MICHIGAN

OFFICE OF THE AUDITOR GENERAL

AUDIT REPORT

FINANCIAL AUDIT
INCLUDING THE PROVISIONS OF THE SINGLE AUDIT ACT
OF THE

DEPARTMENT OF ATTORNEY GENERAL

October 1, 2002 through September 30, 2004

THOMAS H. MCTAVISH, C.P.A.
AUDITOR GENERAL

11-100-05

"...The auditor general shall conduct post audits of financial transactions and accounts of the state and of all branches, departments, offices, boards, commissions, agencies, authorities and institutions of the state established by this constitution or by law, and performance post audits thereof."

– Article IV, Section 53 of the Michigan Constitution

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Michigan

Office of the Auditor General

REPORT SUMMARY

Financial Audit

Including the Provisions of the Single Audit Act

Report Number:
11-100-05

Department of Attorney General

October 1, 2002 through September 30, 2004

Released:
June 2005

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 of Attorney General's financial schedules.

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Internal Control Over Financial Reporting

We identified reportable conditions related to internal control over financial reporting (Findings 1 and 2). We consider Finding 1 to be a material weakness.

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Noncompliance or Other Matters Material to the Financial Schedules

We identified an instance of noncompliance or other matters applicable to the financial schedules that is required to be reported under *Government Auditing Standards* (Finding 1).

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Federal Awards:

Auditor's Reports Issued on Compliance

We audited 2 programs as major programs and issued 2 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 identify any material weaknesses in internal control over major programs. However, we did identify reportable conditions (Findings 4 and 5).

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Required Reporting of Noncompliance

We identified instances of noncompliance that are required to be reported in accordance with U.S. Office of Management and Budget (OMB) Circular A-133 (Findings 4 and 5).

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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 related to the biennial internal control evaluation (Finding 3).

~ ~ ~ ~ ~ ~ ~ ~ ~ ~

We audited the following programs as major programs:

CFDA Number	***Program Title***	***Compliance Opinion***
93.563	Child Support Enforcement	Unqualified
93.775	State Medicaid Fraud Control Units	Unqualified

A copy of the full report can be obtained by calling 517.334.8050 or by visiting our Web site at: http://audgen.michigan.gov

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Thomas H. McTavish, C.P.A.
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THOMAS H. MCTAVISH, C.P.A.
AUDITOR GENERAL

June 30, 2005

The Honorable Mike Cox
Attorney General
G. Mennen Williams Building
Lansing, Michigan

Dear Mr. Cox:

This is our report on the financial audit, including the provisions of the Single Audit Act, of the Department of Attorney General for the period October 1, 2002 through September 30, 2004.

This report contains our report summary; our independent auditor's report on the financial schedules; and the Department of Attorney General financial schedules, notes to the financial schedules, and a supplemental financial schedule. This report also contains our independent auditor's report on internal control over financial reporting and on compliance and other matters, our independent auditor's report 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 corrective action plan and a glossary of acronyms and terms.

Our findings and recommendations are contained in Section II and Section III of the schedule of findings and questioned costs. The agency preliminary responses are 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 AND FINANCIAL SCHEDULES

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THOMAS H. MCTAVISH, C.P.A.
AUDITOR GENERAL

Independent Auditor's Report on the Financial Schedules

The Honorable Mike Cox
Attorney General
G. Mennen Williams Building
Lansing, Michigan

Dear Mr. Cox:

We have audited the financial schedules of the Department of Attorney General for the fiscal years ended September 30, 2004 and September 30, 2003, as identified in the table of contents. 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.

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 1, the financial schedules present only the revenues and the sources and disposition of authorizations for the Department of Attorney General's General Fund accounts, presented using the current financial resources measurement focus and the modified accrual basis of accounting. Accordingly, these financial schedules do not purport to, and do not, constitute a complete financial presentation of either the Department or the State's General Fund in conformity 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 revenues and the sources and disposition of authorizations of the Department of Attorney General for the fiscal years ended September 30, 2004 and September 30, 2003 on the basis of accounting described in Note 1.

In accordance with *Government Auditing Standards*, we have also issued a report dated March 25, 2005 on our consideration of the Department's internal control over financial reporting and on our tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements and other matters. The purpose of that report is to describe the scope of our testing of the internal control over financial reporting and compliance and the results of that testing and not to provide an opinion on the internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* and should be considered in assessing the results of our audit.

The 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*, is presented for purposes of additional analysis and is 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

March 25, 2005

DEPARTMENT OF ATTORNEY GENERAL

Schedule of General Fund Revenues

Fiscal Years Ended September 30

	2004	2003
REVENUES (Note 3)		
From federal agencies	$ 4,601,861	$ 3,561,127
From services	7,886,241	7,955,084
From licenses and permits	1,557,869	1,550,169
Miscellaneous:		
Tobacco settlement proceeds	3,036,397	10,300,013
Court settlements	2,418,520	2,699,194
Court fines, fees, and assessments	1,240,798	702,586
Forfeitures and seizures	586,797	87,660
Other	2,279,840	1,119,730
Total Revenues	$ 23,608,323	$ 27,975,563

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

DEPARTMENT OF ATTORNEY GENERAL
Schedule of Sources and Disposition of General Fund Authorizations
Fiscal Years Ended September 30

	2004	2003
SOURCES OF AUTHORIZATIONS (Note 2)		
General purpose appropriations	$ 30,259,900	$ 32,363,383
Balances carried forward	4,042,322	764,370
Restricted financing sources (Note 3a)	24,203,273	22,404,136
Less: Intrafund expenditure reimbursements	(6,926,177)	(6,624,170)
Total	$ 51,579,318	$ 48,907,719
DISPOSITION OF AUTHORIZATIONS (Note 2)		
Gross expenditures (Note 3a)	$ 50,405,896	$ 50,629,193
Less: Intrafund expenditure reimbursements (Note 3d)	(6,926,177)	(6,624,170)
Net expenditures	$ 43,479,719	$ 44,005,023
Balances carried forward:		
Encumbrances	$ 2,293,675	$ 2,062,160
Restricted revenues - not authorized	3,443,296	1,980,162
Total balances carried forward	$ 5,736,971	$ 4,042,322
Balances lapsed (Note 3a)	$ 2,362,629	$ 860,374
Total	$ 51,579,318	$ 48,907,719

The accompanying notes are an integral part of 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 Attorney General for the fiscal years ended September 30, 2004 and September 30, 2003. 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)*. The Department's financial transactions recorded in the Tobacco Settlement Trust Fund and the Utility Consumer Representation Fund are not presented in these financial schedules, but are accounted for separately in those Funds' financial statements, which are also presented in the *SOMCAFR*.

The notes accompanying these financial schedules relate directly to the Department of Attorney General. The *SOMCAFR* provides more extensive disclosures regarding the State's significant accounting policies; budgeting, budgetary control, and legal compliance; and pension benefits and other postemployment benefits.

b. Measurement Focus, Basis of Accounting, and Presentation

The financial schedules contained in this report are presented using the current financial resources measurement focus and the modified accrual basis of accounting, as provided by generally accepted accounting principles applicable to governments. Under the modified accrual basis of accounting, revenues are recognized as they become susceptible to accrual, generally when they are both measurable and available. Revenues are considered available when they are collected within the current period or soon enough thereafter to pay liabilities of the current period. Expenditures generally are recorded when a liability is incurred; however, certain expenditures related to long-term obligations are recorded only when payment is due and payable.

The accompanying financial schedules present only the revenues and the sources and disposition of authorizations of the Department of Attorney General's General Fund accounts. Accordingly, these financial schedules do not purport to, and do not, constitute a complete financial presentation of either the Department or the State's General Fund in conformity with generally accepted accounting principles.

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 revenues.

b. Restricted financing sources: Collections of restricted revenues, 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 revenues - authorized or restricted revenues - not authorized.

c. Intrafund expenditure reimbursements: Funding from other General Fund departments to finance a program or a portion of a program that is the responsibility of the receiving department.

d. Encumbrances: Authorizations carried forward to finance payments for goods or 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.

e. Restricted revenues - not authorized: Revenues that, by statute, are restricted for use to a particular program or activity. Generally, the expenditure of the restricted revenues is subject to annual legislative

appropriation. Restricted revenues - not authorized balances include $2,585,685 and $433,934 in fiscal years 2003-04 and 2002-03, respectively, collected by the Medicaid Fraud Control Unit. Also, balances totaling $201,840 and $570,316 in fiscal years 2003-04 and 2002-03, respectively, relate to antitrust enforcement settlement collections that are subject to appropriation by the Legislature for the Department of Community Health.

f. 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.

Note 3 Differences in Reporting From the *SOMCAFR*

Department of Management and Budget (DMB) Administrative Guide procedure 1210.09 prohibits State agencies from issuing financial information inconsistent with the *SOMCAFR* unless they have received a waiver to do so from the DMB Office of Financial Management. The Office of Financial Management issued the following waivers to the Department to present corrected financial schedules:

a. In fiscal year 2003-04, the Office of Financial Management changed its method of computing and recording accrued payroll and fringe benefit expenditures. In the *SOMCAFR,* the expenditures are not reported at the agency level; instead, they are presented at the Statewide level. Reporting these transactions at the department level resulted in an increase of $281,056 in expenditures, a decrease of $242,523 in balances lapsed, and an increase of $38,533 in restricted financing sources on the schedule of sources and disposition of General Fund authorizations.

b. In fiscal year 2002-03, miscellaneous revenue is increased by $2.7 million on the schedule of General Fund revenues for a new tobacco settlement agreement that was not part of the master settlement agreement (the tobacco settlement agreement with Philip Morris, et al.). The Office of Financial Management attributed this new settlement to the master settlement agreement and revenues were recorded in the Michigan Merit Award Trust Fund and the Tobacco Settlement Trust Fund. However, these revenues should have been recorded in the General Fund.

c. In fiscal year 2003-04, federal revenue is decreased by $502,065 on the schedule of General Fund revenues to correct an error in establishing a federal account receivable.

d. The financial schedules are corrected to reflect the appropriate accounting treatment for transactions with other State agencies for reimbursements for legal services provided and the Department's status as a subrecipient of other State agencies for federal programs. The impact of these adjustments in fiscal year 2003-04 is an increase to federal revenue of $1.7 million, an increase to service revenue of $4.9 million, a decrease to license and permit revenue of $173,000, a decrease to miscellaneous revenue of $391,000, and a decrease to interfund transfers of $2.6 million on the schedule of General Fund revenues and a decrease of $3.5 million to intrafund expenditure reimbursements on the schedule of sources and disposition of General Fund authorizations. The impact of these adjustments in fiscal year 2002-03 is an increase to federal revenue of $475,000, an increase to service revenue of $7.3 million, a decrease to license and permit revenue of $149,000, a decrease to miscellaneous revenue of $295,000, and a decrease to interfund transfers of $4.5 million on the schedule of General Fund revenues and a decrease of $2.8 million to intrafund expenditure reimbursements on the schedule of sources and dispositions of General Fund authorizations.

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SUPPLEMENTAL
FINANCIAL SCHEDULE

DEPARTMENT OF ATTORNEY GENERAL
Schedule of Expenditures of Federal Awards (1)
For the Period October 1, 2002 through September 30, 2004

Federal Agency/Program	*CFDA* (2) Number	Pass-Through Identification Number	For the Fiscal Year Ended September 30, 2003 Directly Expended	Distributed to Subrecipient	Total Expended and Distributed
U.S. Department of Justice					
Direct Program:					
Community Prosecution and Project Safe Neighborhoods	16.609		$ 40,000	$	$ 40,000
Pass-Through Program:					
Michigan Department of Community Health					
Byrne Formula Grant Program	16.579	70857-4K02	462,824		462,824
Total U.S. Department of Justice			**$ 502,824**	**$ 0**	**$ 502,824**
U.S. Department of Health and Human Services					
Direct Program:					
State Medicaid Fraud Control Units	93.775		$ 2,745,555	$	$ 2,745,555
Pass-Through Program:					
Michigan Department of Human Services					
Child Support Enforcement	93.563	03-IA-43	317,140		317,140
Total U.S. Department of Health and Human Services			**$ 3,062,695**	**$ 0**	**$ 3,062,695**
Total Expenditures of Federal Awards			$ 3,565,519	$ 0	$ 3,565,519

(1) Basis of Presentation: This schedule includes the federal grant activity of the Department of Attorney General and is presented on the modified accrual basis of accounting. The information in this schedule is presented in accordance with 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.

(2) *CFDA* is defined as *Catalog of Federal Domestic Assistance.*

For the Fiscal Year Ended September 30, 2004				
Pass-Through Identification Number	Directly Expended	Distributed to Subrecipient	Total Expended and Distributed	Total Expended and Distributed for the Two-Year Period
	$ 40,000	$	$ 40,000	$ 80,000
9XDBVX0026	122,246		122,246	585,070
	$ 162,246	**$ 0**	**$ 162,246**	**$ 665,070**
	$ 2,554,096	$	$ 2,554,096	$ 5,299,651
04-IA-43	1,840,767		1,840,767	2,157,907
	$ 4,394,863	**$ 0**	**$ 4,394,863**	**$ 7,457,558**
	$ 4,557,109	$ 0	$ 4,557,109	$ 8,122,628

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INDEPENDENT AUDITOR'S REPORTS ON INTERNAL CONTROL AND COMPLIANCE

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THOMAS H. MCTAVISH, C.P.A.
AUDITOR GENERAL

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

The Honorable Mike Cox
Attorney General
G. Mennen Williams Building
Lansing, Michigan

Dear Mr. Cox:

We have audited the financial schedules of the Department of Attorney General for the fiscal years ended September 30, 2004 and September 30, 2003, as identified in the table of contents, and have issued our report thereon dated March 25, 2005. 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.

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 an opinion on the internal control over financial reporting. However, we noted certain matters involving the internal control over financial reporting and its operation that we consider to be reportable conditions. 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 initiate, record, process, and report financial data consistent with the assertions of management in the financial schedules. The reportable conditions are described in the accompanying schedule of findings and questioned costs as Findings 1 and 2.

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 that might be reportable conditions and, accordingly, would not necessarily disclose all reportable conditions that are also considered to be material weaknesses. However, of the reportable conditions identified in the previous paragraph, we consider Finding 1 to be a material weakness.

Compliance and Other Matters

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 grant agreements, 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 an instance of noncompliance or other matters that is required to be reported under *Government Auditing Standards* and which is described in the accompanying schedule of findings and questioned costs as Finding 1.

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

March 25, 2005

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THOMAS H. MCTAVISH, C.P.A.
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

The Honorable Mike Cox
Attorney General
G. Mennen Williams Building
Lansing, Michigan

Dear Mr. Cox:

Compliance

We have audited the compliance of the Department of Attorney General 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 two-year period ended September 30, 2004. 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 Attorney General complied, in all material respects, with the requirements referred to in the first paragraph that are applicable to each major federal program for the two-year period ended September 30, 2004. However, the results of our

auditing procedures disclosed instances of noncompliance with those requirements, which are required to be reported in accordance with OMB Circular A-133 and which are described in the accompanying schedule of findings and questioned costs as Findings 4 and 5.

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.

We noted certain matters involving the internal control over compliance and its operation that we consider to be reportable conditions. Reportable conditions involve matters coming to our attention relating to significant deficiencies in the design or operation of the internal control over compliance that, in our judgment, could adversely affect the Department's ability to administer a major federal program in accordance with the applicable requirements of laws, regulations, contracts, and grants. The reportable conditions are described in the accompanying schedule of findings and questioned costs as Findings 4 and 5.

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 the applicable requirements of laws, regulations, contracts, and grants caused by error or fraud 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. Our consideration of the internal control over compliance would not necessarily disclose all matters in the internal control 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 neither of the reportable conditions identified in the previous paragraph is 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

March 25, 2005

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 weakness* identified?	Yes
Reportable condition* identified that is not considered to be a material weakness?	Yes
Noncompliance or other matters material to the financial schedules?	Yes

Federal Awards

Internal control over major programs:	
Material weaknesses identified?	No
Reportable conditions identified that are not considered to be material weaknesses?	Yes
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)?	Yes

Identification of major programs:

CFDA Number	Name of Federal Program
93.563	Child Support Enforcement
93.775	State Medicaid Fraud Control Units

Dollar threshold used to distinguish between type A and type B programs:	$300,000
Auditee qualified as a low-risk auditee*?	No

** See glossary at end of report for definition.*

Section II: Findings Related to the Financial Schedules

FINDING (110501)

1. Internal Control Over Financial Reporting and Accounting

The Department of Attorney General had not established a process to record reimbursements for services it provided to other State agencies that ensured compliance with State accounting policy and with generally accepted accounting principles (GAAP). We consider this to be a material internal control weakness and material noncompliance with Section 18.1485 of the *Michigan Compiled Laws*.

As a result, for fiscal years 2003-04 and 2002-03, the Department incorrectly recorded in the State's accounting system expenditure credits totaling $1,831,443 and $2,336,651 and interfund transfers totaling $2,552,122 and $4,537,302 when it should have recorded revenue totaling $4,383,565 and $6,873,953, respectively.

The Department provided services to other State agencies. The other State agencies reimbursed the Department for the cost of these services from the State's General Fund (intrafund transactions) and from other governmental funds (interfund transactions). Department of Management and Budget (DMB) Financial Management Guide (FMG) Chapter 16 and GAAP provide guidance on the appropriate revenue and expenditure recognition for interagency reimbursements. For intrafund reimbursement for services provided, an agency receiving payment for services should record an expenditure credit. For interfund reimbursement for services provided, an agency receiving payment for services should record revenue.

Our review of the Department's methods of recording these interagency transactions in the State's accounting system disclosed:

a. The Department recorded expenditure credits totaling $2,396,051 and $2,780,794 for fiscal years 2003-04 and 2002-03, respectively, for services it provided that were reimbursed from other State governmental funds. The Department should have recorded revenue for these interfund reimbursements.

b. The Department recorded interfund transfers totaling $2,552,123 and $4,537,302 for fiscal years 2003-04 and 2002-03, respectively, for services it

provided that were reimbursed from other State governmental funds. The Department should have recorded revenue for these interfund reimbursements.

c. The Department recorded revenue totaling $564,609 and $444,143 for fiscal years 2003-04 and 2002-03, respectively, for services it provided to other General Fund departments and agencies. The Department should have recorded expenditure credits for these intrafund reimbursements.

On March 30, 2005, the Department received approval from the DMB Office of Financial Management to present corrected financial schedules. The impact of this approval is that the financial schedules are correctly presented in this report for the Department but differ from the *State of Michigan Comprehensive Annual Financial Report (SOMCAFR)*.

RECOMMENDATION

We recommend that the Department establish a process to record reimbursements for services it provides to other State agencies that ensures compliance with State accounting policy and with GAAP.

FINDING (110502)

2. Federal Funds Passed Between State Agencies

The Department had not established a process to ensure compliance with State accounting policy for recording transactions involving federal funds passed between State agencies.

As a result, the Department incorrectly recorded net expenditure credits of $1,713,230 and $500,566 in fiscal years 2003-04 and 2002-03, respectively, when it should have recorded federal revenue.

FMG Chapter 16 provides guidance to agencies regarding determining the appropriate designation of the agency receiving federal funds from another State agency as either a subrecipient* or a vendor. Payments to subrecipients should be recorded as a revenue reduction by the paying agency and as federal revenue by

** See glossary at end of report for definition.*

the receiving agency. Payments to vendors should be recorded as both an expenditure and federal revenue by the paying agency and an expenditure credit by the receiving agency. This accounting treatment is used to avoid the double reporting of federal revenue within the General Fund.

OMB Circular A-133 states that the characteristics indicative of a subrecipient include having the responsibility for determining the eligibility of those who are to receive the federal assistance or for making programmatic decisions. Vendors provide goods or services ancillary to the operation of the federal program.

Our review of the Department's agreements and relationships with other State agencies and its method of recording the receipt of federal funds from other State agencies disclosed:

a. Although the Department was a subrecipient for two federal programs, it recorded expenditure credits from the Department of Human Services (DHS) totaling $1,853,954 and $317,140 and from the Department of Community Health (DCH) totaling $128,465 and $461,601 for fiscal years 2003-04 and 2002-03, respectively. As a subrecipient, the Department should have recorded federal revenue.

   The Department informed us that it recorded expenditure credits for one of the federal programs because it believed it was a vendor, not a subrecipient. However, because the Department determined eligibility, made programmatic decisions, and was designated as a subrecipient in its agreement with DHS, the Department should have recorded revenue. In addition, the Department was initially not sure of its designation regarding the second federal program. The Department subsequently informed us that it had contacted DCH and agreed that it should have recorded revenue because it was a subrecipient for the program.

b. Although the Department was a vendor to DCH for a third federal program, it recorded federal revenue totaling $269,189 and $278,175 for fiscal years 2003-04 and 2002-03, respectively. As a vendor, the Department should have recorded expenditure credits.

On March 30, 2005, the Department received approval from the DMB Office of Financial Management to present corrected financial schedules. The impact of this approval is that the financial schedules are correctly presented in this report for the Department but differ from the *SOMCAFR*.

RECOMMENDATION

We recommend that the Department establish a process to ensure compliance with State accounting policy for recording transactions involving federal funds passed between State agencies.

FINDING (110503)

3. Biennial Internal Control Evaluation

The Department did not evaluate its internal control as required by Section 18.1485 of the *Michigan Compiled Laws* and DMB Administrative Guide procedure 1270.01.

As a result, the Department increased its risk of noncompliance, fraud, and/or abuse. Also, conducting such an internal control evaluation may have provided earlier identification of the material internal control weakness related to financial reporting and accounting described in Finding 1.

Section 18.1485 of the *Michigan Compiled Laws* and DMB Administrative Guide procedure 1270.01 require State departments to establish internal accounting and administrative control systems. Departments are to perform periodic evaluations to maintain ongoing assurances about the continued effectiveness of internal control and to identify the need for changes. Departments are to report the results of such evaluations on May 1 of each odd number year based on evaluations of the systems as of October 1 of the preceding year.

The Department informed us that because of staff turnover it had not performed the biennial internal control evaluation required for the period ended September 30, 2002. In lieu of performing the evaluation, the Department relied on assurances from a prior employee that there had not been any changes in internal control and subsequently reported such information to DMB.

RECOMMENDATION

We recommend that the Department evaluate its internal control as required by Section 18.1485 of the *Michigan Compiled Laws* and DMB Administrative Guide procedure 1270.01.

Section III: Findings and Questioned Costs* Related to Federal Awards

FINDING (110504)

4. Child Support Enforcement, *CFDA* 93.563

U.S. Department of Health and Human Services	*CFDA* 93.563: Child Support Enforcement
Award Number: 04-IA-43	Award Period: 10/01/2003 - 09/30/2004
Pass-Through Agency: Michigan Department of Human Services	Questioned Costs: $13,186

The Department did not maintain documentation to support some of the costs of its Child Support Enforcement Program. As a result, the federal grantor agency could disallow $13,186 in Program expenditures.

The Department is a subrecipient of DHS for the Child Support Enforcement Program. For fiscal year 2003-04, the Department reported Program expenditures to DHS totaling $1,853,953 but documented only $1,840,767 in Program expenditures, resulting in an overbilling of $13,186.

OMB Circular A-87, *Cost Principles for State, Local, and Indian Tribal Governments,* requires costs to be adequately documented to be allowable for federal reimbursement.

RECOMMENDATION

We recommend that the Department maintain documentation to support the costs of its federal programs.

** See glossary at end of report for definition.*

FINDING (110505)

5. State Medicaid Fraud Control Units, *CFDA* 93.775

U.S. Department of Health and Human Services	*CFDA* 93.775: State Medicaid Fraud Control Units
Award Number: 01-0301-MI-5050 01-0401-MI-5050	Award Period: 10/01/2002 - 09/30/2003 10/01/2003 - 09/30/2004
	Questioned Costs: $44,012

The Department used a direct cost method to charge terminal leave payments to the State Medicaid Fraud Control Units Program without obtaining prior approval of the method from the cognizant federal agency.

As a result, the federal grantor agency could disallow Program expenditures of $44,012 for these payments. The Department directly charged terminal leave payments totaling $16,053 and $27,959 for fiscal years 2003-04 and 2002-03, respectively, to the Program.

OMB Circular A-87 requires that, when an employee retires or terminates, payments for unused leave be allocated as a general administrative expense rather than charged as a direct expenditure to the program unless the cognizant federal agency grants prior approval for the use of the direct cost method.

RECOMMENDATION

We recommend that the Department obtain prior approval from the cognizant federal agency before using the direct cost method to charge terminal leave payments to federal programs.

OTHER SCHEDULES

DEPARTMENT OF ATTORNEY GENERAL

Summary Schedule of Prior Audit Findings

As of September 30, 2004

There were no findings in the prior Department of Attorney General Single Audit.

DEPARTMENT OF ATTORNEY GENERAL

Corrective Action Plan

As of April 15, 2005

FINDINGS RELATED TO THE FINANCIAL SCHEDULES

Finding Number:	110501
Finding Title:	Internal Control Over Financial Reporting and Accounting
Management Views:	The Department of Attorney General agrees with the recommendation. We also recognize that these are only financial reporting classifications errors and have no impact on the total funding of the Department.
Corrective Action:	We have substantially reviewed and obtained clarification from the Office of Financial Management regarding Department of Management and Budget (DMB) Financial Management Guide (FMG) Chapter 16. Based on this review and the substance of our client-agency relationships, we will provide the paying agency the correct transaction coding on our fiscal year 2004-05 second quarter billings. We will provide guidance regarding correcting the first quarter payments we received with the wrong coding. We have also strengthened our internal control by enhancing our monitoring process to include verification that the client-agency used the proper accounting treatment.
Anticipated Completion Date:	April 15, 2005
Responsible Individual:	James Selleck, Director of the Office of Fiscal Management

Finding Number: 110502
Finding Title: Federal Funds Passed Between State Agencies

Management Views: The Department of Attorney General agrees in part with the recommendation. We disagree that the recording of expenditure credits with regard to the Department of Human Services (DHS) was incorrect because the Department's relationship with DHS has always been a vendor relationship instead of the reported subrecipient relationship.

Corrective Action: We have substantially reviewed and obtained clarification from the Office of Financial Management regarding FMG Chapter 16. Based on this review and the substance of our client-agency relationships, we will provide the paying agency the correct transaction coding on our fiscal year 2004-05 second quarter billings. We will provide guidance regarding correcting the first quarter billings. We have also strengthened our internal control by enhancing our monitoring process to include verification that the client-agency used the proper accounting treatment.

Anticipated Completion Date: April 15, 2005

Responsible Individual: James Selleck, Director of the Office of Fiscal Management

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Finding Number: 110503
Finding Title: Biennial Internal Control Evaluation

Management Views: The Department of Attorney General agrees with the recommendation. The current administration realizes how important the biennial internal control evaluation is and, therefore, the evaluation covering the current

administration's term (fiscal year 2002-03 and fiscal year 2003-04) will be completed by May 1, 2005.

Corrective Action: The biennial internal control evaluation for fiscal years 2002-03 and 2003-04 is on schedule to be completed by May 1, 2005.

Anticipated Completion Date: May 1, 2005

Responsible Individual: James Selleck, Director of the Office of Fiscal Management

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FINDINGS RELATED TO FEDERAL AWARDS

Finding Number: 110504
Finding Title: Child Support Enforcement, *CFDA* 93.563

Management Views: The Department of Attorney General agrees with the recommendation.

Corrective Action: We reduced our fiscal year 2004-05 first quarter reimbursement amount requested from DHS to reflect the prior year overpayment for our Child Support Enforcement services.

Anticipated Completion Date: April 15, 2005

Responsible Individual: James Selleck, Director of the Office of Fiscal Management

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Finding Number: 110505
Finding Title: State Medicaid Fraud Control Units, *CFDA* 93.775

Management Views:	The Department of Attorney General agrees with the recommendation.
Corrective Action:	We reduced our fiscal year 2004-05 second quarter federal reimbursement amount to reflect the total prior years' overpayments.
Anticipated Completion Date:	April 15, 2005
Responsible Individual:	James Selleck, Director of the Office of Fiscal Management

GLOSSARY

Glossary of Acronyms and Terms

CFDA	*Catalog of Federal Domestic Assistance.*
DCH	Department of Community Health.
DHS	Department of Human Services.
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.
FMG	Financial Management Guide.
GAAP	generally accepted accounting principles.
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.
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 changes in

financial position 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 and/or financial statement 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 significant deficiency in the design or operation of internal control that, in the auditor's judgment, could adversely affect the entity's ability to (1) initiate, record, process, 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.

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 State 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.

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STATE OF MICHIGAN

OFFICE of the AUDITOR GENERAL