REPORT NO. 2009-031
NOVEMBER 2008

DEPARTMENT OF STATE

DIVISION OF CORPORATIONS

Operational Audit

July 2006 through February 2008

STATE OF FLORIDA
AUDITOR GENERAL
DAVID W. MARTIN, CPA

The Department of State is created by Section 20.10, Florida Statutes. The head of the Department is the Secretary, who is appointed by the Governor and subject to confirmation by the Senate. The Secretaries who served during the audit period are shown below.

Secretary	Dates of Service
Sue M. Cobb	**January 3, 2006, to January 2, 2007**

The audit team leader was Susan Walthall, CPA, and the audit was supervised by Christi Alexander, CPA. Please address inquiries regarding this report to Nancy C. Tucker, CPA, Audit Manager, by e-mail nancytucker@aud.state.fl.us or by telephone (850-487-4370).

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DEPARTMENT OF STATE

Division of Corporations

SUMMARY

Our operational audit of the Department of State (Department) for the period July 2006, through February 2008, and selected Department actions through June 2008, focused on the processes and controls established by the Division of Corporations (Division) related to revenues and cash receipts and selected information technology (IT) functions relating to change management and access controls. Our audit also included a follow-up on selected prior audit findings. Our audit disclosed the following deficiencies:

Information Technology Controls

CHANGE MANAGEMENT CONTROLS

Finding No. 1: **Division change management controls need improvement.**

ACCESS CONTROLS

Finding No. 2: **Division access controls need enhancement.**

Division Processes and Controls

PROVIDER CONTRACTS

Finding No. 3: **The Division did not include penalty and dispute resolution provisions within one of its provider agreements. In addition, the Division did not adequately monitor and enforce provider contract terms and conditions.**

CONTRACT MONITORING

Finding No. 4: **The Division's contract with its document management service provider did not require an independent auditor's report describing the effectiveness of the provider's relevant internal controls.**

RECONCILIATION PROCESS

Finding No. 5: **The Division did not perform reconciliations between the State's accounting system and the Division's revenue records.**

Apostille and Certificate of Notarial Authority Program

REVENUE COLLECTION CONTROLS

Finding No. 6: **The Division did not, in some instances, adequately resolve prior audit findings related to the apostille revenue collection process.**

BACKGROUND

Within the Department, the Division of Corporations (Division) provides a Statewide registry and information resource for almost all business activity in Florida. The Division maintains a single central commercial repository for recording and retrieving commercial information and related documentation.

All commercial documents received and filed by the Division are public records. Under State law,[1] the Division's duty to file documents is ministerial and does not create a presumption that the information contained in the

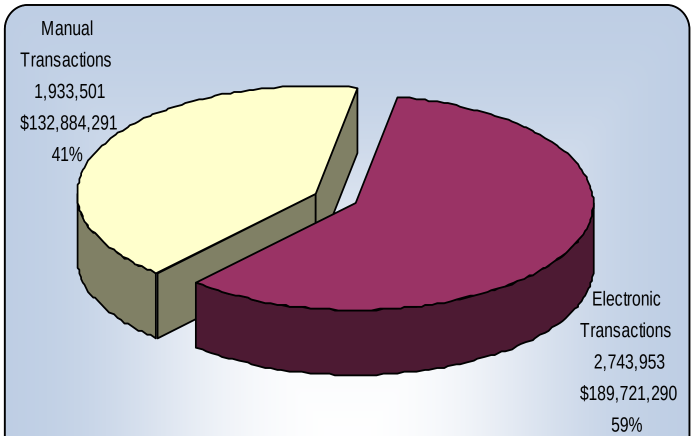
[1] **Section 607.0125(4), Florida Statutes.**

documents submitted by business entities and individuals is valid or correct. Division staff accept and process documents that meet statutory requirements and are accompanied by the proper fee. The Division also is responsible for the certification and authentication of these records domestically, nationally, and internationally.

The Division has established an in-house database, the Corporate System, that provides an electronic filing service and a public access network to help carryout the multiple functions for which the Division is tasked with performing. Customers have the option to file commercial documents manually (mail-in or walk-in) or electronically (online).

During the audit period, Corporate System revenues and receipts totaled $322.6 million and related to approximately 4.7 million transactions, as shown in Chart 1. Included in this amount were key commercial filings totaling $281.2 million and other miscellaneous revenues and receipts.[2]

Chart 1
Commercial Documents
(Electronic vs. Manual)
For the Period July 1, 2006, through February 29, 2008



Filing Type	Manual	Electronic	Total
Annual Reports	$ 38,598,342	$ 62,746,336	$101,344,678
Supplemental Corporate Fees	33,609,903	67,638,850	101,248,753
Corporate Fees	28,312,294	23,963,193	52,275,487
Fictitious Names	4,536,257	6,641,710	11,177,967
Certificates	5,203,378	5,433,253	10,636,631
Partnerships	3,643,704	473,620	4,117,324
Trademarks	413,041	-	413,041
Subtotal	$114,316,920	$166,896,962	$281,213,882
Other Miscellaneous	18,567,371	22,824,328	41,391,699
Total	$132,884,291	$189,721,290	$322,605,581

Source: Corporate System.

[2] **Miscellaneous revenues and receipts include, but are not limited to, administrative fines, lien fees, and penalties.**

FINDINGS AND RECOMMENDATIONS

Information Technology Controls

Finding No. 1: Change Management Controls

Effective change management controls include procedures to ensure that all changes are properly authorized, tested, and approved prior to implementation. Examples of change management controls that are typically employed to ensure continued integrity of application systems include:

- Effective written procedures that describe all Division practices for requesting system modifications.
- Procedures and processes that separate the responsibility for moving approved changes into the production environment from the responsibility for developing the changes.

Our audit disclosed that Division change management controls needed improvements in the following areas:

- Although the Division had established change management control policies and procedures related to the Corporate System, such procedures did not describe all Division practices for requesting System modifications. Upon audit inquiry, Division management indicated that the Division informally required the use of an approved Application Modification Form (Form) for all changes prior to a modification. However, the Division had not established written procedures describing this practice. Absent such procedures, system modification requests and authorizations may not be consistently documented and maintained.
- Upon receipt of the approved Form, the programmer was to develop the requested modifications to the Corporate System. Once accepted by the user, the programmer at times also moved the modifications into production. As a result, there was not always a separation of duties for developing and moving changes into production.

It is imperative that the change management process is adequately controlled to minimize the risk that unauthorized or erroneous program changes will be implemented. Additionally, without effective written communication of the change management policies and procedures, the risk is increased that unauthorized or untested program changes may be applied to Department data.

Recommendation: To ensure that change management controls are effective, the Division should modify procedures to describe all Division practices for requesting system modifications. Additionally, the Division should separate the responsibility for moving approved changes into the production environment from the responsibility for developing the changes. Alternatively, for the changes moved into production, the Department could consider increased monitoring by staff not associated with the application's programming.

Finding No. 2: Access Controls

The establishment of access control policies and procedures helps to ensure that data and information technology resources will be protected. Proper access controls, among other things, should prevent or timely detect unnecessary and unauthorized disclosure, modification, or destruction of programs and data files.

During our review of Division Corporate System controls, we identified deficiencies in the access controls implemented by the Division. Specific details of these deficiencies are not disclosed in this report to avoid any possibility of compromising Division data and information technology resources. However, appropriate Division personnel have been notified of the deficiencies.

Recommendation: To enhance the security of data and information technology resources, the Division should implement appropriate access controls for the Corporate System.

Division Processes and Controls

Finding No. 3: Provider Contracts

In an outsourcing environment in which government services are provided by the private sector, agency responsibility shifts from direct service provision to oversight. Such responsibility requires policies, procedures, and implementation plans that form a comprehensive monitoring infrastructure that ensures contracted service providers use State resources in accordance with contract terms, and effectively achieve program objectives and goals.

During the audit period, the Division had contracts in effect with two providers to assist with day-to-day corporate filing activities. On June 15, 2000, the Division entered into a letter of understanding with one of the providers under which the provider (electronic payment provider) was to design and maintain Web pages for credit card and electronic check authorizations. In addition, on January 1, 2004, the Division signed a contract with a second provider (document management provider) to provide services in the areas of telephone customer service; receiving, processing, depositing, and managing various documents through the use of a post office box; automated cash management; and electronic document management.

Our review of the contracts and 28 selected transactions processed by the providers disclosed the following:

- The Division's agreement with the electronic payment provider did not include penalty and dispute resolution provisions. To encourage vendor performance, agreements should contain penalty provisions. Absent such provisions, the Division may not have an effective means, other than litigation, to compel vendor performance. Further, disputes between contracting parties may emerge during the course of a project, and at times, may place at risk the effective and efficient completion of projects. Incorporating into agreements a mechanism to promptly and adequately address disputes in a good faith manner may help to avoid litigation.
- Provider agreements included terms requiring that funds be timely deposited. For 15 of 25 transactions reviewed, fees collected by the electronic payment provider were deposited from 3 to 4 business days after receipt, contrary to agreement provisions that required the electronic payment provider to transfer money on a daily basis via ACH[3] to the designated bank account within 48 hours. Likewise, terms in the document management provider agreement required funds to be deposited by 2:00 P.M. the next business day; however, for the 3 document management provider transactions tested, deposits were made from 3 to 6 business days after the funds were received.

  In response to audit inquiry, Division management indicated that provider deposit dates were routinely monitored by Division staff. However, Division efforts to monitor and enforce provider contract terms were not documented, thus limiting our review of the nature of such efforts. The absence of a strong and documented monitoring function limits Division management's assurance that vendors performed their duties in a manner consistent with the contract requirements. Moreover, the lack of timely deposits resulted in a loss of interest earnings to the State.

Recommendation: To effectively achieve program objectives and goals, the Division should ensure that future agreements include clauses that provide mechanisms to address vendor nonperformance issues and agreement disputes. In addition, the Division should establish procedures to document monitoring efforts and actions taken to enforce agreement terms and conditions.

[3] **The Automated Clearing House (ACH) is the electronic network for financial transactions in the United States.**

Finding No. 4: Contract Monitoring

The Division's contract with the document management provider did not include provisions requiring the provider to obtain a SAS 70[4] report describing internal controls related to corporate filings activities and providing an assessment of the effectiveness of those controls.

Absent the receipt and review of such reports, the Division lacked reasonable assurance that internal controls, significant to the accomplishment of the Division's responsibilities, were in place and functioning effectively. As indicated in Finding No. 3, the document management provider was required by contract to provide telephone customer service; receive, process, and manage various documents and related fees; and provide automated cash management and electronic document management.

Recommendation: We recommend the Division amend its provider contract to require the submission of a SAS 70 report addressing the effectiveness of relevant corporate filing internal controls.

Finding No. 5: Reconciliation Process

The Division had not established or implemented procedures to reconcile revenues recorded in the Corporate System to those recorded in the State's accounting system, FLAIR.[5] As part of our review of the commercial transaction process, we traced the deposits recorded in FLAIR to the related Corporate System transactions and noted that some deposits were not recorded until 16 days after the transactions had occurred in the Corporate System. Subsequent to audit inquiry, the Department's Bureau of Planning, Budget and Financial Services performed a reconciliation as of February 2008 that noted transactions totaling $12,593,568 for deposits that had been recorded in the Corporate System and deposited in the State Treasury, but not recorded in FLAIR.

Absent periodic reconciliation of the data in the Corporate System to that in FLAIR, management has reduced assurance of the accuracy and completeness of Department records.

Recommendation: The Department should establish and implement procedures to ensure that data recorded in the Corporate System are periodically reconciled to related information in FLAIR.

Apostille and Certificate of Notarial Authority Program

Finding No. 6: Revenue Collection Controls

The apostille and certificate of notarial authority process, established pursuant to State law,[6] provides that, upon receipt of a written request, notarized documents, and a fee of $10, the Secretary of State will issue an apostille or a certificate of notarial authority allowing for documents notarized in the State of Florida to be recognized in foreign countries as valid documents.

During the audit period, the Division processed both walk-in and mail-in requests for apostilles and certificates of notarial authority, recording associated revenue in FLAIR totaling $2,207,481. Funds collected were deposited directly into the General Revenue Fund in accordance with State law.[7]

[4] **Statement on Auditing Standard 70 (SAS 70), Service Organizations.**
[5] **Florida Accounting Information Resource Subsystem.**
[6] **Sections 15.16(8) and 117.103, Florida Statutes.**
[7] **Section 15.09(4), Florida Statutes.**

In audit report No. 2005-052, we made several recommendations specifically related to strengthening controls over the revenue collection process and enhancing controls over the safeguarding of certificate forms. To evaluate the status of the Division's efforts to implement corrective actions, we reviewed the apostille and certificates of notarial authority revenue collection process. Our review disclosed the following deficiencies:

- Transfers of collections between employees were not documented. Documenting the transfer of collections between employees through the use of a transfer document can provide effective accountability should a loss of collections occur.
- Revenue collection duties were not properly separated as one employee was responsible for the receipt and custody of the collections (opening and processing of mail receipts), the recording of the collections in accounting records, and securing the collections until delivery to the Fiscal Office for deposit.
- The Division did not reconcile certificates issued to revenues collected. Although the Division had begun to utilize pre-numbered forms, such numbers were not entered into the Apostille and Certificate System to assist the Division in reconciling revenues deposited to documentation of certificates issued. A proper reconciliation should account for all documents, including those voided.

Recommendation: We again recommend that the Division document the transfer of collections between employees and, to the extent practical, separate duties so that one employee does not have control of all aspects of transactions (i.e., both recording responsibility and custody of assets). The Division should also periodically account for all certificates, both used and unused, and reconcile the number of certificates used to the revenues recorded.

PRIOR AUDIT FOLLOW-UP

As part of our audit, we determined that Department staff had corrected, or were in the process of correcting, the findings included in audit report Nos. 2005-052, 2006-194, 2007-076, and 2007-087, unless otherwise noted above.

OBJECTIVES, SCOPE, AND METHODOLOGY

This operational audit focused on the processes and controls established by the Division related to revenues and cash receipts and selected information technology (IT) functions. Our objectives were:

- To evaluate the effectiveness of established controls in achieving management's control objectives in the categories of compliance with controlling laws, administrative rules, and other guidelines; the economic, efficient, and effective operation of State government; the validity and reliability of records and reports; and the safeguarding of assets.
- To evaluate management's performance in achieving compliance with controlling laws, administrative rules, and other guidelines; the economic, efficient, and effective operation of State government; the validity and reliability of records and reports; and the safeguarding of assets.
- To determine whether management had corrected, or was in the process of correcting, all applicable deficiencies disclosed in prior audit report Nos. 2005-052, 2006-194, 2007-076, and 2007-087.
- To identify statutory and fiscal changes that may be recommended to the Legislature pursuant to Section 11.45(7)(h), Florida Statutes.

We conducted this operational audit in accordance with applicable generally accepted government auditing standards. Those standards require that we plan and perform the audit to obtain sufficient, appropriate evidence to provide a reasonable basis for our findings and conclusions based on our audit objectives. We believe that the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objectives.

Our audit included examinations of various transactions (as well as events and conditions) occurring during the period July 2006 through February 2008, and selected actions through July 2008. In conducting our audit, we:

- Interviewed Department personnel.
- Obtained an understanding of internal controls and tested key processes and procedures related to revenues and cash receipts and information technology controls.
  - Examined a total of 40 transactions from the Corporate System to determine Department compliance with controlling laws and provider compliance with selected contract terms.
- Evaluated the actions taken by Department management to address findings disclosed in audit report Nos. 2005-052, 2007-076, and 2007-087 and selected findings disclosed in audit report No. 2006-194.[8] Specifically, we:
  - Reviewed the revenue collection process for the apostilles and certificates of notarial authority to determine the effectiveness of Department procedures.
  - Reviewed the Department's use of the *Florida Voting Systems Certification Checklist and Test Record*.
  - Reviewed Department procedures to determine whether the procedures for the approval of voting equipment required that the Secretary and his designees periodically affirm the absence of pecuniary and other conflicts of interests.
  - Reviewed Department procedures and examined the control listing of certified voting systems to determine whether the procedures reasonably ensured that the control listing was accurate and complete and that the Department had verified that the Supervisors of Elections had submitted the voting system information required by Section 101.5607(1)(a), Florida Statutes.
  - Examined documentation demonstrating whether the Department had verified that county voter education programs were in compliance with Department rules and county *Memoranda of Agreement for Receipt and Use of Voter Education Funds* and that the counties had properly expended and reported the use of voter education funds.
  - Verified that the Department had taken measures to incorporate Federal information and requirements into applicable interagency agreements.
  - Evaluated Department utilization of MyFloridaMarketPlace (MFMP) and the related procedures to determine whether the procedures required that confidential information not be included in MFMP, approved direct orders be obtained prior to the receipt of any goods or services, and the appropriate update of MFMP for invoices paid directly through the State's accounting system. The results of our survey of Department MFMP utilization will be disclosed in our operational audit report issued on the Department of Management Services.
  - Reviewed Department procedures to determine whether the procedures included provisions for verifying payroll data contained in People First and that provided by the Bureau of State Payrolls; auditing employee leave balances; and properly securing People First access through the use of user role code assignments and approvals.
- Performed various other auditing procedures as necessary to accomplish the objectives of the audit.

[8] Audit report Nos. 2008-141 and 2008-187 also included procedures to evaluate actions taken by the Department to address the findings included in report No. 2006-194.

AUTHORITY

Section 11.45, Florida Statutes, requires that the Auditor General conduct an operational audit of each State agency on a biennial basis. Pursuant to the provisions of Section 11.45, Florida Statutes, I have directed that this report be prepared to present the results of our operational audit.

David W. Martin, CPA
Auditor General

MANAGEMENT RESPONSE

In a response letter dated October 27, 2008, the Secretary of the State concurred with our audit findings and recommendations. The Secretary's response is included in its entirety at the end of this report as **APPENDIX A**.

APPENDIX A
MANAGEMENT RESPONSE

FLORIDA DEPARTMENT of STATE

CHARLIE CRIST
Governor

KURT S. BROWNING
Secretary of State

October 27, 2008

David W. Martin, CPA
G74 Claude Pepper Building
111 West Madison Street
Tallahassee, Florida 32399-1450

Re: Operational Audit of the Department of State, Division of Corporations, for the period July 2006 through February 2008, and selected Department actions through June 2008.

Dear Mr. Martin:

Please accept this letter and attachment as the Department's response to your letter dated September 26, 2008, applicable to audit referenced above.

Please do not hesitate to contact me if you have any further questions.

Dawn K. Roberts

Dawn K. Roberts
Assistant Secretary/Chief of Staff

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APPENDIX A
MANAGEMENT RESPONSE (Continued)

PRELIMINARY AND TENTATIVE AUDIT FINDINGS RESPONSE

Finding No. 1

Change Management Controls need improvement.

Before a new application is brought up or a current one is modified, it is tested by more than one systems person as well as several end-users. Effective immediately, we will require formal signatures on the application modification form as modifications are tested and as they are brought into production. As time permits, we will write a procedural document describing each step on the form. At times the person developing the application is also the one bringing it into production. However, this is not always the case. It is only the data base administrator or the program administrator that does the ACMS builds. No one else has the authority to do so. In a small applications office, there is not enough staff to segregate workloads and design and rewrite new systems.

Finding No. 2

Logical access control mechanisms for the Corporate System did not enforce prudent password controls.

The Division has implemented additional system controls to address deficiencies identified by the audit. Specific details of those additional controls are not disclosed in this response to avoid any possibility of compromising data and information technology resources. The Division can discuss those changes with the audit team.

Finding No. 3

Provider Contracts lack penalty and dispute provisions for vendor non-performance.

The document management contract ends December 31, 2008, and these functions will no longer be outsourced. The electronic payment agreement is currently under review. We are in the process of developing an exception request as provided by law. Upon approval of this exception request, this function will be bid and a new contract will ensue. This new contract will have the necessary penalty, dispute resolution, and monitoring provisions.

Finding No. 4

Contract Monitoring lacked SAS 70 report.

The document management contract ends December 31, 2008, and these functions will no longer be outsourced. We will require the submission of an SAS 70 report addressing the effectiveness of relevant corporate filing internal controls in the electronic payment agreement. In the future any new contracts will require this report.

Finding No. 5

Reconciliation Process for corporate system and FLAIR was not adequate.

Reconciliations with FLAIR and the Corporations system will be conducted monthly by Financial Management and Corporations. FLAIR will be balanced to the Corporations detail with accompanying detail of differences. This process will begin effective the October 31 closeout. Reconciliations shall be complete by the end of the second week following close out.

Finding No. 6

Revenue collection controls for Apostilles and certificates of notarial authority were inadequate.

The documentation of the transfer of collection between employees with current staffing is not practical at this time. However, we will explore options to work towards this goal. Revenue collection duties will be separated from certificate production duties in the same manner as corporate revenues effective December 1, 2008. Also, certificates, both used and unused, will be reconciled to ensure the number of certificates used to the revenues recorded.