

FINANCIAL AUDIT
INCLUDING THE PROVISIONS OF THE SINGLE AUDIT ACT
OF THE
DEPARTMENT OF MILITARY AND VETERANS AFFAIRS

October 1, 1999 through September 30, 2001



Michigan
Office of the Auditor General
REPORT SUMMARY

Financial Audit

*Including the Provisions of the Single Audit Act
 October 1, 1999 through September 30, 2001*

Department of Military and Veterans Affairs

**Report Number:
 51-100-02**

**Released:
 June 2002**

A Single Audit is designed to meet the needs of all financial report users, including an entity's federal grantor agencies. The audit determines if the financial schedules and/or financial statements are fairly presented; considers internal control over financial reporting and internal control over federal program compliance; determines compliance with State compliance requirements material to the financial schedules and/or financial statements; and assesses compliance with direct and material requirements of the major federal programs.

Financial Schedules:

Auditor's Report Issued

We issued an unqualified opinion on the Department's financial schedules.

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Internal Control Over Financial Reporting

We did not identify any material weaknesses in internal control over financial reporting. However, we did identify a reportable condition (Finding 1).

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**Noncompliance Material to
 the Financial Schedules**

We did not identify any instances of noncompliance applicable to the financial schedules that are required to be reported under *Government Auditing Standards*.

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Federal Awards:

Auditor's Reports Issued on Compliance

We audited 4 programs as major programs and issued 4 unqualified opinions. The federal programs audited as major programs are identified on the back of this summary.

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Internal Control Over Major Programs

We did not report any findings related to internal control over major programs.

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Required Reporting of Noncompliance

We did not identify any instances of noncompliance that are required to be reported in accordance with U.S. Office of Management and Budget (OMB) Circular A-133.

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Systems of Accounting and Internal Control:

We determined that the Department was in substantial compliance with Sections

18.1483 - 18.1487 of the *Michigan Compiled Laws*. However, we did identify a reportable condition (Finding 1).



We audited the following programs as major programs:

<u>CFDA Number</u>	<u>Program Title</u>	<u>Compliance Opinion</u>
12.401	National Guard Military Operations and Maintenance Projects	Unqualified
12.404	National Guard Civilian Youth Opportunities	Unqualified
64.014	Veterans State Domiciliary Care	Unqualified
64.015	Veterans State Nursing Home Care	Unqualified

A copy of the full report can be obtained by calling 517.334.8050 or by visiting our Web site at: www.state.mi.us/audgen/



Michigan Office of the Auditor General
201 N. Washington Square
Lansing, Michigan 48913

Thomas H. McTavish, C.P.A.
Auditor General

James S. Neubecker, C.P.A., C.I.A., D.P.A.
Executive Deputy Auditor General

Michael J. Mayhew, C.P.A.
Deputy Auditor General for Audits

June 11, 2002

Major General E. Gordon Stump, Director
Department of Military and Veterans Affairs
2500 South Washington Avenue
Lansing, Michigan

Dear General Stump:

This is our report on the financial audit, including the provisions of the Single Audit Act, of the Department of Military and Veterans Affairs for the period October 1, 1999 through September 30, 2001.

This report contains our report summary; our independent auditor's report on the financial schedules; and the Department of Military and Veterans Affairs financial schedules, notes to the financial schedules, and supplemental financial schedules. This report also contains our independent auditor's reports on compliance and on internal control over financial reporting and on compliance with requirements applicable to each major program and on internal control over compliance in accordance with U.S. Office of Management and Budget Circular A-133 and our schedule of findings and questioned costs. In addition, this report contains the Department's summary schedule of prior audit findings, its corrective action plan, and a glossary of acronyms and terms.

Our finding and recommendation are contained in Section II of the schedule of findings and questioned costs. The agency's preliminary response is contained in the corrective action plan. The *Michigan Compiled Laws* and administrative procedures require that the audited agency develop a formal response within 60 days after release of the audit report.

We appreciate the courtesy and cooperation extended to us during this audit.

AUDITOR GENERAL

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Independent Auditor's Report on
the Financial Schedules

January 22, 2002

Major General E. Gordon Stump, Director
Department of Military and Veterans Affairs
2500 South Washington Avenue
Lansing, Michigan

Dear General Stump:

We have audited the accompanying schedule of General Fund revenue and transfers and the schedule of sources and disposition of General Fund authorizations of the Department of Military and Veterans Affairs for the fiscal years ended September 30, 2001 and September 30, 2000. These financial schedules are the responsibility of the Department's management. Our responsibility is to express an opinion on these financial schedules based on our audit. The financial transactions of the Department are accounted for principally in the General Fund of the State of Michigan.

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 financial schedules are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial schedules. An audit also includes assessing the accounting principles used and the significant estimates made by management, as well as evaluating the overall financial schedule presentation. We believe that our audit provides a reasonable basis for our opinion.

As described in Note 1b, the accompanying financial schedules include only the revenue and transfers and the sources and disposition of authorizations for the Department of Military and Veterans Affairs' General Fund accounts, presented on the modified accrual basis of accounting. Accordingly, these financial schedules are not intended to constitute a complete financial presentation of either the Department or the

State's General Fund in accordance with accounting principles generally accepted in the United States of America.

In our opinion, the financial schedules referred to in the first paragraph present fairly, in all material respects, the revenue and transfers and the sources and disposition of authorizations of the Department of Military and Veterans Affairs for the fiscal years ended September 30, 2001 and September 30, 2000, on the basis of accounting described in Note 1b.

In accordance with *Government Auditing Standards*, we have also issued a report dated January 22, 2002 on our tests of the Department's compliance with certain provisions of laws, regulations, contracts, and grants and on our consideration of its internal control over financial reporting. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* and should be read in conjunction with this report in considering the results of our audit.

The accompanying schedule of expenditures of federal awards, required by U.S. Office of Management and Budget Circular A-133, *Audits of States, Local Governments, and Non-Profit Organizations*, and other supplemental financial schedules, consisting of the schedule of certain General Fund assets and liabilities and the schedule of disposition of General Fund authorizations by appropriation unit, are presented for purposes of additional analysis and are not a required part of the Department's financial schedules referred to in the first paragraph. Such information has been subjected to the auditing procedures applied in the audit of the financial schedules and, in our opinion, is fairly stated, in all material respects, in relation to the financial schedules taken as a whole.

AUDITOR GENERAL

DEPARTMENT OF MILITARY AND VETERANS AFFAIRS
Schedule of General Fund Revenue and Transfers
Fiscal Years Ended September 30

	<u>2001</u>	<u>2000</u>
REVENUE		
Federal Revenue:		
National Guard Bureau	\$ 19,981,545	\$ 19,128,702
Veterans Administration State Home Program	14,639,645	14,449,225
Medicare	770,483	660,093
Department of Education	198,038	97,529
Total Federal Revenue	<u>\$ 35,589,711</u>	<u>\$ 34,335,549</u>
Cost-of-care assessments	17,303,467	16,787,076
Armory Rental Program	245,898	237,311
Armory sales		150,000
Miscellaneous	176,998	240,537
Total Revenue	<u>\$ 53,316,074</u>	<u>\$ 51,750,473</u>
TRANSFERS		
From the Mackinac Bridge Authority	<u>35,088</u>	<u>25,993</u>
Total Revenue and Transfers	<u><u>\$ 53,351,162</u></u>	<u><u>\$ 51,776,466</u></u>

The accompanying notes are an integral part of the financial schedules.

DEPARTMENT OF MILITARY AND VETERANS AFFAIRS
Schedule of Sources and Disposition of General Fund Authorizations
Fiscal Years Ended September 30

	<u>2001</u>	<u>2000</u>
SOURCES OF AUTHORIZATIONS (Note 2)		
General purpose appropriations	\$ 41,647,700	\$ 40,600,500
Balances carried forward	5,748,996	5,163,559
Restricted financing sources	53,251,493	51,609,267
Budgetary adjustment	<u>10,262</u>	<u>78,144</u>
 Total	 <u>\$ 100,658,451</u>	 <u>\$ 97,451,470</u>
 DISPOSITION OF AUTHORIZATIONS (Note 2)		
Expenditures and transfers	<u>\$ 95,685,397</u>	<u>\$ 90,405,324</u>
Balances carried forward:		
Multi-year projects	\$	\$ 2,598,570
Encumbrances	1,267,013	595,624
Restricted revenue - authorized	674,517	1,249,685
Restricted revenue - not authorized	<u>1,808,337</u>	<u>1,958,051</u>
Total balances carried forward	<u>\$ 3,749,867</u>	<u>\$ 6,401,930</u>
Balances lapsed	<u>\$ 1,223,187</u>	<u>\$ 644,216</u>
 Total	 <u>\$ 100,658,451</u>	 <u>\$ 97,451,470</u>

The accompanying notes are an integral part of the financial schedules.

Notes to the Financial Schedules

Note 1 Significant Accounting Policies

a. Reporting Entity

The accompanying financial schedules report the results of the financial transactions of the Department of Military and Veterans Affairs for the fiscal years ended September 30, 2001 and September 30, 2000. The financial transactions of the Department are accounted for principally in the State's General Fund and are reported on in the *State of Michigan Comprehensive Annual Financial Report (SOMCAFR)*. In addition, the Department is responsible for the supervision and direction of the Michigan Veterans' Trust Fund. The Fund provides grants to assist veterans and their dependents. The Fund also provides administrative support for the Vietnam Veterans' Memorial Monument Fund. These Funds receive separate financial and performance audits and are not included in the scope of this audit.

The notes accompanying these financial schedules relate directly to the Department. The *SOMCAFR* provides more extensive general disclosures regarding the State's Summary of Significant Accounting Policies; Budgeting, Budgetary Control, and Legal Compliance; Pension Benefits and Other Postemployment Benefits; and Compensated Absences.

b. Basis of Accounting and Presentation

The financial schedules contained in this report are prepared on the modified accrual basis of accounting, as provided by accounting principles generally accepted in the United States of America for governmental funds. The modified accrual basis of accounting, which emphasizes the measurement of current financial resource flows, is explained in more detail in the *SOMCAFR*.

The accompanying financial schedules include only the revenue and transfers and the sources and disposition of authorizations for the Department of Military and Veterans Affairs' General Fund accounts. Accordingly, these financial schedules are not intended to constitute a

complete financial presentation of either the Department or the State's General Fund in accordance with accounting principles generally accepted in the United States of America.

c. Pension Benefits

The Department received annual appropriations for military retirement benefits for the Michigan National Guard members and special duty officers. These appropriations are made from the General Fund on a pay-as-you-go basis. Expenditures for the military retirement plan totaled \$2,249,129 for fiscal year 2000-01 and \$2,204,400 for fiscal year 1999-2000. The actuarially determined unfunded liabilities for the military retirement plan as of September 30, 2001 totaled \$34.4 million.

Note 2 Schedule of Sources and Disposition of General Fund Authorizations

The various elements of the schedule of sources and disposition of General Fund authorizations are defined as follows:

- a. General purpose appropriations: Original appropriations and any supplemental appropriations that are financed by General Fund/general purpose revenue.
- b. Balances carried forward: Authorizations for multi-year projects, encumbrances, restricted revenue - authorized, and restricted revenue - not authorized that were not spent as of the end of the prior fiscal year. These authorizations are available for expenditure in the current fiscal year for the purpose of the carry-forward without additional legislative authorization, except for the restricted revenue - not authorized.
- c. Restricted financing sources: Collections of restricted revenue, restricted transfers, and restricted intrafund expenditure reimbursements to finance programs as detailed in the appropriations act. These financing sources are authorized for expenditure up to the amount appropriated. Depending upon program statute, any amounts received in excess of the appropriation are, at year-end, either converted to general purpose financing sources and made available for general appropriation in the next fiscal year or carried forward to the next fiscal year as either restricted revenue - authorized or restricted revenue - not authorized.

- d. Multi-year projects: Unexpended authorizations for work projects and capital outlay projects that are carried forward to subsequent fiscal years for the completion of the projects. The Department also had authorizations for large capital outlay projects that were accounted for by the Department of Management and Budget. Unexpended authorizations carried forward for these projects totaled \$27,314,866 for fiscal year 2000-01 and \$25,870,136 for fiscal year 1999-2000.
- e. Encumbrances: Authorizations carried forward to finance payments for goods and services ordered in the old fiscal year but not received by fiscal year-end. These authorizations are generally limited to obligations funded by general purpose appropriations.
- f. Restricted revenue - authorized: Revenue that, by statute or the State Constitution, is restricted and authorized for use to a particular program or activity. Generally, this revenue may be expended upon receipt without additional legislative authorization.
- g. Restricted revenue - not authorized: Revenue that, by statute, is restricted for use to a particular program or activity. However, the Department had not received legislative authorization to expend the revenue. The Department's fiscal year 2000-01 significant carry-forwards of this type were revenues collected by the Homes for Veterans for the cost-of-care assessments (\$994,133) and the U.S. Department of Veterans Affairs federal assistance (\$763,045).
- h. Balances lapsed: Authorizations that were unexpended and unobligated at the end of the fiscal year. These amounts are available for legislative appropriation in the subsequent fiscal year.

SUPPLEMENTAL
FINANCIAL SCHEDULES

DEPARTMENT OF MILITARY AND VETERANS AFFAIRS
 Schedule of Certain General Fund Assets and Liabilities
As of September 30

ASSETS	<u>2001</u>	<u>2000</u>
Due from federal agencies	\$ 7,752,975	\$ 4,832,676
Due from the Mackinac Bridge Authority	\$ 35,200	\$ 25,993
Miscellaneous accounts receivable	\$ 80,791	\$ 54,747
Inventories	\$ 394,251	\$ 334,181
LIABILITIES		
Accounts payable	\$ 6,342,411	\$ 5,227,953
Deferred revenue	\$ 77,740	\$ 64,712
Due to other funds	\$ 2,937	\$ 3,611
Other liabilities	\$ 666,259	\$ 641,473

This schedule is not a balance sheet and is not intended to report financial position. The schedule presents certain General Fund assets and liabilities that are the responsibility of the Department of Military and Veterans Affairs. The schedule does not include assets and liabilities that are accounted for centrally by the State, such as land, buildings, equipment, equity in Common Cash, cash in transit, and warrants outstanding.

DEPARTMENT OF MILITARY AND VETERANS AFFAIRS
Schedule of Disposition of General Fund Authorizations by Appropriation Unit
Fiscal Years Ended September 30

<u>Appropriation Unit</u>	2001				
	Total Authorizations	Appropriation Transfers	Expenditures and Transfers Out	Balances Carried Forward	Balances Lapsed
Headquarters and armories	\$ 13,650,972	\$ 200,000	\$ 13,693,868	\$ 55,894	\$ 101,209
Military training sites and support facilities	15,700,102	(200,000)	15,339,943	74,243	85,916
Departmentwide support	8,647,403		7,575,789	1,038,837	32,777
Veterans service organizations	3,884,400		3,884,300		100
Grand Rapids Home for Veterans	42,748,150		41,146,095	930,588	671,468
D.J. Jacobetti Home for Veterans	14,254,951		12,726,246	1,247,572	281,132
Michigan Veterans' Trust Fund	351,200		299,387	1,229	50,584
Vietnam Veterans' Memorial Monument Fund	1,411,013		1,009,509	401,504	
Accounts receivable write-offs	<u>10,262</u>		<u>10,262</u>		
Total	<u>\$ 100,658,451</u>	<u>\$ 0</u>	<u>\$ 95,685,397</u>	<u>\$ 3,749,867</u>	<u>\$ 1,223,187</u>

2000				
<u>Total Authorizations</u>	<u>Appropriation Transfers</u>	<u>Expenditures and Transfers Out</u>	<u>Balances Carried Forward</u>	<u>Balances Lapsed</u>
\$ 13,299,257	\$ (37,500)	\$ 13,213,624	\$ 28,325	\$ 19,809
14,977,172	(400,000)	14,281,876	3,596	291,700
9,356,203	37,500	7,914,383	1,451,601	27,719
3,914,500		3,914,400		100
40,076,807	287,800	38,503,259	1,803,776	57,572
13,996,975	112,200	12,265,068	1,703,619	140,487
341,400		234,570		106,830
1,411,013			1,411,013	
<u>78,144</u>		<u>78,144</u>		
<u>\$ 97,451,470</u>	<u>\$ 0</u>	<u>\$ 90,405,324</u>	<u>\$ 6,401,930</u>	<u>\$ 644,216</u>

DEPARTMENT OF MILITARY AND VETERANS AFFAIRS
Schedule of Expenditures of Federal Awards *
For the Period October 1, 1999 through September 30, 2001

For the Fiscal Year Ended September 30, 2000

Grantor Agency/Federal Assistance Program Title	CFDA ** Number	Pass-Through Identification Number	Directly Expended by Department	In-Kind Assistance (Note 1)	Distributed to Subrecipient	Total Expended, Distributed, and In-Kind Assistance
U.S. Department of Defense						
Direct Programs:						
National Guard Military Operations and Maintenance Projects:						
Appendix 1 Army National Guard Real Property Operations and Maintenance (Note 3)	12.401		\$ 8,352,123	\$ 254,524	\$	\$ 8,606,647
Appendix 2 Army National Guard Environmental Resources Management	12.401		1,724,695	493,700		2,218,395
Appendix 3 Army National Guard Security Guard Activities	12.401		310,727			310,727
Appendix 4 Army National Guard Electronic Security Systems	12.401		130,743			130,743
Appendix 5 Army National Guard Telecommunications	12.401		1,002,106			1,002,106
Appendix 6 Army National Guard Aviation Operations	12.401		33,420			33,420
Appendix 7 Army National Guard Automated Target Systems	12.401		324,510			324,510
Appendix 9 Army National Guard Store Front Recruiting Office Leases	12.401		129,323			129,323
Appendix 21 Air National Guard Facilities Operations and Maintenance	12.401		2,540,743	592,000		3,132,743
Appendix 22 Air National Guard Environmental	12.401		40,131			40,131
Appendix 23 Air National Guard Security Guard Activities	12.401		1,062,183			1,062,183
Appendix 24 Air National Guard Fire Protection Distance Learning Network	12.401		2,193,226	18,000		2,211,226
Total National Guard Military Operations and Maintenance Projects			<u>\$ 17,843,930</u>	<u>\$ 1,358,224</u>	<u>\$ 0</u>	<u>\$ 19,202,154</u>
National Guard Civilian Youth Opportunities:						
Challenge Program	12.404		\$ 1,852,053	\$	\$	\$ 1,852,053
Starbase Program	12.404				<u>425,325</u>	<u>425,325</u>
Total National Guard Civilian Youth Opportunities			<u>\$ 1,852,053</u>	<u>\$</u>	<u>\$ 425,325</u>	<u>\$ 2,277,378</u>
Total U.S. Department of Defense			<u>\$ 19,695,983</u>	<u>\$ 1,358,224</u>	<u>\$ 425,325</u>	<u>\$ 21,479,532</u>
U.S. Department of Justice						
Direct Program:						
Equitable Sharing of Federally Forfeited Property	16 ***		\$ 6,781	\$	\$	\$ 6,781
Total U.S. Department of Justice			<u>\$ 6,781</u>	<u>\$ 0</u>	<u>\$ 0</u>	<u>\$ 6,781</u>
U.S. Department of Veterans Affairs						
Direct Programs:						
Veterans State Domiciliary Care	64.014		\$ 901,579	\$	\$	\$ 901,579
Veterans State Nursing Home Care	64.015		12,959,667			12,959,667
Total U.S. Department of Veterans Affairs (Note 3)			<u>\$ 13,861,246</u>	<u>\$ 0</u>	<u>\$ 0</u>	<u>\$ 13,861,246</u>
U.S. Department of Education						
Pass-Through Program:						
Michigan Department of Community Health Safe and Drug-Free Schools and Communities: State Grants	84.186	MYC2001	\$ 97,529	\$	\$	\$ 97,529
Total U.S. Department of Education			<u>\$ 97,529</u>	<u>\$ 0</u>	<u>\$ 0</u>	<u>\$ 97,529</u>
Total Expenditures of Federal Awards			<u>\$ 33,661,539</u>	<u>\$ 1,358,224</u>	<u>\$ 425,325</u>	<u>\$ 35,445,088</u>

* Basis of Presentation: This schedule includes the federal grant activity of the Department of Military and Veterans Affairs and is presented on the modified accrual basis of accounting. The information in this schedule is presented in accordance with the requirements of OMB Circular A-133, *Audits of States, Local Governments, and Non-Profit Organizations*. Therefore, some amounts presented in this schedule may differ from amounts presented in, or used in the preparation of, the financial schedules.

** CFDA is defined as *Catalog of Federal Domestic Assistance*.

*** CFDA number not available. Number derived from federal agency number and grant or contract number, if available.

For the Fiscal Year Ended September 30, 2001

Directly Expended by Department	In-Kind Assistance (Note 1)	Distributed to Subrecipient	Total Expended, Distributed, and In-Kind Assistance	Total Expended, Distributed, and In-Kind Assistance for the Two-Year Period
\$ 10,056,046	\$	\$	\$ 10,056,046	\$ 18,662,693
1,505,276	409,200		1,914,476	4,132,871
368,989			368,989	679,716
247,021			247,021	377,764
922,268			922,268	1,924,374
33,420			33,420	66,840
526,828			526,828	851,338
119,436			119,436	248,759
2,384,326	2,812,626		5,196,952	8,329,695
99,705			99,705	139,836
1,239,867			1,239,867	2,302,050
2,447,130	11,000		2,458,130	4,669,356
19,579			19,579	19,579
<u>\$ 19,969,891</u>	<u>\$ 3,232,826</u>	<u>\$ 0</u>	<u>\$ 23,202,717</u>	<u>\$ 42,404,871</u>
\$ 1,662,771	\$	\$	\$ 1,662,771	\$ 3,514,824
		501,888	501,888	927,213
<u>\$ 1,662,771</u>	<u>\$</u>	<u>\$ 501,888</u>	<u>\$ 2,164,659</u>	<u>\$ 4,442,037</u>
<u>\$ 21,632,662</u>	<u>\$ 3,232,826</u>	<u>\$ 501,888</u>	<u>\$ 25,367,376</u>	<u>\$ 46,846,908</u>
\$	\$	\$	\$	\$ 6,781
<u>\$ 0</u>	<u>\$ 0</u>	<u>\$ 0</u>	<u>\$ 0</u>	<u>\$ 6,781</u>
\$ 987,596	\$	\$	\$ 987,596	\$ 1,889,175
13,968,256			13,968,256	26,927,923
<u>\$ 14,955,852</u>	<u>\$ 0</u>	<u>\$ 0</u>	<u>\$ 14,955,852</u>	<u>\$ 28,817,098</u>
\$ 198,038	\$	\$	\$ 198,038	\$ 295,567
<u>\$ 198,038</u>	<u>\$ 0</u>	<u>\$ 0</u>	<u>\$ 198,038</u>	<u>\$ 295,567</u>
<u>\$ 36,786,552</u>	<u>\$ 3,232,826</u>	<u>\$ 501,888</u>	<u>\$ 40,521,266</u>	<u>\$ 75,966,354</u>

Notes to the Schedule of Expenditures of Federal Awards

Note 1 In-Kind Assistance

As part of the National Guard Cooperative Agreement, the U.S. Department of Defense also provided in-kind assistance in the form of direct federal payment for services and supplies for the military operations and maintenance projects.

Note 2 Medicare Revenue

The Grand Rapids Home for Veterans and the D.J. Jacobetti Home for Veterans received federal Medicare Program revenue totaling \$770,483 in fiscal year 2000-01 and \$660,093 in fiscal year 1999-2000. The Medicare revenue was received from Blue Cross Blue Shield. Medicare revenue is not considered federal assistance, but rather as reimbursement from Blue Cross Blue Shield for the purchase of services provided by the Homes. Therefore, Medicare revenue is not included on this schedule.

Note 3 Transfers for Capital Outlay Projects

This schedule includes the costs of military operations and maintenance projects that are administered by the Office of Facilities, Department of Management and Budget (DMB). In accordance with State accounting policy, these costs are recorded as expenditures by DMB. The Department requests and receives reimbursement from the National Guard Bureau, U.S. Department of Defense, and transfers the related revenue to a DMB federal revenue account. However, because the Department is responsible for federal compliance related to these projects, the expenditures have been recorded as directly expended by the Department on this schedule. The transfers totaled \$2,155,175 in fiscal year 2000-01 and \$989,452 in fiscal year 1999-2000.

This schedule also includes federal revenue transferred from the U.S. Department of Veterans Affairs to DMB for capital outlay projects at the D.J. Jacobetti Home for Veterans, which were administered by the Office of Facilities. The transfers totaled \$200,000 in fiscal year 2000-01 and \$21,322 in fiscal year 1999-2000.

INDEPENDENT AUDITOR'S REPORTS ON COMPLIANCE AND INTERNAL CONTROL

Independent Auditor's Report on Compliance and
on Internal Control Over Financial Reporting

January 22, 2002

Major General E. Gordon Stump, Director
Department of Military and Veterans Affairs
2500 South Washington Avenue
Lansing, Michigan

Dear General Stump:

We have audited the General Fund financial schedules of the Department of Military and Veterans Affairs for the fiscal years ended September 30, 2001 and September 30, 2000 and have issued our report thereon dated January 22, 2002. 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.

Compliance

As part of obtaining reasonable assurance about whether the Department's financial schedules are free of material misstatement, we performed tests of its compliance with certain provisions of laws, regulations, contracts, and grants, noncompliance with which could have a direct and material effect on the determination of financial schedule amounts. 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 that are required to be reported under *Government Auditing Standards*.

Internal Control Over Financial Reporting

In planning and performing our audit, we considered the Department's internal control over financial reporting in order to determine our auditing procedures for the purpose of expressing our opinion on the financial schedules and not to provide assurance on the internal control over financial reporting. However, we noted a certain matter involving the internal control over financial reporting and its operation that we consider to be a reportable condition. Reportable conditions involve matters coming to our attention relating to significant deficiencies in the design or operation of the internal control over financial reporting that, in our judgment, could adversely affect the Department's ability

to record, process, summarize, and report financial data consistent with the assertions of management in the financial schedules. The reportable condition is described in the accompanying schedule of findings and questioned costs as Finding 1.

A material weakness is a reportable condition in which the design or operation of one or more of the internal control components does not reduce to a relatively low level the risk that misstatements caused by error or fraud in amounts that would be material in relation to the financial schedules being audited may occur and not be detected within a timely period by employees in the normal course of performing their assigned functions.

Our consideration of the internal control over financial reporting would not necessarily disclose all matters in the internal control over financial reporting that might be reportable conditions and, accordingly, would not necessarily disclose all reportable conditions that are also considered to be material weaknesses. However, we believe that the reportable condition identified in the previous paragraph is not a material weakness.

This report is intended solely for the information and use of the State's management, the Legislature, federal awarding agencies, and pass-through entities and is not intended to be and should not be used by anyone other than these specified parties. However, this report is a matter of public record and its distribution is not limited.

AUDITOR GENERAL

Independent Auditor's Report on Compliance With
Requirements Applicable to Each Major Program
and on Internal Control Over Compliance in
Accordance With OMB Circular A-133

January 22, 2002

Major General E. Gordon Stump, Director
Department of Military and Veterans Affairs
2500 South Washington Avenue
Lansing, Michigan

Dear General Stump:

Compliance

We have audited the compliance of the Department of Military and Veterans Affairs with the types of compliance requirements described in the U.S. Office of Management and Budget (OMB) Circular A-133 Compliance Supplement that are applicable to each major federal program for the fiscal years ended September 30, 2001 and September 30, 2000. The Department's major federal programs are identified in the summary of auditor's results section of the accompanying schedule of findings and questioned costs. Compliance with the requirements of laws, regulations, contracts, and grants applicable to each major federal program is the responsibility of the Department's management. Our responsibility is to express an opinion on the Department's compliance based on our audit.

We conducted our audit of compliance in accordance with auditing standards generally accepted in the United States of America; the standards applicable to financial audits contained in *Government Auditing Standards* issued by the Comptroller General of the United States; and OMB Circular A-133, *Audits of States, Local Governments, and Non-Profit Organizations*. Those standards and OMB Circular A-133 require that we plan and perform the audit to obtain reasonable assurance about whether noncompliance with the types of compliance requirements referred to in the previous paragraph that could have a direct and material effect on a major federal program occurred. An audit includes examining, on a test basis, evidence about the Department's compliance with those requirements and performing such other procedures as we considered necessary in the circumstances. We believe that our audit provides a reasonable basis for our opinion. Our audit does not provide a legal determination of the Department's compliance with those requirements.

In our opinion, the Department of Military and Veterans Affairs complied, in all material respects, with the requirements referred to in the second previous paragraph that are applicable to each major federal program for the fiscal years ended September 30, 2001 and September 30, 2000.

Internal Control Over Compliance

The management of the Department is responsible for establishing and maintaining effective internal control over compliance with the requirements of laws, regulations, contracts, and grants applicable to federal programs. In planning and performing our audit, we considered the Department's internal control over compliance with requirements that could have a direct and material effect on a major federal program in order to determine our auditing procedures for the purpose of expressing our opinion on compliance and to test and report on the internal control over compliance in accordance with OMB Circular A-133.

Our consideration of the internal control over compliance would not necessarily disclose all matters in the internal control that might be material weaknesses. A material weakness is a reportable condition in which the design or operation of one or more of the internal control components does not reduce to a relatively low level the risk that noncompliance with applicable requirements of laws, regulations, contracts, and grants that would be material in relation to a major federal program being audited may occur and not be detected within a timely period by employees in the normal course of performing their assigned functions. We noted no matters involving the internal control over compliance and its operation that we consider to be material weaknesses.

This report is intended solely for the information and use of the State's management, the Legislature, federal awarding agencies, and pass-through entities and is not intended to be and should not be used by anyone other than these specified parties. However, this report is a matter of public record and its distribution is not limited.

AUDITOR GENERAL

SCHEDULE OF FINDINGS AND QUESTIONED COSTS*

Section I: Summary of Auditor's Results

Financial Schedules

Type of auditor's report issued: Unqualified*

Internal control* over financial reporting:

Material weaknesses* identified? No

Reportable condition* identified that is not considered to be a material weakness? Yes

Noncompliance material to the financial schedules? No

Federal Awards

Internal control over major programs:

Material weaknesses identified? No

Reportable conditions identified that are not considered to be material weaknesses? None reported

Type of auditor's report issued on compliance for major programs: Unqualified

Any audit findings disclosed that are required to be reported in accordance with U.S. Office of Management and Budget (OMB) Circular A-133, Section 510(a)? No

* See glossary at end of report for definition.

Identification of major programs:

<u>CFDA Number</u>	<u>Name of Federal Program</u>
12.401	National Guard Military Operations and Maintenance Projects
12.404	National Guard Civilian Youth Opportunities
64.014	Veterans State Domiciliary Care
64.015	Veterans State Nursing Home Care

Dollar threshold used to distinguish between type A and type B programs: \$2,278,991

Auditee qualified as a low-risk auditee*? No

Section II: Findings Related to the Financial Schedules

FINDING (510201)

1. Internal Auditor Independence

The Department's internal auditor was not organizationally independent.

Section 18.1486(2) of the *Michigan Compiled Laws* requires each department's internal auditor to report to and be under the general supervision of the department head.

The Department's internal auditor was under the supervision of the deputy director of the Veterans Affairs Directorate, whose responsibilities include oversight of the Michigan Veterans' Trust Fund and the Grand Rapids Home for Veterans and the D.J. Jacobetti Home for Veterans. This is considered a weakness in the Department's internal control because it impairs the internal auditor's independence with respect to audits of the Fund and the Homes for Veterans.

* See glossary at end of report for definition.

The Department provided us with a letter affirming the independence of the internal auditor. However, to avoid any future independence impairments, the internal auditor should be assigned to the Department director.

RECOMMENDATION

We recommend that the Department provide for organizational independence of the internal auditor.

The status of the findings related to the financial schedules that were reported in prior Single Audits is disclosed in the summary schedule of prior audit findings.

Section III: Findings and Questioned Costs Related to Federal Awards

We did not report any findings related to federal awards.

The status of the findings related to federal awards that were reported in prior Single Audits is disclosed in the summary schedule of prior audit findings.

OTHER SCHEDULES

DEPARTMENT OF MILITARY AND VETERANS AFFAIRS
Summary Schedule of Prior Audit Findings
As of September 30, 2001

PRIOR AUDIT FINDINGS RELATED TO THE FINANCIAL SCHEDULES

Audit Findings That Have Been Fully Corrected:

Audit Period: October 1, 1997 through September 30, 1999
Finding Number: 510001
Finding Title: Schedule of Expenditures of Federal Awards (SEFA)
Comments: See Finding 510002 with the findings related to federal awards.

PRIOR AUDIT FINDINGS RELATED TO FEDERAL AWARDS

Audit Findings That Have Been Fully Corrected:

Audit Period: October 1, 1997 through September 30, 1999
Finding Number: 510002
Finding Title: Schedule of Expenditures of Federal Awards (SEFA)
Finding: The Department did not have internal control procedures to reconcile program expenditures reported on its SEFA with expenditure amounts reported in the Michigan Administrative Information Network (MAIN).
Comments: The Department has revised year-end closing procedures to ensure that federal program expenditures which are reported in its SEFA are properly reconciled with MAIN.

DEPARTMENT OF MILITARY AND VETERANS AFFAIRS
Corrective Action Plan
As of April 15, 2002

FINDINGS RELATED TO THE FINANCIAL SCHEDULES

Finding Number: 510201
Finding Title: Internal Auditor Independence
Management Views: The Department agrees with the Office of the Auditor General's interpretation of the statute and the resultant finding.
Corrective Action: The internal auditor will report to the Department director.
Anticipated Completion Date: April 2002
Responsible Individual: Joel Wortley, Chief Financial Officer, Office of Financial Services

FINDINGS RELATED TO FEDERAL AWARDS

There were no findings related to federal awards for fiscal years 1999-2000 and 2000-01.

Glossary of Acronyms and Terms

<i>CFDA</i>	<i>Catalog of Federal Domestic Assistance.</i>
DMB	Department of Management and Budget.
financial audit	An audit that is designed to provide reasonable assurance about whether the financial schedules and/or financial statements of an audited entity are fairly presented in conformity with the disclosed basis of accounting.
internal control	A process, effected by management, designed to provide reasonable assurance regarding the reliability of financial reporting, effectiveness and efficiency of operations, and compliance with applicable laws and regulations.
low-risk auditee	As provided for in OMB Circular A-133, an auditee that may qualify for reduced federal audit coverage if it receives an annual Single Audit and it meets other criteria related to prior audit results. In accordance with State statute, this Single Audit was conducted on a biennial basis; consequently, this auditee is not considered a low-risk auditee.
MAIN	Michigan Administrative Information Network.
material misstatement	A misstatement in the financial schedules and/or financial statements that causes the schedules and/or statements to not present fairly the financial position or the results of operations or cash flows in conformity with the disclosed basis of accounting.
material noncompliance	Violations of laws and regulations that could have a direct and material effect on major federal programs or on financial schedule amounts.
material weakness	A reportable condition related to the design or operation of internal control that does not reduce to a relatively low level

the risk that either misstatements caused by error or fraud in amounts that would be material in relation to the financial schedules and/or financial statements or noncompliance with applicable requirements of laws, regulations, contracts, and grants that would be material in relation to a major federal program being audited may occur and not be detected within a timely period by employees in the normal course of performing their assigned functions.

OMB

U.S. Office of Management and Budget.

questioned cost

A cost that is questioned by the auditor because of an audit finding: (1) which resulted from a violation or possible violation of a provision of a law, regulation, contract, grant, cooperative agreement, or other agreement or document governing the use of federal funds, including funds used to match federal funds; (2) where the costs, at the time of the audit, are not supported by adequate documentation; or (3) where the costs incurred appear unreasonable and do not reflect the actions a prudent person would take in the circumstances.

reportable condition

A matter coming to the auditor's attention relating to a deficiency in the design or operation of internal control that, in the auditor's judgment, could adversely affect the entity's ability to (1) record, process, summarize, and report financial data consistent with the assertions of management in the financial schedules and/or financial statements or (2) administer a major federal program in accordance with the applicable requirements of laws, regulations, contracts, and grants.

SEFA

schedule of expenditures of federal awards.

Single Audit

A financial audit, performed in accordance with the Single Audit Act Amendments of 1996, that is designed to meet the needs of all federal grantor agencies and other financial report users. In addition to performing the audit in

accordance with the requirements of 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, a Single Audit requires the assessment of compliance with requirements that could have a direct and material effect on a major federal program and the consideration of internal control over compliance in accordance with OMB Circular A-133.

SOMCAFR

State of Michigan Comprehensive Annual Financial Report.

subrecipient

A nonfederal entity that expends federal awards received from another nonfederal entity to carry out a federal program.

unqualified opinion

An auditor's opinion in which the auditor states that:

- a. The financial schedules and/or financial statements presenting the basic financial information of the audited agency are fairly presented in conformity with the disclosed basis of accounting; or
- b. The financial schedules and/or financial statements presenting supplemental financial information are fairly stated in relation to the basic financial schedules and/or financial statements. In issuing an "in relation to" opinion, the auditor has applied auditing procedures to the supplemental financial schedules to the extent necessary to form an opinion on the basic financial schedules and/or financial statements, but did not apply auditing procedures to the extent that would be necessary to express an opinion on the supplemental financial schedules taken by themselves; or
- c. The audited agency complied, in all material respects, with the cited requirements that are applicable to each major federal program.