

DEPARTMENT OF STATE

STATE OF LOUISIANA



FINANCIAL AUDIT SERVICES

PROCEDURAL REPORT

ISSUED JULY 11, 2018

**LOUISIANA LEGISLATIVE AUDITOR
1600 NORTH THIRD STREET
POST OFFICE BOX 94397
BATON ROUGE, LOUISIANA 70804-9397**

LEGISLATIVE AUDITOR
DARYL G. PURPERA, CPA, CFE

ASSISTANT LEGISLATIVE AUDITOR
FOR STATE AUDIT SERVICES
NICOLE B. EDMONSON, CIA, CGAP, MPA

DIRECTOR OF FINANCIAL AUDIT
ERNEST F. SUMMERVILLE, JR., CPA

Under the provisions of state law, this report is a public document. A copy of this report has been submitted to the Governor, to the Attorney General, and to other public officials as required by state law. A copy of this report is available for public inspection at the Baton Rouge office of the Louisiana Legislative Auditor.

This document is produced by the Louisiana Legislative Auditor, State of Louisiana, Post Office Box 94397, Baton Rouge, Louisiana 70804-9397 in accordance with Louisiana Revised Statute 24:513. One copy of this public document was produced at an approximate cost of \$0.30. This material was produced in accordance with the standards for state agencies established pursuant to R.S. 43:31. This report is available on the Legislative Auditor's website at www.la.la.gov. When contacting the office, you may refer to Agency ID No. 3525 or Report ID No. 80180067 for additional information.

In compliance with the Americans With Disabilities Act, if you need special assistance relative to this document, or any documents of the Legislative Auditor, please contact Elizabeth Coxe, Chief Administrative Officer, at 225-339-3800.

Louisiana Legislative Auditor

Daryl G. Purpera, CPA, CFE

Department of State



July 2018

Audit Control # 80180067

Introduction

The primary purpose of our procedures at the Department of State (DOS) was to evaluate certain controls DOS uses to ensure accurate financial reporting, compliance with applicable laws and regulations, and to provide overall accountability over public funds. In addition, we determined whether management has taken action to correct the findings reported in the prior report.

Results of Our Procedures

We evaluated DOS's operations and system of internal control through inquiry, observation, and review of its policies and procedures, including a review of the applicable laws and regulations. Based on the documentation of DOS's controls and our understanding of related laws and regulations, and the results of our analytical procedures, we performed procedures on selected controls and transactions relating to professional service contracts, purchasing card expenditures, payroll expenditures, election cost recoveries, and commercial revenues.

Follow-up on Prior-report Findings

We reviewed the status of the prior-report findings in DOS's procedural report dated July 27, 2016. We determined that management has resolved the finding related to Inadequate Documentation for Election Expenses. The finding related to Fines on Foreign Corporations and Foreign Limited Liability Companies was based on our conclusion that DOS was responsible for assessing fines established in Louisiana Revised Statute (R.S.) 12:315 and 12:1356 and failed to do so. In the 2017 Regular Session, Act 367 repealed R.S. 12:315 and R.S. 1356 in their entirety.

Current-report Finding

Inadequate Controls and Lack of Written Policies over the Filing of Annual Reports

DOS does not have written policies in place to ensure adequate controls over the filing of annual reports as it relates to the associated fees and potential revocations of articles of organization and articles of incorporation for limited liability companies (LLCs) and nonprofit corporations

(nonprofits), respectively. We examined 46 active LLCs and 26 active nonprofits from a listing provided by DOS as of February 28, 2018, and noted the following:

- Seven LLCs and one nonprofit were active even though they did not file an accepted annual report, nor was a fee collected by DOS for three consecutive years.
- Four LLCs and one nonprofit were active even though DOS did not collect the annual reporting fee for three consecutive years.
- Six LLCs and three nonprofits were active even though they did not file a satisfactory annual report for three consecutive years.

Louisiana revised statutes require LLCs and nonprofits to file annual reports with DOS and authorize a filing fee of \$30 for LLCs and \$10 for nonprofits. DOS is required to revoke the articles of LLCs and nonprofits if they fail to file an annual report for three consecutive years. The annual report provides DOS with current business information including changes in registered agent, contact information, and physical location.

While performing our procedures, DOS management indicated that some LLCs and nonprofits only file and pay for their annual report once or twice every three years to avoid revocation. DOS management also indicated that those LLCs and nonprofits that are not filing and paying every year are not paying for any of the years they failed to pay when they make subsequent filings. Based on this information, we performed additional procedures and noted the following:

- In analyzing a sample of 44 LLCs and 40 nonprofits, we determined that if DOS had adequate policies in place requiring LLCs and nonprofits to pay the annual report fee for those years that they failed to pay, potentially more than \$4 million could have been collected during calendar years 2015, 2016, and 2017.

Based on current DOS practices, LLCs and nonprofits are allowed to remain active even though they have not filed their annual report, paid their annual reporting fee, or filed a satisfactory report. Not ensuring that these annual requirements are enforced could incentivize LLCs and nonprofits to report only once every three years. These less frequent filings result in less revenue collected by DOS.

DOS management represented to us that its procedures are in compliance with applicable revised statutes and that it is authorized to collect only the current year's annual reporting fee. Management further represented that changes to its procedures would require changes to the law, and that it has been working with the Louisiana Law Institute since 2017 to revise the applicable statutes to enable DOS to collect annual reporting fees for those years that a LLC or nonprofit failed to file.

DOS management should establish written policies and procedures to ensure adequate controls over the filing of annual reports, associated filing fees, and potential revocations of the articles of LLCs and nonprofits. Management concurred in part with the finding and indicated that new

procedures will be developed related to unsatisfactory annual reports filed by LLCs and nonprofits (see Appendix A).

Professional Service Contracts

The majority of DOS's professional service contracts are for software consulting services related to elections and commercial services. We performed procedures to determine whether payments were made in accordance with applicable procurement laws and regulations. Based on the results of our procedures, DOS had adequate controls in place to ensure that payments for professional service contracts were for reasonable services, accurate, and made in accordance with applicable laws.

Purchasing Card Expenditures

DOS participates in the State of Louisiana's LaCarte Purchasing Card program for general office supplies and administrative expenditures. We obtained an understanding of DOS's controls over access to and use of these cards.

We analyzed LaCarte card transaction listings for the period July 1, 2016, through February 5, 2018, and reviewed selected transactions. Based on the results of our procedures, DOS had adequate controls to ensure that purchases were approved and made for proper business purposes; sufficient documentation was maintained to support purchases; and purchases were properly reconciled to invoices and receipts.

Payroll Expenditures

Salaries and related benefits comprised approximately 32% and 34% of DOS's expenditures in fiscal years 2016 and 2017, respectively. We obtained an understanding of DOS's controls over the time and attendance function and reviewed selected employee time statements and leave and overtime records. Based on the results of our procedures, DOS had adequate controls in place to ensure timely review and approval of employee time statements and leave requests, employees were paid the amounts authorized, and leave taken was properly accounted for.

Election Cost Recoveries

Louisiana Revised Statute 18.1400.3 provides for the elections costs that DOS recovers from parish governing authorities. The amount recovered depends on the type of election and also the items on the ballot. We obtained an understanding of DOS's controls over recovering election costs from local governments in accordance with Louisiana Revised Statutes and the Louisiana Election Code. Our procedures determined that DOS has adequate controls over election cost recoveries.

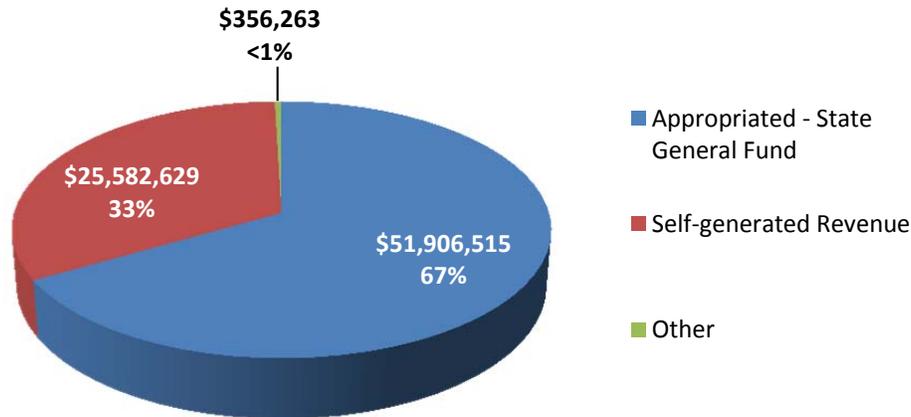
Commercial Revenues

We obtained a basic understanding of DOS’s policies and controls over the filing of annual reports, as it relates to associated fees and potential revocations of articles for nonprofit corporations, limited liability companies, domestic corporations, and foreign corporations. We also obtained an understanding of DOS’s policies and procedures over the filing of annual reports as it relates to associated fees and potential suspensions of notaries. Based on the results of our procedures, we determined that some nonprofits and LLCs are active and in good standing when their articles should have been revoked, are not filing annual reports in accordance with Louisiana Revised Statutes, and that potentially more than \$4,000,000 of annual reporting fees could have been collected but were not during calendar years 2015, 2016, and 2017 (see Current-report Finding section).

Trend Analysis

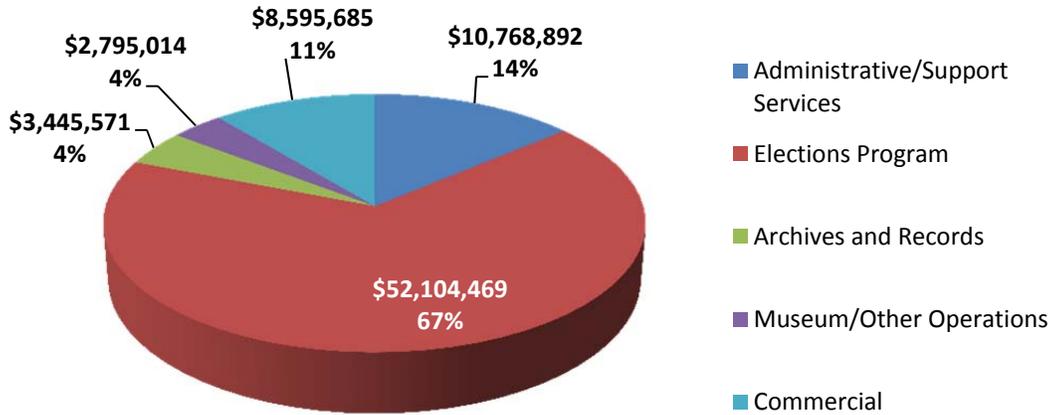
We compared the most current and prior-year financial activity using DOS’s Annual Fiscal Reports and/or system-generated reports and obtained explanations from DOS’s management for any significant variances. We also prepared an analysis of DOS’s sources of revenues and expenditures for FY 2017.

Exhibit 1
Fiscal Year 2017 Sources of Revenue
Total: \$77,845,407



Source: 2017 DOS Annual Fiscal Report

Exhibit 2
Fiscal Year 2017 Sources of Expenditures
Total: \$77,709,631



Source: 2017 DOS Appropriation Report

Under Louisiana Revised Statute 24:513, this letter is a public document, and it has been distributed to appropriate public officials.

Respectfully submitted,

Thomas H. Cole, CPA
First Assistant Legislative Auditor

AEB:JT:BH:EFS:aa

DOS 2018

APPENDIX A: MANAGEMENT'S RESPONSE

SECRETARY OF STATE
STATE OF LOUISIANA

R. KYLE ARDOIN
SECRETARY OF STATE



P.O. BOX 94125
BATON ROUGE, LA 70804-9125
225.922.2880

May 30, 2018

Mr. Daryl G. Purpera, CPA, CFE
Legislative Auditor
1600 North Third Street
Baton Rouge, LA 70804-9397

Dear Mr. Purpera,

This letter serves as the response by the Louisiana Department of State (DOS) to the Legislative Auditor's preliminary draft of findings and recommendations related to inadequate controls and lack of written policies over the filing of annual reports. Based on inquiries and test work performed on active LLCs and nonprofits, the auditors concluded that DOS is potentially allowing LLCs and nonprofits to remain active when they should be revoked. This conclusion was reached based on review of 46 active LLCs and 26 active nonprofits. The auditors recommend DOS management establish written policies and procedures to ensure adequate controls over the filing of annual reports, associated filing fees, and potential revocations of articles of LLCs and nonprofits.

The Louisiana Department of State concurs, only in part, to this finding and the reasons are as follows:

While we agree that the laws for Limited Liability Companies and Non-Profit Corporations should be consistent with those of Domestic Corporations, we cannot collect fees or reports that are not legislatively mandated. As stated in conversations with the auditors, we are working closely with the Louisiana Law Institute (and have been since 2017) to revise applicable statutes so that DOS may collect these fees and reports. Until the time when such Legislation has been passed, DOS must continue to collect only the fees and reports mandated by current statute.

There are several reasons why a Limited Liability Company or Non-Profit would not be revoked even though it did not file the required report(s). If a business has started the withdrawal process (foreign entities) or the dissolution process (domestic entities), the business will not be revoked. If a business has not begun to dissolve or withdraw, but meets the criteria below, we mark the company/corporation as "unsatisfactory".

- 1.) The company/corporation attempts to file an annual report (via mail, fax or email).
- 2.) Said report is not able to be filed due to an error or omission.

This "unsatisfactory" mark prevents the company from being revoked, thereby giving the business additional time to file a corrected report. In these cases, the business attempted and sent fees to file the report, and rather than have the company revoked while the annual report is in transit for corrections, we allow the business time to correct and resubmit. The filing fee is retained and applied to the future filing. We admit this system is flawed, in that it prevents revocation indefinitely, and the company may never send in a corrected report.

Mr. Daryl G. Purpera
May 30, 2018
Page 2

New procedures for the return of unsatisfactory annual reports for limited liability companies and non-profit corporations will need to be implemented. The Manager over the Annual Reports section along with the Supervisor over the Annual Reports section will develop and confer with IT to make new procedures to be put into effect until such time that a new law makes these entities consistent with Corporations. The new procedures will involve the return of the non-compliant annual report, the return of the filing fee and a letter giving a deadline for corrections with a warning and date for the revocation. The deadline for the development of these policies and procedures will be July 1st and should new programming be necessary, a deadline of September 1st will be given for those changes.

Thank you for the opportunity to respond to this finding and recommendation. If you need any additional information, please do not hesitate to contact me directly.

Sincerely,

A handwritten signature in blue ink, appearing to read "R. Kyle Ardoin". The signature is fluid and cursive, with the first letter "R" being particularly large and stylized.

R. Kyle Ardoin
Secretary of State

APPENDIX B: SCOPE AND METHODOLOGY

We performed certain procedures at the DOS for the period from July 1, 2016, through June 27, 2018. Our objective was to evaluate certain controls DOS uses to ensure accurate financial reporting, compliance with applicable laws and regulations, and to provide accountability over public funds. The scope of our procedures, which are summarized below, was significantly less than an audit conducted in accordance with *Government Auditing Standards*, issued by the Comptroller General of the United States. We did not audit or review the DOS's Annual Fiscal Reports, and accordingly, we do not express an opinion on those reports. The DOS's accounts are an integral part of the State of Louisiana's financial statements, upon which the Louisiana Legislative Auditor expresses opinions.

- We evaluated DOS's operations and system of internal controls through inquiry, observation, and review of its policies and procedures, including a review of the laws and regulations applicable to DOS.
- Based on the documentation of DOS's controls and our understanding of related laws and regulations, we performed procedures on selected controls and transactions relating to professional service contracts, purchasing card expenditures, payroll expenditures, election cost recoveries, and commercial revenues.
- We compared the most current and prior-year financial activity using DOS's Annual Fiscal Reports and/or system-generated reports to identify trends and obtained explanations from DOS's management for any significant variances that could potentially indicate areas of risk.

The purpose of this report is solely to describe the scope of our work at DOS and not to provide an opinion on the effectiveness of DOS's internal control over financial reporting or on compliance. Accordingly, this report is not intended to be, and should not be, used for any other purpose.