



# MICHIGAN

OFFICE OF THE AUDITOR GENERAL

## AUDIT REPORT



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

“...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:  
 25-100-05

*Department of History, Arts and Libraries*

*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 History, Arts and Libraries' (HAL'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).

~ ~ ~ ~ ~

**Noncompliance or Other Matters  
 Material to the Financial Schedules**

We did not identify any instances of noncompliance or other matters applicable to the financial schedules that are required to be reported under *Government Auditing Standards*. However, we did identify a reportable condition (Finding 2).

~ ~ ~ ~ ~

**Federal Awards:**

**Auditor's Reports Issued on Compliance**

We audited 2 programs as major programs and issued 2 qualified 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 identified reportable conditions related to internal control over major programs (Findings 4 and 5). We consider Findings 4 and 5 to be material weaknesses.

~ ~ ~ ~ ~

**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).

~ ~ ~ ~ ~

**Systems of Accounting and Internal Control:**

We determined that HAL was in substantial compliance with Sections 18.1483 - 18.1487 of the *Michigan Compiled Laws*. However, we did identify a reportable condition (Finding 3).

~ ~ ~ ~ ~

**Background:**

HAL was created in August 2001 by Act 63, P.A. 2001 (Sections 399.701 - 399.722 of the *Michigan Compiled Laws*).

~ ~ ~ ~ ~

We audited the following programs as major programs:

<u>CFDA Number</u>	<u>Program Title</u>	<u>Compliance Opinion</u>
17.225	Unemployment Insurance (Reed Act Distribution)	Qualified
45.310	State Library Program	Qualified

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.**  
Auditor General

**Scott M. Strong, C.P.A., C.I.A.**  
Deputy Auditor General



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

June 30, 2005

Dr. William M. Anderson, Director  
Department of History, Arts and Libraries  
702 West Kalamazoo Street  
Lansing, Michigan

Dear Dr. Anderson:

This is our report on the financial audit, including the provisions of the Single Audit Act, of the Department of History, Arts and Libraries (HAL) 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 HAL financial schedules, notes to the financial schedules, and schedule of expenditures of federal awards. 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 HAL's summary schedule of prior audit findings, its 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

Dr. William M. Anderson, Director  
Department of History, Arts and Libraries  
702 West Kalamazoo Street  
Lansing, Michigan

Dear Dr. Anderson:

We have audited the financial schedules of the Department of History, Arts and Libraries 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 transfers and the sources and disposition of authorizations for the Department of History, Arts and Libraries' 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 transfers and the sources and disposition of authorizations of the Department of History, Arts and Libraries 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 17, 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 17, 2005

DEPARTMENT OF HISTORY, ARTS AND LIBRARIES  
Schedule of General Fund Revenues and Transfers  
Fiscal Years Ended September 30

	2004	2003
REVENUES		
From federal agencies:		
Institute of Museum and Library Services (Note 4)	\$ 5,255,485	\$ 3,908,144
U.S. Department of the Interior	809,900	1,095,153
National Endowment for the Arts	653,450	667,500
Other federal funds	98,497	1,209
Total from federal agencies	\$ 6,817,332	\$ 5,672,006
Miscellaneous revenues	1,845,149	2,534,498
Total Revenues	\$ 8,662,481	\$ 8,206,504
TRANSFERS (Note 3)		
From Michigan Unemployment Compensation Fund	\$ 2,779,847	\$ 1,522,000
From other funds	55,700	
Total Transfers	\$ 2,835,547	\$ 1,522,000
Total Revenues and Transfers	\$ 11,498,028	\$ 9,728,504

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

DEPARTMENT OF HISTORY, ARTS AND LIBRARIES  
Schedule of Sources and Disposition of General Fund Authorizations  
Fiscal Years Ended September 30

	<u>2004</u>	<u>2003</u>
<b>SOURCES OF AUTHORIZATIONS (Note 2)</b>		
General purpose appropriations	\$ 44,201,700	\$ 58,451,636
Budgetary transfers in (out)		978,700
Balances carried forward (Note 4)	2,362,172	2,123,859
Restricted financing sources (Note 4)	12,764,100	10,815,172
Less: Interfund expenditure reimbursements	<u>(1,156,798)</u>	<u>(1,096,409)</u>
 Total	 <u>\$ 58,171,174</u>	 <u>\$ 71,272,958</u>
 <b>DISPOSITION OF AUTHORIZATIONS (Note 2)</b>		
Gross expenditures and transfers out	\$ 57,234,067	\$ 69,993,804
Less: Interfund expenditure reimbursements	<u>(1,156,798)</u>	<u>(1,096,409)</u>
Net expenditures and transfers out	<u>\$ 56,077,269</u>	<u>\$ 68,897,395</u>
Balances carried forward:		
Multi-year projects	\$	\$ 14,834
Encumbrances	148,251	580,706
Restricted revenues - authorized	937,256	1,254,521
Restricted revenues - not authorized (Note 4)	<u>575,044</u>	<u>512,111</u>
Total balances carried forward	<u>\$ 1,660,551</u>	<u>\$ 2,362,172</u>
Balances lapsed	<u>\$ 433,354</u>	<u>\$ 13,391</u>
 Total	 <u>\$ 58,171,174</u>	 <u>\$ 71,272,958</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 History, Arts and Libraries (HAL) for the fiscal years ended September 30, 2004 and September 30, 2003. The financial transactions of HAL 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 notes accompanying these financial schedules relate directly to HAL. 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.

The mission of HAL is to enrich the quality of life for Michigan residents by providing access to information, preserving and promoting Michigan's heritage, and fostering cultural creativity.

HAL was created by Act 63, P.A. 2001 (Sections 399.701 - 399.722 of the *Michigan Compiled Laws*), effective August 6, 2001. The Library of Michigan, which was initially created in 1837 and shifted to the control of the Legislative Council by Act 540, P.A. 1982, was created within HAL by Act 62, P.A. 2001, effective October 1, 2001. All of the programs and financial operations of the Library of Michigan during fiscal year 2000-01 became part of HAL for fiscal year 2001-02. Other major programs that were transferred to HAL, effective for fiscal year 2001-02, include the Michigan Council for Arts and Cultural Affairs, which was transferred from the Department of Consumer and Industry Services; the Michigan Film Office, which was transferred from the Michigan Economic Development Corporation; the Michigan Historical Center, which was transferred from the Department of State; and the Mackinac Island State Park Commission, which was transferred from the Department of Natural Resources.

Executive Order No. 2002-17, effective December 20, 2002, transferred the State Records Management program to HAL from the Department of Management and Budget (DMB). The financial schedules do not include the financial activities related to the microfilm funds, which are accounted for in the Office Services Revolving Fund, an internal service fund. This fund is audited separately.

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 to be 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 transfers and the sources and disposition of authorizations for HAL's General Fund accounts. Accordingly, these financial schedules do not purport to, and do not, constitute a complete financial presentation of either HAL 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. HAL's General Fund/general purpose appropriations decreased by approximately \$14.2 million from fiscal year 2002-03 to fiscal year 2003-04.

- b. Budgetary transfers in (out): Legislatively approved transfers of spending authorization between accounts within a department or between departments. These also include administrative transfers, such as entries to complete the financial closing of the State's fiscal year, that are approved by the DMB Office of Financial Management. Significant transfers in to HAL for fiscal year 2002-03 included \$954,700 from DMB.
- c. Balances carried forward: Authorizations for multi-year projects, encumbrances, restricted revenues - authorized, and restricted revenues - 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 restricted revenues - not authorized. Significant balances carried forward into HAL in fiscal year 2003-04 included \$415,939 from Heritage Publications magazine subscriptions and \$176,953 from Museum Store operations. Significant balances carried forward into HAL in fiscal year 2002-03 included \$701,196 from Michigan Historical Center administration and services, \$420,748 from Heritage Publications magazine subscriptions, \$302,591 from Library of Michigan user fees, and \$173,727 from Museum Store operations.
- d. 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. HAL's significant restricted financing sources for fiscal year 2003-04 included \$5,255,485 from State Library Program federal grants; \$2,779,847 from Unemployment Insurance federal funds; \$809,900 from Historic Preservation Fund federal grants; \$653,450 from the National Endowment for the Arts funds; and \$512,711 from Heritage Publications magazine subscriptions. HAL's significant restricted financing sources for fiscal year 2002-03 included \$3,908,144 from the State Library Program federal grants; \$1,522,000 from Unemployment Insurance federal funds;

\$1,416,342 from Library of Michigan user fees; \$1,095,153 from Historic Preservation Fund federal grants; \$667,500 from National Endowment for the Arts funds; and \$530,130 from Heritage Publications magazine subscriptions.

- e. 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.
- f. 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. The significant encumbrance for HAL in fiscal year 2002-03 was \$310,751 for Michigan Historical Center administration and services.
- g. Restricted revenues - authorized: Revenues that, by statute or the State Constitution, are restricted and authorized for use to a particular program or activity. Generally, these revenues may be expended upon receipt without additional legislative authorization. Significant restricted revenues - authorized for HAL in fiscal year 2003-04 included \$469,544 from Library of Michigan user fees and \$249,507 from Museum Store operations. Significant restricted revenues - authorized for HAL in fiscal year 2002-03 included \$1,007,286 from Library of Michigan user fees and \$176,953 from Museum Store operations.
- h. 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. Significant restricted revenues - not authorized for HAL in fiscal year 2003-04 included \$443,117 from Heritage Publications magazine subscriptions. Significant restricted revenues - not authorized for HAL in fiscal year 2002-03 included \$415,939 from Heritage Publications magazine subscriptions.
- i. 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. Significant lapses for HAL in

fiscal year 2003-04 included \$144,894 for operations and \$142,848 for Michigan Historical Center administration and services.

Note 3 Schedule of General Fund Revenues and Transfers

In fiscal year 2003-04 and 2002-03, HAL received significant transfers of \$2,779,847 and \$1,522,000, respectively, from the Michigan Unemployment Compensation Fund. These amounts were appropriated for the Unemployment Insurance program to provide employment related services.

Note 4 Corrected Financial Schedule Presentations

The accompanying schedules have been adjusted to reflect the correction of financial errors that occurred in fiscal years 2003-04 and 2002-03.

HAL's federal revenues and federal accounts receivable were overstated by approximately \$876,000 as of September 30, 2003 because of an accounting error. HAL identified this error during fiscal year 2003-04. Instead of adjusting the amounts incorrectly recorded during fiscal year 2002-03, HAL attempted to offset this error by not recording approximately \$873,000 in federal revenue that was earned and received during fiscal year 2003-04. As a result, federal revenues were understated by approximately \$873,000 as of September 30, 2004.

In accordance with Section 18.1485 of the *Michigan Compiled Laws* (a section of the Management and Budget Act), HAL requested and the DMB Office of Financial Management granted a waiver to present the financial schedules with corrected balances in revenues from federal agencies, balances carried forward, and restricted financing sources in fiscal year 2003-04 and revenues from federal agencies, restricted financing sources, and restricted revenues - not authorized in fiscal year 2002-03. The waiver authorization affected the dollar amounts reported in the schedule of General Fund revenues and transfers and the schedule of sources and disposition of General Fund authorizations.

SUPPLEMENTAL  
FINANCIAL SCHEDULE

DEPARTMENT OF HISTORY, ARTS AND LIBRARIES  
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 Subrecipients	Total Expended and Distributed
<b><u>U.S. Department of Commerce</u></b>					
Pass-Through Program:					
Michigan Department of Environmental Quality Coastal Zone Management Administration Awards	11.419	03-CD-11.06 02-CE-7.02 03-CE-13.01 04-CE-9.01	\$ 3,756 20,794 5,768	\$	\$ 3,756 20,794 5,768 0
<b>Total U.S. Department of Commerce</b>			<b>\$ 30,318</b>	<b>\$ 0</b>	<b>\$ 30,318</b>
<b><u>U.S. Department of the Interior</u></b>					
Direct Program:					
Historic Preservation Fund Grants-In-Aid	15.904		\$ 1,005,826	\$ 89,326	\$ 1,095,152
<b>Total U.S. Department of the Interior</b>			<b>\$ 1,005,826</b>	<b>\$ 89,326</b>	<b>\$ 1,095,152</b>
<b><u>U.S. Department of Labor</u></b>					
Pass-Through Program:					
Michigan Unemployment Insurance Agency Unemployment Insurance (Reed Act Distribution) (3)	17.225		\$ 450,000	\$ 1,072,000	\$ 1,522,000
<b>Total U.S. Department of Labor</b>			<b>\$ 450,000</b>	<b>\$ 1,072,000</b>	<b>\$ 1,522,000</b>
<b><u>U.S. Department of Transportation</u></b>					
Pass-Through Program:					
Michigan Department of Transportation Highway Planning and Construction (Federal-Aid Highway Program)	20.205	ENH200200261 ENH200200207 ENH200200321 ENH200300067	\$ 15,895 88,116	\$	\$ 15,895 88,116 0 0
<b>Total U.S. Department of Transportation</b>			<b>\$ 104,011</b>	<b>\$ 0</b>	<b>\$ 104,011</b>
<b><u>National Endowment for the Arts</u></b>					
Direct Program:					
Promotion of the Arts - Partnership Agreements	45.025		\$	\$ 667,500	\$ 667,500
<b>Total National Endowment for the Arts</b>			<b>\$ 0</b>	<b>\$ 667,500</b>	<b>\$ 667,500</b>
<b><u>National Endowment for the Humanities</u></b>					
Direct Programs:					
Promotion of the Humanities - Federal/State Partnership	45.129		\$	\$	\$ 0
<b>Total National Endowment for the Humanities</b>			<b>\$ 0</b>	<b>\$ 0</b>	<b>\$ 0</b>
<b><u>Institute of Museum and Library Services</u></b>					
Direct Program:					
State Library Program	45.310		\$ 3,052,801	\$ 855,343	\$ 3,908,144
<b>Total Institute of Museum and Library Services</b>			<b>\$ 3,052,801</b>	<b>\$ 855,343</b>	<b>\$ 3,908,144</b>

This schedule continued on next page.

For the Fiscal Year Ended September 30, 2004			Total Expended and Distributed for the Two-Year Period
Directly Expended	Distributed to Subrecipients	Total Expended and Distributed	
\$	\$	\$ 0	\$ 3,756
		0	20,794
28,934		28,934	34,702
17,069		17,069	17,069
<b>\$ 46,003</b>	<b>\$ 0</b>	<b>\$ 46,003</b>	<b>\$ 76,321</b>
\$ 725,476	\$ 84,926	\$ 810,402	\$ 1,905,554
<b>\$ 725,476</b>	<b>\$ 84,926</b>	<b>\$ 810,402</b>	<b>\$ 1,905,554</b>
\$ 548,900	\$ 2,286,647	\$ 2,835,547	\$ 4,357,547
<b>\$ 548,900</b>	<b>\$ 2,286,647</b>	<b>\$ 2,835,547</b>	<b>\$ 4,357,547</b>
\$	\$	\$ 0	\$ 15,895
11,884		11,884	100,000
161,250		161,250	161,250
16,268		16,268	16,268
<b>\$ 189,402</b>	<b>\$ 0</b>	<b>\$ 189,402</b>	<b>\$ 293,413</b>
\$	\$ 654,454	\$ 654,454	\$ 1,321,954
<b>\$ 0</b>	<b>\$ 654,454</b>	<b>\$ 654,454</b>	<b>\$ 1,321,954</b>
\$ 500	\$	\$ 500	\$ 500
<b>\$ 500</b>	<b>\$ 0</b>	<b>\$ 500</b>	<b>\$ 500</b>
\$ 4,511,300	\$ 715,246	\$ 5,226,546	\$ 9,134,690
<b>\$ 4,511,300</b>	<b>\$ 715,246</b>	<b>\$ 5,226,546</b>	<b>\$ 9,134,690</b>

DEPARTMENT OF HISTORY, ARTS AND LIBRARIES  
Schedule of Expenditures of Federal Awards (1)  
For the Period October 1, 2002 through September 30, 2004  
Continued

Federal Agency/Program	CFDA (2) Number	Pass-Through Identification Number	For the Fiscal Year Ended September 30, 2003		
			Directly Expended	Distributed to Subrecipients	Total Expended and Distributed
<b>U.S. National Commission on Libraries and Information Sciences</b>					
Direct Program:					
Library Statistics Program - Training and Technical Assistance	84 (4)		\$ 1,209	\$	\$ 1,209
<b>Total U.S. National Commission on Libraries and Information Sciences</b>			<b>\$ 1,209</b>	<b>\$ 0</b>	<b>\$ 1,209</b>
Total Expenditures of Federal Awards			<u>\$ 4,644,165</u>	<u>\$ 2,684,169</u>	<u>\$ 7,328,334</u>

- (1) Basis of Presentation: This schedule includes the federal grant activity for the Department of History, Arts and Libraries 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.
- (2) CFDA is defined as *Catalog of Federal Domestic Assistance*.
- (3) These funds were received through a transfer from the Michigan Unemployment Insurance Agency.
- (4) CFDA number not available. Number derived from the federal agency number.

<u>For the Fiscal Year Ended September 30, 2004</u>			<u>Total Expended and Distributed for the Two-Year Period</u>
<u>Directly Expended</u>	<u>Distributed to Subrecipients</u>	<u>Total Expended and Distributed</u>	
\$ _____	\$ _____	\$ _____ 0	\$ _____ 1,209
<b>\$ 0</b>	<b>\$ 0</b>	<b>\$ 0</b>	<b>\$ 1,209</b>
<u>\$ 6,021,581</u>	<u>\$ 3,741,273</u>	<u>\$ 9,762,854</u>	<u>\$ 17,091,188</u>

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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

Dr. William M. Anderson, Director  
Department of History, Arts and Libraries  
702 West Kalamazoo Street  
Lansing, Michigan

Dear Dr. Anderson:

We have audited the financial schedules of the Department of History, Arts and Libraries 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 17, 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 a 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 initiate, record, process, 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 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.

#### 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 no instances of noncompliance or other matters that are required to be reported under *Government Auditing Standards*. However, we noted reportable conditions, which are described in Findings 2 and 3.

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 17, 2005



STATE OF MICHIGAN  
OFFICE OF THE AUDITOR GENERAL  
201 N. WASHINGTON SQUARE  
LANSING, MICHIGAN 48913  
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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

Dr. William M. Anderson, Director  
Department of History, Arts and Libraries  
702 West Kalamazoo Street  
Lansing, Michigan

Dear Dr. Anderson:

Compliance

We have audited the compliance of the Department of History, Arts and Libraries 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.

Except as discussed in the following paragraph, 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.

We were unable to obtain sufficient documentation supporting the compliance of the Department with the State Library Program regarding matching, level of effort, and earmarking requirements nor were we able to satisfy ourselves as to the Department's compliance with those requirements by other auditing procedures.

As described in Finding 4 in the accompanying schedule of findings and questioned costs, the Department did not comply with requirements regarding allowable costs/cost principles that are applicable to its Unemployment Insurance (Reed Act Distribution) program. Compliance with such requirements is necessary, in our opinion, for the Department to comply with the requirements applicable to that program.

In our opinion, except for the effects of such noncompliance, if any, as might have been determined had we been able to examine sufficient evidence regarding the Department of History, Arts and Libraries' compliance with the requirements of the State Library Program regarding matching, level of effort, and earmarking requirements and except for the noncompliance described in the previous paragraph, the Department of History, Arts and Libraries complied, in all material respects, with the requirements referred to in the first paragraph that are applicable to each of its major federal programs for the two-year period ended September 30, 2004. The results of our auditing procedures also disclosed another instance of noncompliance with those requirements, which is required to be reported in accordance with OMB Circular A-133 and which is described in the accompanying schedule of findings and questioned costs as Finding 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, of the reportable conditions identified in the previous paragraph, we consider Findings 4 and 5 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

March 17, 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 weaknesses\* identified? No

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

Noncompliance or other matters material to the financial schedules? No

### Federal Awards

Internal control over major programs:

Material weaknesses identified? Yes

Reportable conditions identified that are not considered to be material weaknesses? No

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

Unemployment Insurance (Reed Act Distribution) Qualified\*

State Library Program Qualified

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:

<u>CFDA Number</u>	<u>Name of Federal Program</u>
17.225	Unemployment Insurance (Reed Act Distribution)
45.310	State Library Program

\* See glossary at end of report for definition.

Dollar threshold used to distinguish between type A and type B programs: \$512,736  
Auditee qualified as a low-risk auditee\*? No

## Section II: Findings Related to the Financial Schedules

### **FINDING (250501)**

#### 1. Internal Control Over Financial Reporting

The Department of History, Arts and Libraries' (HAL's) internal control over financial reporting did not ensure that transactions were accurately recorded and that identified errors were corrected. As a result, HAL's accounting records did not support its financial schedules.

During fiscal year 2002-03, HAL earned revenues totaling approximately \$876,000, associated with one of its federal grant programs, and appropriately recorded this amount in the State's accounting system as federal revenue and as a federal account receivable. However, when HAL later received this revenue, HAL again recorded this as federal revenue. As a result, HAL's federal revenues and federal accounts receivable were overstated by approximately \$876,000 as of September 30, 2003.

HAL identified this error during fiscal year 2003-04. Instead of adjusting the amounts incorrectly recorded during fiscal year 2002-03, HAL attempted to offset this error by not recording approximately \$873,000 in federal revenue that was earned and received during fiscal year 2003-04. As a result, federal revenues were understated by approximately \$873,000 as of September 30, 2004.

Section 18.1485 of the *Michigan Compiled Laws* (a section of the Management and Budget Act) requires that HAL establish and maintain an internal accounting and administrative control system, including a system of authorization and recordkeeping procedures to control assets, liabilities, revenues, and expenditures. The Department of Management and Budget (DMB) Administrative Guide procedure 1210.09 stipulates that State agencies must not issue financial

\* See glossary at end of report for definition.

information that is inconsistent with financial statements, schedules, or accounts of the State, unless they obtain a waiver from the DMB Office of Financial Management.

Consequently, as a result of our audit, HAL requested and obtained a waiver from the Office of Financial Management. The waiver allowed HAL to report accurate balances in revenues from federal agencies, balances carried forward, and restricted financing sources in fiscal year 2003-04 and revenues from federal agencies, restricted financing sources, and restricted revenues - not authorized in fiscal year 2002-03 on the financial schedules that appear in this report.

## **RECOMMENDATION**

We recommend that HAL improve its internal control over financial reporting to ensure that transactions are accurately recorded and that identified errors are corrected.

## **FINDING (250502)**

### 2. Indirect Costs

HAL did not establish an indirect cost rate and charge indirect costs to awards, contracts, and grants, including those received from the federal government. As a result, HAL did not recover eligible indirect costs from the federal government.

Section 460, Act 431, P.A. 1984, as amended, requires each State agency to establish an indirect cost rate and to charge indirect costs to all awards, contracts, and grants, including payroll-related expenditures for awards, contracts, and grants received from the federal government.

During our audit period, HAL expended approximately \$17.1 million from 14 separate federal awards, including payroll-related expenditures of approximately \$1.4 million for 4 federal awards. Indirect costs are generally recovered by applying an appropriate indirect cost billing rate to eligible payroll-related expenditures that are charged to a federal grant award.

We also noted that HAL did not charge eligible payroll-related expenditures to the Unemployment Insurance program (*CFDA* 17.225) or to the State Library Program (*CFDA* 45.310). The federal regulations for both of these programs allowed HAL to

charge the grant awards for payroll-related expenditures. These programs had total expenditures of approximately \$4.4 million and \$9.1 million during the period October 1, 2002 through September 30, 2004. Because HAL did not charge eligible payroll-related expenditures to the programs, there were no indirect costs recovered from these programs. Although HAL was able to earn the full amount of the federal grant awards for these programs by charging only non-payroll related expenditures, it used General Fund dollars to pay for administrative costs that could have been paid by the federal grants.

The amounts potentially recoverable as indirect cost revenues could not be estimated because HAL had not established an indirect billing rate and also because HAL had not charged eligible payroll-related expenditures to all federal programs.

### **RECOMMENDATION**

We recommend that HAL establish an indirect cost rate and charge indirect costs to awards, contracts, and grants, including those received from the federal government.

### **FINDING (250503)**

#### **3. Internal Auditors' Independence**

HAL's internal audit staff were not organizationally independent. As a result, HAL was not in compliance with Section 18.1486(2) of the *Michigan Compiled Laws*.

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

HAL's internal auditor was under the day-to-day supervision of HAL's director but also acted as the assistant budget officer reporting to the budget officer. The budget officer reported to the deputy director in charge of administrative services. HAL's internal auditor also supervised other HAL staff members working in the internal audit function, including the budget officer who worked part-time in the internal audit function during fiscal year 2003-04.

## **RECOMMENDATION**

We recommend that HAL fully comply with Section 18.1486(2) of the *Michigan Compiled Laws*, which requires that internal auditors be organizationally independent.

**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**

### **FINDING (250504)**

4. Unemployment Insurance (Reed Act Distribution), CFDA 17.225

U.S. Department of Labor	CFDA 17.225: Unemployment Insurance (Reed Act Distribution)
Award Number: Not Applicable	Award Period: 07/25/2002 - 09/30/2004
Pass-Through Program: Michigan Unemployment Insurance Agency	Questioned Costs: Undeterminable

HAL's internal control over the Unemployment Insurance (Reed Act Distribution) program did not ensure compliance with federal laws and regulations regarding allowable costs/cost principles. Our review disclosed material weaknesses in internal control and material noncompliance\* with federal laws and regulations regarding allowable costs/cost principles.

Internal control that does not ensure compliance with applicable federal laws and regulations could result in sanctions and/or disallowances of Unemployment Insurance (Reed Act Distribution) awards.

The U.S. Department of Labor (USDOL) distributed approximately \$291 million dollars to the State in accordance with provisions of the Temporary Extended Unemployment Compensation Act of 2002. These funds are referred to as "Reed

\* See glossary at end of report for definition.

Act funds" and were distributed to the State to address unemployment insurance needs and to provide employment services. Of the \$291 million dollars distributed to the State, approximately \$4.3 million was appropriated to HAL for the purpose of providing libraries with computers and training library staff to assist claimants in accessing Michigan Unemployment Insurance Agency Web sites.

USDOL Training and Employment Guidance Letters No. 18-01 and No. 24-01 stipulate that Reed Act distributions may not pay costs for nonemployment services program activities and that, when activities are jointly shared with nonemployment services programs, the related costs must be allocated between the Reed Act and the other program activities. Also, HAL received a letter in October 2002 from the acting regional director of the USDOL Office of Workforce Security. In this letter, the USDOL identified concerns with the State's appropriation of Reed Act funds to libraries for the purchase of computers, which could be used for nonemployment activities. The letter further stated that, in cases in which an activity benefits nonemployment programs, the State must allocate costs in proportion to the benefit received by the separate activities.

Our review of HAL's expenditures of the Reed Act funds disclosed:

- a. HAL awarded Reed Act funds totaling approximately \$1.9 million and \$190,000 to two municipal public libraries during our audit period to generally provide employment related activities. Our review of the grant award documentation disclosed that some of the goods and services provided by the Reed Act funds could also have been used for nonemployment activities. HAL did not require the libraries to allocate costs if funded activities would provide benefits to nonemployment activities. For example, the purchase of equipment for additional computer access to the Internet provides benefits for all library computer users. Our review also disclosed that at least one of the municipal libraries intended to use a portion of the funds to provide computer and Internet training to the public. Our review further disclosed that the grant agreement documents did not require either library to identify and report any nonemployment activities so that the related costs could be appropriately allocated to a separate funding source.

- b. HAL awarded Reed Act funds totaling approximately \$330,000 to 13 cooperative libraries\* in fiscal years 2003-04 and 2002-03. Our review of 6 sampled grants and related documentation disclosed that the grants generally related to providing goods and services for employment related activities. Our review also disclosed that some of the goods and services provided by the Reed Act funds could also have been used for nonemployment activities. For example, services provided included basic computer training for word processing and e-mail software. Purchases included videoconferencing cameras and other multipurpose software. From our review, we also determined that at least one of the cooperative libraries used the Reed Act funds to teach the general public basic computer skills and to upgrade the broadband computer connection speeds at a library that is a combination school and public library. Our review further disclosed that the grant agreement documents did not require the cooperative libraries to identify and report any nonemployment activities so that the related costs could be allocated to a separate funding source.
  
- c. HAL awarded Reed Act funds totaling approximately \$880,000 to 286 local libraries during fiscal year 2003-04 for the purposes of assisting the libraries in improving broadband computer connection speeds. Our review of 15 sampled grants and related documentation disclosed that these grants were awarded in conjunction with a privately funded grant, with the Reed Act funds providing approximately 92% of the funding provided to the local libraries. Increased computer connection speeds benefit all individuals using the Internet at the local libraries, including both those using it for employment related activities as well as nonemployment related activities. The guidance provided by the USDOL indicates that, in instances in which an activity benefits nonemployment programs, the State must allocate costs in proportion to the benefit received by the separate activities. Based upon the results of our review, we believe that allocating 92% of the related costs to the Reed Act funds to provide employment services was not reasonable.
  
- d. HAL entered into an agreement with a vendor to provide access to an on-line database. This database provides test preparation materials and interactive practice tests to help improve scores on academic, civil service, military, and

\* See glossary at end of report for definition.

professional licensing and certification examinations and other adult basic education (ABE) materials. Our review of the database disclosed that it offers 24 modules, which include the following categories: College Entrance Exams, SAT (Scholastic Aptitude Test) 2005 Preparation, Graduate School Entrance Exams, Elementary School Skills Improvement, Middle School Skills Improvement, High School Skills Improvement, GED (General Educational Development), and U.S. Citizenship. USDOL instructions clearly prohibit the use of Reed Act funds to be used to provide GED/ABE programs, subsidies, or training. The database is made available to all citizens Statewide via the Michigan eLibrary (MeL) for a period of seven years at a total cost of \$950,000. Our review disclosed that HAL did not allocate any portion of the \$950,000 in costs to other nonemployment funding sources to attempt to appropriately distribute the database costs.

**RECOMMENDATION**

We recommend that HAL improve its internal control over the Unemployment Insurance program to ensure compliance with federal laws and regulations regarding allowable costs/cost principles.

**FINDING (250505)**

5. State Library Program, CFDA 45.310

Institute of Museum and Library Services	CFDA 45.310: State Library Program
Award Numbers: LS-00-02-0023-02 LS-00-03-0023-03 LS-00-04-0023-04	Award Periods: 10/01/2002 - 09/30/2003 10/01/2002 - 09/30/2004 10/01/2003 - 09/30/2005
	Questioned Costs: \$ 0

HAL's internal control over the State Library Program did not ensure compliance with federal laws and regulations regarding matching, level of effort, and earmarking; reporting; and subrecipient\* monitoring. Our review disclosed a material weakness in internal control used to identify all eligible State expenditures to be used in the determination of the federal level of effort.

\* See glossary at end of report for definition.

Internal control that does not ensure compliance with federal laws and regulations could result in sanctions, disallowances, and/or reductions of future State Library Program awards.

Our exceptions, by compliance area, are as follows:

a. Matching, Level of Effort, and Earmarking

HAL did not have an effective process in place to identify all eligible State expenditures to be used in the determination of the federal level of effort.

HAL is required, as a condition of eligibility for federal funding, to maintain its financial contribution at a level not less than the average contributions of the prior three years. This ensures that federal assistance results in an increased level of library-related activity and that a state does not simply replace state dollars with federal dollars over time.

Title 20, Section 9133(c) of the *Code of Laws of the United States* provides that state expenditures for library programs that are consistent with the broader purposes of the State Library Program shall be included in the determination of level of effort. The level of effort provisions are broader than matching provisions and would include support for promoting access to learning and information resources in all types of libraries for individuals of all ages.

HAL informed us that it had expended \$1.4 million and \$1.2 million during fiscal years 2003-04 and 2002-03, respectively, for library programs that were consistent with federal level of effort requirements. However, HAL could not explain why the process it used to calculate its level of effort only used a portion of the State funding provided to public libraries. Our review disclosed that HAL provided support totaling approximately \$13.9 million and \$13.2 million during fiscal years 2003-04 and 2002-03, respectively, to public libraries through the State Aid to Public Libraries Act.

We could not determine HAL's average financial contributions for the prior three years to determine if HAL had complied with federal level of effort requirements.

b. Reporting

HAL underreported its expenditures used to determine compliance with federal level of effort requirements.

The State Library Program grant award requires HAL to report its level of effort in its annual report. This amount is to include all funds expended by HAL for library programs that are consistent with the purposes of the State Library Program.

Based upon our review of the most current annual report submitted to the federal government that covered fiscal year 2002-03 data and discussions with the State Library Program management, we determined that HAL identified expenditures totaling \$1.2 million that qualified under level of effort requirements for fiscal year 2002-03. However, in its report to the federal government, HAL reported only \$500,000 as its total level of effort expenditures for fiscal year 2002-03.

c. Subrecipient Monitoring

HAL's internal control over subrecipient monitoring regarding equipment purchased with federal funds did not ensure that equipment was recorded and monitored to help prevent loss, damage, or theft.

OMB Circular A-133, section 400(d)(3), requires HAL to monitor the activities of subrecipients to ensure that federal awards are administered in compliance with laws, regulations, and the provisions of contracts or grant agreements. In an effort to monitor subrecipient compliance with federal requirements regarding equipment purchases, HAL published and distributed the Library Services and Technology Act Grant Administration Handbook providing guidelines to the subrecipients to assist them in administering their grants.

The Grant Administration Handbook provides specific subrecipient guidelines for complying with the use, maintenance, and disposition of equipment purchased with federal State Library Program funds. These guidelines include submitting a separate equipment inventory form when requesting reimbursement, performing a physical inventory every two years and submitting documentation to HAL, and developing adequate maintenance procedures to keep equipment in good condition. In addition, the guidelines

require HAL to conduct random site visits to monitor subrecipients' compliance with federal requirements.

HAL did not adhere to its prescribed procedures regarding subrecipient monitoring. Our review of State Library Program records and discussions with Program management disclosed that physical inventories of equipment were not submitted by subrecipients every two years as required and that the checklist used by HAL to perform periodic subrecipient site visits did not include procedures to inspect equipment and records to help ensure that equipment was adequately safeguarded and maintained. Our review also disclosed that a subrecipient purchased equipment costing \$60,000 but did not include the required inventory form with its request for reimbursement.

### **RECOMMENDATION**

We recommend that HAL improve its internal control over the State Library Program to ensure compliance with federal laws and regulations regarding matching, level of effort, and earmarking; reporting; and subrecipient monitoring.

**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 HISTORY, ARTS AND LIBRARIES  
Summary Schedule of Prior Audit Findings  
As of September 30, 2004

**PRIOR AUDIT FINDINGS RELATED TO THE FINANCIAL SCHEDULES**

Audit Findings That Have Been Fully Corrected:

**Audit Period:** October 1, 2001 through September 30, 2002

**Finding Number:** 250301

**Finding Title:** Internal Control Over Cash Receipts

**Finding:** The Department of History, Arts and Libraries (HAL) should improve its internal control over mail opening and the processing of cash receipts.

**Comments:** HAL submitted justification for alternate controls and internal operating procedures to the Office of Financial Management, Department of Management and Budget, and has received approval of the waiver requested.

**PRIOR AUDIT FINDINGS RELATED TO FEDERAL AWARDS**

Audit Findings That Have Been Fully Corrected:

**Audit Period:** October 1, 2001 through September 30, 2002

**Finding Number:** 250302

**Finding Title:** Indirect Costs

**Finding:** HAL applied its predetermined indirect cost rate against ineligible expenditures. As a result, HAL overdrew federal funds, as indirect costs, from the Historic Preservation Fund Grants-In-Aid Program (CFDA 15.904) totaling \$30,031.

**Comments:**

HAL received authorization from the grantor agency (Heritage Preservation Services, National Park Service, U.S. Department of the Interior) and has corrected the overdrawn indirect costs through an accounting recode process.

DEPARTMENT OF HISTORY, ARTS AND LIBRARIES

Corrective Action Plan

As of June 23, 2005

**FINDINGS RELATED TO THE FINANCIAL SCHEDULES**

**Finding Number:** 250501

**Finding Title:** Internal Control Over Financial Reporting

**Management Views:** The Department of History, Arts and Libraries (HAL) agrees with the finding.

During fiscal year 2002-03, revenue in the amount of \$876,000 was overstated in the financial schedules. The overstatement was caused when a work project was established for projects funded under the federal Library Services and Technology Act (LSTA) during the fiscal year 2002-03 year-end closing process, which unknowingly duplicated a receivable already recorded by HAL in the Michigan Administrative Information Network (MAIN). This was the first time a work project was established for LSTA projects. Establishing the work project allowed the carry-over of all revenue sources, causing the overstatement.

During fiscal year 2003-04, HAL identified the overstatement and contacted its liaison at the Office of Financial Management (OFM), Department of Management and Budget (DMB), to request direction on how to correct the fiscal year 2002-03 financial schedules. OFM indicated that the amount of the overstatement was not a material change for the *State of Michigan Comprehensive Annual Financial Report (SOMCAFR)*. Therefore, no fiscal year 2002-03 correction was needed from a Statewide perspective. OFM stated that the revenue could be

used against fiscal year 2003-04 expenditures, which HAL did. This caused the understatement of revenue in HAL's fiscal year 2003-04 financial schedules.

**Corrective Action:**

HAL requested and received a waiver from OFM, granting permission for HAL's financial schedules to differ from the *SOMCAFR*. HAL is now aware of the accounting events that occur when using different transaction codes to establish work projects and their effects on year-end closing. HAL is also aware that the measure of materiality for HAL is different than that used by OFM for the *SOMCAFR*. HAL will continue to evaluate its processes in efforts for continuous improvement to internal control over financial reporting.

**Anticipated Completion Date:**

On March 14, 2005, OFM provided the requested waiver allowing HAL's financial schedules to differ from the *SOMCAFR* for fiscal years 2002-03 and 2003-04 (see Note 4 to the financial schedules).

**Responsible Individual:**

Janet Laverty, Chief Financial Officer

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**Finding Number:**

250502

**Finding Title:**

Indirect Costs

**Management Views:**

HAL does not agree with the finding.

In compliance with Section 460, Act 431, P.A. 1984, and related State policies and procedures, HAL established an indirect cost rate of zero and provided the requisite notification of the rate to the director of DMB, the chairs of the Senate and House Appropriations Committees, and the directors of the Senate and House Fiscal Agencies.

In its performance audit of Statewide Federal Indirect Cost Recovery and Usage, released in June 2000, the Auditor General recommended that agencies "...develop plans for recovering allowable indirect costs from federal grants in consultation with DMB or establish that not charging federal indirect costs is in the best interest of the State."

HAL followed this recommendation of the Auditor General and established that not charging federal indirect costs is in the best interest of the State. The use of a greater than zero indirect cost rate would not affect the amount of federal funds granted to the State; however, it would result in a reduction in the funds available for direct program expenditures, negatively impacting program effectiveness. Section 460, Act 431, P.A. 1984, clearly recognizes that the authority for such a determination rests with each State agency.

**Corrective Action:** None required

**Anticipated Completion Date:** Not applicable

**Responsible Individual:** Mark Hoffman, Deputy Department Director

**Auditor's Epilogue:** HAL is required by Section 460, Act 431, P.A. 1984, to establish an indirect cost rate and to charge that indirect cost rate to all awards, contracts, and grants. Section 460 does not provide for a department to establish an indirect cost rate of zero.

In addition, HAL has not established that it is in the best interest of the State to forgo recovering indirect costs from its federal programs and returning those funds to the State's General Fund.

Because HAL did not recover indirect costs, State General Fund money was used to subsidize the operations of a federally funded program.

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**Finding Number:** 250503  
**Finding Title:** Internal Auditors' Independence

**Management Views:** HAL agrees with the finding.

While the internal auditor and staff assisting her directly and independently reported to HAL's director for all audit activities, they did not organizationally report to HAL's director for all other activities.

**Corrective Action:** HAL was reorganized so that the internal auditor and staff assisting her report directly to, and are under the general supervision of, HAL's director for all activities.

**Anticipated Completion Date:** Completed March 14, 2005

**Responsible Individual:** Bill Anderson, Department Director

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#### FINDINGS RELATED TO FEDERAL AWARDS

**Finding Number:** 250504  
**Finding Title:** Unemployment Insurance (Reed Act Distribution),  
*CFDA 17.225*

**Management Views:** HAL does not agree with the finding.

Due to the closure of unemployment offices across the State in less populated areas and a sudden reduction in unemployment workers as a result of many retirements under an early out retirement program,

unemployed and underemployed workers were re-directed to public libraries for assistance with filing for unemployment benefits and employment-seeking activities. Therefore, as the Auditor General states, "... approximately \$4.3 million was appropriated to HAL for the purpose of providing libraries with computers and training library staff to assist claimants in accessing Michigan Unemployment Insurance Agency Web sites."

The Office of Inspector General, U.S. Department of Labor, recently completed a survey of Michigan's use of Reed Act funds. This survey included a detailed review of the activities that were funded through HAL. The report on the results of this survey noted no exceptions or improprieties in how the funds were used by HAL and the activities funded.

HAL believes that it exercised due diligence in attempting to ensure that the use of Reed Act funds was appropriate. HAL had its grant agreement documents reviewed by the Attorney General. The grant agreements were revised to incorporate the legal advice and recommendations of the Attorney General prior to their use as the contract documents.

The agreements clearly state that grants must be used only to support employment related activities. The contract used to award grants to cooperative libraries states: "Congress allocated to the states certain Reed Act funds, which are part of a state's unemployment fund and are to be used for employment enhancement activities . . . ." The contract also states: "Only those encumbrances and expenditures that further the purpose for which Reed Act grants are awarded will be considered allowable."

Additionally, the grant agreement for libraries states: "The Grantee agrees to furnish the Library with the results of the outcome-based evaluation as set forth in the description of 'Project Work' in Section 4 above, by June 30, 2005."

As a result, each grantee will provide a signed, written report to HAL on the use of the grant, including information from informal surveys of users of funded activities. HAL has reviewed the reports received to date, including survey results, and determined that they clearly show that the granted funds supported employment related activities.

The Auditor General questions the use of Reed Act funds to purchase a subscription to the LearnATest database. The general educational development (GED) materials noted in the finding are but one of 23 categories of practice test and test preparation materials available on the LearnATest Web site. Reed Act funds were used to purchase access via the Michigan eLibrary (MeL) to the site. It is not possible to purchase access to the site without the GED category being included.

**Corrective Action:** None required. HAL does not agree with the finding. Additionally, HAL no longer administers Reed Act funding under the Unemployment Insurance program.

**Anticipated Completion Date:** Not applicable

**Responsible Individual:** Mark Hoffman, Deputy Department Director

**Auditor's Epilogue:** The auditors do not disagree with the statements expressed in the preceding management views. However, the views do not address the reason this finding was included in the audit report. In September

2002, HAL received a letter from the U.S. Department of Labor which stated that, because the Reed Act funds could be used for nonemployment activities, HAL must allocate costs in proportion to the benefits received by employment and nonemployment related activities. These instructions were reaffirmed by the U.S. Department of Labor in an e-mail sent on March 7, 2005. HAL did not require its subrecipients of the Reed Act funds to identify and report nonemployment related activities and did not require that costs be allocated in proportion to benefits received by both employment and nonemployment related activities.

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**Finding Number:**

250505

**Finding Title:**

State Library Program, *CFDA* 45.310

**Management Views:**

HAL does not agree with items a. and b. of the finding.

When LSTA was first implemented in fiscal year 1997-98, the Library of Michigan discussed maintenance of effort requirements with the administrators of the Institute of Museum and Library Services (IMLS), the federal agency under which LSTA grants are awarded.

It was agreed that the Library of Michigan could report \$500,000 expended in support of library automation and Statewide database as its maintenance of effort for fiscal year 1997-98. During those discussions, IMLS agreed that the Library of Michigan need expend and report only the minimum maintenance of effort level of expenditures required to be deemed in satisfaction of the terms of the legislation and its grant. This practice has continued with the full acceptance of IMLS.

HAL agrees with item c. of the finding (subrecipient monitoring) and will initiate corrective action. The lapse in properly tracking equipment according to HAL's established procedures resulted from the loss of experienced staff.

**Corrective Action:**

HAL has instituted improved management oversight to see that all procedures are being followed. To ensure that the equipment monitoring records are current, inventories will be sent by June 30, 2005 to libraries that have purchased equipment with LSTA funds with a last reported fair market value of \$5,000 or more. Equipment inventory confirmations will be sent every two years, until the fair market value of equipment purchased with LSTA funds is recorded as less than \$5,000. Site visits will include the monitoring of subrecipients' compliance with federal requirements.

**Anticipated Completion Date:** June 30, 2005

**Responsible Individual:** Nancy Robertson, State Librarian

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# GLOSSARY

## Glossary of Acronyms and Terms

ABE	adult basic education.
<i>CFDA</i>	<i>Catalog of Federal Domestic Assistance.</i>
cooperative libraries	Libraries or service centers designated by a cooperative board to execute services established by a cooperative plan and provided to libraries participating in a cooperative.
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.
GED	general educational development.
HAL	Department of History, Arts and Libraries.
IMLS	Institute of Museum and Library Services.
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.
LSTA	Library Services and Technology Act.

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.
OFM	Office of Financial Management.
OMB	U.S. Office of Management and Budget.
qualified opinion	An auditor's opinion in which the auditor: <ul style="list-style-type: none"> <li>a. Identifies a scope limitation or one or more instances of misstatements that impact the fair presentation of the financial schedules and/or financial statements presenting the basic financial information of the audited agency in conformity with the disclosed basis of accounting or the financial schedules presenting supplemental financial information 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</li> </ul>

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

- b. Expresses reservations about the audited agency's compliance, in all material respects, with the cited requirements that are applicable to each major federal program. 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.

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. Violations of State laws, regulations, contracts, and grant agreements that should be communicated to management but are not material to the financial schedules and/or financial statements may also be reported.

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 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.

USDOL

U.S. Department of Labor.

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