the procedures to the staff member and requested that he/she review the description and add, change or delete information as he/she deemed necessary to portray the most accurate description of the job. We then wrote a revised description of the job procedures based upon the changes the staff member noted.

After the procedures were written we flow-charted the movement of receipts through each individual's job. We then used the flow charts and the written procedures to identify deficiencies in control structure design. We stress that only **DEFICIENCIES** in internal control structure were identified. Since we did not perform an audit of the Secretary of States' Office, failures in the internal control system were not identified.

SUMMARY OF DEFICIENCIES NOTED AND RECOMMENDATIONS

We noted the following deficiencies in the internal control structure:

1. There is an absence of an overall plan of organization, therefore, there is an inadequate control structure design.

We Recommend:

- a. Establish an organizational infrastructure with a chart delineating lines of AUTHORITY and ACCOUNTABILITY.
 - b. Specific, detailed job descriptions must be developed for each employee.
2. There is no segregation of duties among the employees. Employees handle the transaction from the beginning to the end of the transaction cycle.

We Recommend:

- a. Only two employees should open the mail. A detailed mail register should be kept. All checks and cash should be removed from mail before it is disbursed to clerks for paperwork processing. All checks and cash deposited, refunds will be made or invoices issued if applicable.
 - b. There must be only one cashier. The register must be kept locked at all times. All checks and cash stored in register.
 - c. Only one employee should make out the office fund allocation slip for cash and checks received in mail. This employee should be one of the employees who opens the mail.
3. The system of reviews and approvals of transactions, accounting entries and systems output appears to be too inadequate to reveal discrepancies.

We Recommend:

- a. Only two employees should open the mail. A detailed mail register should be kept. All checks and cash should be removed from mail before it is disbursed to clerks for paperwork processing. All checks and cash deposited, refunds will be made or invoices issued if applicable.
- b. Deposits to the Board of Investments must be made daily. Any cash and checks received after deposit made should be placed in vault at night. Deposit should be made late in workday to eliminate holding a large quantity of checks and cash in vault at night.

- c. Only one employee should make out the office fund allocation slip for cash and checks received in mail. This employee should be one of the employees who opens the mail.
 - d. Each employee must keep a list of daily walk-in customers who paid by check or cash. That employee should complete a receipt for the customer, complete a fund allocation slip and immediately take the check or cash to the cashier.
4. There are inadequate provisions for the safeguarding of assets. The procedure for handling cash and checks received is to enter the receipts into an unlocked register with no security sign-on. Every employee in the office has access to the register.

We Recommend:

- a. There must be only one cashier. The register must be kept locked at all times. All checks and cash stored in register.
5. There is no method of tracking mail, no official mail register is kept. Incoming mail is not stamped as to date and time received. There is no recording as to amount of check or cash received or to whom the mail was given for processing.

We Recommend:

- a. Only two employees should open the mail. A detailed mail register should be kept. All checks and cash should be removed from mail before it is disbursed to clerks for paperwork processing. All checks and cash deposited, refunds will be made or invoices issued if applicable.
6. There appears to be inadequate procedures for appropriately assessing and applying accounting procedures in the handling of transactions.

We Recommend:

- a. Specific, detailed job descriptions must be developed for each employee.
- b. Deposits to the Board of Investments must be made daily. Any cash and checks received after deposit made should be placed in vault at night. Deposit should be made late in workday to eliminate holding a large quantity of checks and cash in vault at night.

- c. Each employee must keep a list of daily walk-in customers who paid by check or cash. That employee should complete a receipt for the customer, complete a fund allocation slip and immediately take the check or cash to the cashier.
7. There is no system for posting and invoicing receivables within the office.

We Recommend:

- a. One employee should be responsible for the monthly billing of customers who need to be invoiced, however each employee is responsible for submitting a monthly list of telephone and walk-in customers to be invoiced to the employee responsible for billing.

RECOMMENDATIONS FOR IMPROVING INTERNAL CONTROL

The first deficiency noted in the preceding section is the absence of an overall plan of organization, therefore, there is an inadequate internal control system in operation. The establishment and maintenance of a system of internal controls is the responsibility of management. The overall control environment is set by the management within an office.

We recommend that an overall control structure be implemented beginning with an organization chart and an employee job procedures manual. Each employee should clearly understand the job he/she performs and its' importance within the organization and the lines of authority within the office structure. The employee should be given guidelines to follow.

The guidelines should be consistently applied and adhered to strictly. The employee should know to whom he/she reports and be able to freely discuss job issues with his/her superior without apprehension.

We recommend that employee performance evaluations be completed on a regular basis. A uniform employee evaluation form could be developed for a basis for evaluation. The employee could complete one copy of the form as a self-evaluation and the supervisor should complete one as an evaluation of the employee. The evaluation should then be discussed between the supervisor and the employee. This procedure could possibly help to minimize the misunderstandings as to job duties and responsibilities. Employees and their supervisors would become aware of minor problems before they become major issues.

Our follow up review indicated the Secretary of State's Office has provided the following procedures for the employees: Mail Accounting System; Refund Procedures; Cashier Procedures; Procedures for Walk-in Customers; and Procedures for Problem Transactions for the Corporations Division. We have no evidence of the development of an organizational chart, or that employee evaluations have been initiated.

The second deficiency is a lack of segregation of duties among the employees. Segregation of duties is one of the most important principles of good internal control. The procedures involved in the receipt of checks and cash and the record keeping for those assets and the depositing of those assets with the Board of Investments should all be performed by separate employees. No single employee should have custody of the accounting records and the asset itself. It is recommended that the clerk processing the paperwork, (for example, the foreign corporations clerk, the

domestic corporations clerk, the dissolutions and withdrawals clerk, or the service of process clerk), receive only the paperwork to be processed, not the paperwork and the fee, the check or cash should be removed from the paperwork by another employee and sent directly to a designated cashier. The amount of the fee would be noted on the paperwork to be processed along with the date and time received in the Secretary of State's Office. The processing clerk would then request additional payment by invoicing the corporation for an underpayment or by requesting a refund for an overpayment. The Secretary of State's Office has provided procedures for segregation of duties of the office personnel. Two employees have been assigned as cashiers, with two employees as substitutes. The clerks control the paperwork and the cashiers receive the cash. The Uniform Commercial Code Division (UCC) will be added to the new system when the special receipt printer is installed. Because of heavy volume, the Office believes that this division should not be added until the computer system is fully operable.

The third deficiency noted in our study appears to be the lack of a sufficient system of authorizations and approvals of transactions. In a good system of internal control, one employee's work serves as a check and balance on the previous employee's work as it flows through the system. For example in a sound system of mail receipts, one employee opens the mail, notes the receipt of cash or check on a mail register, removes the check or cash. Another employee takes custody of the checks or cash and makes out a deposit slip and a receipt slip to the customer. The employee's

mail receipt register should then be compared with the second employee's deposit ticket. The cashier's cash register tape would then be compared with the deposit ticket. Each employee serves as an independent check upon the other employee.

The supervisor in each department, such as Uniform Commercial Code, Private Investigators, Service of Process, Notary Public, and Charities should review each clerk's paperwork for completeness and accuracy and sign his/her name in approval. A quarterly report should then be filed with the Deputy Secretary of State or the Secretary of State. That report should include the number of each type of paperwork processed, fees received, refunds issued and dollar amount of invoices issued.

Procedures have been developed by the Secretary of State's Office that may serve as a sufficient system of authorizations and approvals of transactions. The Office has initiated new mail opening and cash register procedures. Office management is responsible to review the clerk's paperwork for completeness and accuracy.

The fourth deficiency noted is the lack of physical safeguarding of the cash and checks. Almost every employee in the Secretary of State's Office handles checks or cash. The checks or cash are kept in unlocked desk drawers until entered into an unlocked, unrestricted access cash register. Cash is put into the drawer of the register, but checks are not. Checks are kept in a stack beside the register.

We recommend that one person be designated as the cashier in the Secretary of State's Office, with one other person knowing the procedures of the cashier in the event of absences of the cashier. This person should be the only person in the office with access to the register. The register should be kept locked. All checks and cash should be kept in the register drawer. The day's mail receipts should be given to the cashier by the person who prepares the deposit and the fund allocation slips. The mail receipts should be entered into the register as soon as the cashier receives them. When receipts are received in person from a walk-in customer the employee should take the cash or check directly to the cashier with a fund allocation slip, after writing the customer a receipt for the amount paid. Each employee receiving cash or checks during the day from a walk-in customer should keep a list of the customer's name, address, the type of service that was rendered, (Corporate, UCC, Service of Process, Private Investigator, Notary, Photocopy) and the amount that was paid. This list should be given to the cashier at the end of the day to compare with the allocations and amounts on the register tape. At the end of the work day: 1) The checks and cash in the register; 2) The mail listing of checks and cash received plus the individual employee listings of walk-in receipts; 3) The register tape; and, 4) The total of the allocation slips should all agree with one another. Under this system there would be four independent totals of checks and cash received that day and those four independent totals should be the same amounts.

The Secretary of State's Office has developed new procedures for the cashier function. The procedures call for two employees at two different locations in the office. A customer that we spoke with said that the clerk did send him to a cashier with an invoice before he could have his work completed.

The fifth deficiency noted is the absence of sufficient controls over the mail. There appears to be no record of the mail that is received each day and of the mail that is outgoing each day. It is difficult therefore to determine if the Secretary of State's Office actually received a piece of mail and to whom the mail was given for processing.

We recommend that two employees be responsible for the incoming mail. One employee receives the mail, opens the mail, stamps the mail as to date and time received, completes the mail register form detailing the type of mail, (UCC, Corporation, Notary, Charity, Fund-raising, Photocopy, etc.), amount of cash or check enclosed, the name of the sender, the name of the Secretary of State's Office employee to whom it is given. That employee removes the check or cash from the paperwork after indicating the amount received on the paperwork. That employee gives the checks/cash to the second mail employee. This second employee takes the cash and checks and one copy of the mail register and prepares a fund allocation slip for each separate check and cash receipt. This employee then takes the cash and checks along with the allocation slips to the cashier to be entered into the register. This second mail employee would also be responsible for

preparing an exception list of checks and cash received that are not accompanied by an invoice or application. It would be this employee's duty to contact the party sending the payment and inquire as to the purpose of the payment.

New procedures have been developed for the incoming mail system in the Secretary of State's Office. The procedures provide for two employees to be responsible for the mail.

Two employees pickup and sort the mail. The employees open the mail for all divisions, except for mail marked "personal" or "confidential". Any mail containing cash is delivered to the fiscal officer for processing. The fiscal officer notes the amounts and delivers the mail to the mail accounting clerk.

The opened mail is sorted into two categories; mail with a payment, and mail without a payment. The mail with payment is delivered to the mail accounting clerk, and mail without payment is delivered to the divisions.

The mail accounting clerk enters data for receipts by mail. The documents are stamped with the date, time and receipt number. A receipt is produced and attached to the documents. When the work for a division is completed, a division report is printed. The mail accounting clerk calls someone from the division to pick up the mail.

When all of the work is completed, a daily report is printed, and the checks and report are delivered to the fiscal officer. The fiscal officer rings the checks and cash into the cash register, and places the money in the vault. When the receipt/check

endorsing machine is received, the separate entering of these transactions on the cash register will end. An allocation report will be printed, which will group the transactions by account to which the money will be deposited.

The next morning the fiscal officer performs the deposit, picking up the checks and cash from the vault, running an adding machine tape to verify the printed reports from the mail accounting clerk, and delivering the report to a Deputy Secretary of State for approvals. At the appropriate time, the fiscal officer makes the deposit to the Board of Investments.

The sixth deficiency in the internal control system in the Secretary of State's Office is that there appears to be an inadequate procedure for appropriately assessing and applying accounting procedures in the handling of transactions. In interviewing the employees it was discovered that some employees were in doubt as to the accounting treatment of incorrect fees and as to the handling of photocopy fees. The treatment of overpayments in particular was not addressed. Some employees stated that they refunded overpayments and some employees stated that they did not refund overpayments. There was no method in place to track the amount of overpayments and to ensure that these overpayments were refunded. There was also inconsistency in the accounting treatment of photocopy money received.

We recommend that appropriate accounting procedures be implemented to deal with the refunds of overpayments. The procedures should be applied on a consistent basis and should be

clearly defined so that the employee knows how to handle the overpayment. The allocation of receipts among the various accounts would be taken care of appropriately by having the one employee complete all the allocation slips instead of each employee making out his/her own allocation slip. This procedure was described in the deficiency section that addressed the mail receipt function. **The Secretary of State's Office has developed new procedures and a "Secretary of State: Refund Request Form" for processing refunds. It appears that this system will provide a more consistent system for making refunds. This system requires that employees provide refunds for all overpayments.**

The seventh deficiency noted was the absence of a system for invoicing customers. The need for invoicing customers arises out of telephone orders and walk-in orders from legal firms requesting copies of documents. Fees received for an amount less than what is actually owed for the service could also result in a need to invoice.

We recommend that each employee should keep a register of the telephone requests and mailing of information he/she performs during the month. At the end of the month, one employee should be responsible for invoicing the mail and walk-in customers from the individual employees' lists. This could be done utilizing the computer system. At the time the mail request or walk-in request is made, the employee filling the order should obtain all information necessary to bill the customer. Once the monthly information has been given to the employee responsible for the

billing, it is the responsibility of that person to follow through with collecting the money. If the customer does not pay the bill, after a reasonable time period (2-3 billings), that customer's name or firm should be circulated to the different clerks and those clerks could be told not to send copies to those individuals or firms until their account is brought up to date.

Beginning October 1, 1994, the Secretary of State's Office no longer invoices customers for services already completed with the exception of the Administrative Law Division. The Secretary has attempted to notify the public by sending notices to customers that are conducting business with the Secretary. According to office personnel, the Administrative Law Division collects fees under Chapter 29A, Article 2, Section 7 of the West Virginia Code, which they believe does not prohibit billing.

The Secretary of State's Office is currently requesting permission to start a prepayment plan. The request was submitted to Paul Mollohan of the Auditor's Office. This will allow regular customers to deposit a check as the prepayment, and receive services on the balance of the prepayment.

CONCLUSION

These recommendations should be followed to strengthen internal controls in the Secretary of State's Office. It must be emphasized that the management is responsible for the establishment of good internal controls. The management sets the overall tone of the organization, therefore, it is of great importance that

management have a positive attitude in approaching the implementation of controls.

It should further be noted, that no system of internal controls is completely failure-proof. Any control system can be circumvented and sabotaged by unethical employees through a variety of methods. It is the responsibility of management, however, to development a system of internal controls and to ensure that the controls are enforced to decrease the incidences of internal control failures.

KEN HECHLER
Secretary of State

MARY P. RATLIFF
Deputy Secretary of State

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Deputy Secretary of State

CATHERINE FREROTTE
Executive Assistant

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(Plus all the volunteer
help we can get)

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November 14, 1994

Mr. Thedford Shanklin
Legislative Postaudit Division
State Capitol

Dear Mr. Shanklin:

Thank you for the opportunity to review the draft report relating to your review of problems with receipt processing in the Secretary of State's office and our efforts to resolve those problems by establishing new procedures.

First, I want to say that we appreciate the time you and your staff has dedicated reviewing the process and making recommendations, and the spirit of cooperation and helpfulness demonstrated throughout the process. We have done our best to develop these procedures and make these changes as quickly and effectively as possible.

In the findings of the report, you have reflected the process of receipt processing which was in effect -- namely, that each employee was responsible for handling a particular transaction from beginning to end, including the entry of receipts into the cash register, the processing of work, and the return of work containing incorrect fees or incorrect or incomplete filings. We have relied on direct supervisors to insure the training of new employees in their divisions in handling transactions correctly and dealing with problems such as overpayments. However, we have now given written instructions pertaining to specific procedures, and will insure that all new procedures are reduced to writing in the form of an employee handbook. Since March, we have been in the process of revising personnel policy and developing a more specific set of job descriptions and evaluation procedures. We expect that to be completed sometime this fall.

In terms of the findings and recommendations relating to receipt processing, we do not disagree with your conclusions. The fact that they are described in this report in the present tense may cause confusion, since the language implies that these conditions still exist. Since this is a current report, a reader would generally assume that anything stated in the present tense is happening now, and the paragraphs in bold describing what has been

Mr. Thedford Shanklin

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November 9, 1994

done to correct these problems do not seem to clear that up. However, as long as everyone understands that the deficiencies have been addressed, we agree that the report represents the facts.

We will continue to work on this project until all the problems and issues are ironed out and the processes work smoothly to insure full compliance with your recommendations, hopefully without sacrificing our history of quick and convenient service to customers.

Sincerely,

A handwritten signature in cursive script, appearing to read "Ken Hechler".

Ken Hechler
Secretary of State

Mr. Thedford Shanklin

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November 9, 1994

done to correct these problems do not seem to clear that up. However, as long as everyone understands that the deficiencies have been addressed, we agree that the report represents the facts.

We will continue to work on this project until all the problems and issues are ironed out and the processes work smoothly to insure full compliance with your recommendations, hopefully without sacrificing our history of quick and convenient service to customers.

Sincerely,


Ken Hechler
Secretary of State

STATE OF WEST VIRGINIA

OFFICE OF LEGISLATIVE AUDITOR, TO WIT:

I, Thedford L. Shanklin, CPA, Director of the Legislative Post Audit Division, do hereby certify that the report appended hereto was made under my direction and supervision, and that the same is a true and correct copy of said report.

Given under my hand this 15th day of November,
1994.

Thedford L. Shanklin

Thedford L. Shanklin, CPA, Director
Legislative Post Audit Division

Copy forwarded to the Secretary of the Department of Administration to be filed as a public record. Copies forwarded to the West Virginia Secretary of State's Office; Governor; Attorney General; and, State Auditor.