



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

Performance Audit
Office of Financial Services
Department of Treasury

Report Number:
271-0147-13

Released:
November 2013

The Office of Financial Services (OFS) provides financial services related to the depositing of State revenues, recording of revenues to the State's accounting system, disbursement of State funds, and administration of all State banking relationships.

Audit Objective:

To assess the effectiveness of OFS's efforts to ensure that receipts are properly safeguarded.

Audit Conclusion:

We concluded that OFS was effective in its efforts to ensure that receipts are properly safeguarded. However, we noted one reportable condition (Finding 1).

Reportable Condition:

OFS, in conjunction with the Office of Infrastructure Protection within Cybersecurity and Infrastructure Protection, Department of Technology, Management, and Budget, did not ensure that access to the secure room was limited to only necessary personnel (Finding 1).

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Audit Objective:

To assess the effectiveness of OFS's efforts to ensure that receipts are recorded in a proper and timely manner.

Audit Conclusion:

We concluded that OFS was effective in its efforts to ensure that receipts are recorded in a proper and timely manner. Our audit report does not include any reportable conditions related to this audit objective.

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Audit Objective:

To assess the effectiveness of OFS's efforts in ensuring that the State of Michigan's warrant paper stock is properly safeguarded.

Audit Conclusion:

We concluded that OFS was effective in its efforts to ensure that the State of Michigan's warrant paper stock is properly safeguarded. Our audit report does not include any reportable conditions related to this audit objective.

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Audit Objective:

To assess the effectiveness of OFS's efforts to ensure that compensating balances are reasonable.

Audit Conclusion:

We concluded that OFS was effective in its efforts to ensure that compensating balances are reasonable. Our audit report does not include any reportable conditions related to this audit objective.

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Agency Response:

Our report contains 1 finding and 1 corresponding recommendation. The Department of Treasury's preliminary response indicates that it and the Department of Technology, Management, and Budget agree with the finding and corresponding recommendation.

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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

November 19, 2013

Mr. R. Kevin Clinton
State Treasurer
Richard H. Austin Building
Lansing, Michigan

Dear Mr. Clinton:

This is our report on the performance audit of the Office of Financial Services, Department of Treasury.

This report contains our report summary; a description of agency; our audit objectives, scope, and methodology and agency responses and prior audit follow-up; comments, finding, recommendation, and agency preliminary response; and a glossary of acronyms and terms.

Our comments, finding, and recommendation are organized by audit objective. The agency preliminary response was taken from the agency's response subsequent to our audit fieldwork. The *Michigan Compiled Laws* and administrative procedures require that the audited agency develop a plan to comply with the audit recommendation and submit it within 60 days after release of the audit report to the Office of Internal Audit Services, State Budget Office. Within 30 days of receipt, the Office of Internal Audit Services is required to review the plan and either accept the plan as final or contact the agency to take additional steps to finalize the plan.

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

Sincerely,


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

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OFFICE OF FINANCIAL SERVICES DEPARTMENT OF TREASURY

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Description of Agency

The Office of Financial Services (OFS), Department of Treasury, provides financial services related to the depositing of State revenues, recording of revenues to the State's accounting system, disbursement of State funds, and administration of all State banking relationships. These services are provided through three sections:

1. Depository Services Section

The Depository Services Section includes the Lockbox and Support Unit and the Remittances and Deposits Unit. The Lockbox and Support Unit's responsibilities include processing items received from bank lockboxes*; processing check traces; and preparing deposits for daily delivery to the bank. The Remittances and Deposits Unit is responsible for processing taxpayer checks and returns received through the mail or hand-delivered by the taxpayer; performing batch-balancing functions; and preparing the daily deposits.

2. Banking and Disbursements Section

The Banking and Disbursements Section's responsibilities include bank relationship management; bank contracts management; credit card, debit card, lockbox, and electronic funds transfer* (EFT) contract administration; State Treasurer warrant oversight; undeliverable warrants follow-up; forgery reporting; and EFT tracking and reporting.

3. Revenue Accounting Section

The Revenue Accounting Section's responsibilities include central agency Statewide accounting in Michigan Administrative Information Network* (MAIN); bank adjustments; Department of Treasury revenue accounting; and daily reconciliation of bank statements of the State Treasurer's concentration account. OFS had 35 employees as of September 1, 2013 and expended appropriations of approximately \$3.6 million in fiscal year 2011-12. In addition, OFS contracted with a service organization* for the initial receipt, distribution, and deposit of approximately \$10.2 billion of the State's revenue.

* See glossary at end of report for definition.

Audit Objectives, Scope, and Methodology and Agency Responses and Prior Audit Follow-Up

Audit Objectives

Our performance audit* of the Office of Financial Services (OFS), Department of Treasury, had the following objectives:

1. To assess the effectiveness* of OFS's efforts to ensure that receipts are properly safeguarded.
2. To assess the effectiveness of OFS's efforts to ensure that receipts are recorded in a proper and timely manner.
3. To assess the effectiveness of OFS's efforts in ensuring that the State of Michigan's warrant paper stock is properly safeguarded.
4. To assess the effectiveness of OFS's efforts to ensure that compensating balances* are reasonable.

Audit Scope

Our audit scope was to examine the operations and related records of the Office of Financial Services. We conducted this performance audit in accordance with generally accepted government auditing standards. Those standards require that we plan and perform the audit to obtain sufficient, appropriate evidence to provide a reasonable basis for our finding and conclusions based on our audit objectives. We believe that the evidence obtained provides a reasonable basis for our finding and conclusions based on our audit objectives. Our audit procedures, which included a preliminary survey, audit fieldwork, report preparation, analysis of agency responses, and quality assurance, were conducted from May through October 2013 and generally covered the period October 1, 2011 through June 30, 2013.

Audit Methodology

We conducted a preliminary review of OFS's operations to formulate a basis for developing our audit objectives and defining our audit scope. Our preliminary review

* See glossary at end of report for definition.

included interviewing OFS personnel; reviewing applicable laws, regulations, policies, procedures, and other information; observing processes; analyzing records and data; and obtaining an understanding of OFS's operational activities and related internal control*.

To accomplish our first objective, we interviewed OFS personnel, observed procedures, and gained an understanding of the methodology used by OFS to receive, process, and prepare for deposit items received from bank lockboxes, received through the mail, and hand-delivered by the taxpayer. We reviewed and analyzed OFS's management assurance project to determine if OFS's review of controls and processes at its service organization was sufficient. We reviewed the service organization's Statement on Standards for Attestation Engagements No. 16* (SSAE 16) report to determine if controls over wire transfers were reviewed and if any deficiencies were noted. We reviewed and analyzed records to determine that only necessary employees had access to the secure room. We reviewed the Payment Card Industry Data Security Standard* (PCI DSS) requirements and the related Attestation of Compliance* to determine that controls over credit card transactions were sufficient and that Michigan was in compliance with the requirements.

To accomplish our second objective, we interviewed OFS personnel and gained an understanding of the process used to deposit and record receipts. We randomly selected 15 business days during our audit period and reviewed documentation to determine if receipts were deposited in a timely manner and were recorded accurately. We did not project the sample results to the remaining population.

To accomplish our third objective, we interviewed OFS personnel and gained an understanding of the process for tracking and ordering the State's warrant paper stock and monitoring the vendor responsible for manufacturing the warrant paper stock. We reviewed the contract with the vendor to determine the contract requirements and to determine if OFS followed State of Michigan procurement policies. We reviewed all warrant paper stock ordered during our audit period to determine that the orders were tracked and received. We randomly selected 15 business days during our audit period and reviewed documentation to determine if OFS reconciled the warrant paper stock inventory. We did not project the sample results to the remaining population.

* See glossary at end of report for definition.

To accomplish our fourth objective, we interviewed OFS personnel and gained an understanding of the process for establishing and monitoring the compensating balance amounts and banking fees. We performed an analysis of the earnings credits*, compensating balances, and banking service charges to determine if the compensating balances were reasonable.

When selecting activities or programs for audit, we use an approach based on assessment of risk and opportunity for improvement. Accordingly, we focus our audit efforts on activities or programs having the greatest probability for needing improvement as identified through a preliminary review. Our limited audit resources are used, by design, to identify where and how improvements can be made. Consequently, we prepare our performance audit reports on an exception basis.

Agency Responses and Prior Audit Follow-Up

Our audit report contains 1 finding and 1 corresponding recommendation. The Department of Treasury's preliminary response indicates that it and the Department of Technology, Management, and Budget agree with the finding and corresponding recommendation.

The agency preliminary response that follows the recommendation in our report was taken from the agency's written comments and oral discussion subsequent to our audit fieldwork. Section 18.1462 of the *Michigan Compiled Laws* and the State of Michigan Financial Management Guide (Part VII, Chapter 4, Section 100) require the Department of Treasury to develop a plan to comply with the audit recommendations and submit it within 60 days after release of the audit report to the Office of Internal Audit Services, State Budget Office. Within 30 days of receipt, the Office of Internal Audit Services is required to review the plan and either accept the plan as final or contact the agency to take additional steps to finalize the plan.

We released our prior performance audit of the Receipts Processing Division, Department of Treasury (27-147-05), in March 2006. The Department complied with all 6 of the recommendations.

* See glossary at end of report for definition.

COMMENTS, FINDING, RECOMMENDATION,
AND AGENCY PRELIMINARY RESPONSE

SAFEGUARDING OF RECEIPTS

COMMENT

Audit Objective: To assess the effectiveness of the Office of Financial Services' (OFS's) efforts to ensure that receipts are properly safeguarded.

Audit Conclusion: We concluded that OFS was effective in its efforts to ensure that receipts are properly safeguarded. However, our audit disclosed one reportable condition* related to secure room access rights (Finding 1).

FINDING

1. Secure Room Access Rights

OFS, in conjunction with the Office of Infrastructure Protection (OIP) within Cybersecurity and Infrastructure Protection, Department of Technology, Management, and Budget (DTMB), did not ensure that access to the secure room was limited to only necessary personnel. As a result, OFS could not ensure that personal taxpayer information, checks, and cash were properly safeguarded against misuse or theft.

Section 18.1485 of the *Michigan Compiled Laws* requires that each department establish and maintain an internal accounting and administrative control system that includes a plan that limits access to the department's resources to authorized personnel whose use is required within the scope of their assigned duties.

OFS maintains a secure room to receive and process approximately \$866.0 million of taxpayer receipts and supporting documentation and agency deposits. OFS approves and denies access to the secure room as necessary for Department of Treasury employees; however, as with any DTMB-managed facility, OIP is ultimately responsible for maintaining control over who can access OFS's secure room by coding user identification badges and system software. OFS periodically reviews the secure room access report that identifies the users who have access to the secure room as well as those who have accessed the secure room.

* See glossary at end of report for definition.

Our review of the May 2013 access report for OFS's secure room determined that 51 (45.9%) of the 111 users who had access to the secure room did not have a direct business need or supervised access, including 29 first responders* and 22 DTMB couriers, respectively. Also, we noted that all 51 employees had access to the secure room outside of normal business hours.

We noted that OFS obtained and reviewed the secure room access report in March 2012. OFS questioned OIP regarding the couriers who had access but had not questioned the first responders' access. OFS indicated that it did not realize that the first responders or the couriers had after-hours access, and it did not consider alternative methods of receiving the mail from the couriers.

Subsequent to our review, OFS informed us that it had requested that OIP delete access for all first responders. In addition, OFS installed a telephone to the secure room for the couriers.

RECOMMENDATION

We recommend that OFS, in conjunction with OIP, ensure that access to the secure room is limited to only necessary personnel.

AGENCY PRELIMINARY RESPONSE

The Department of Treasury and DTMB agree with the recommendation and have informed us that they have complied.

The Department of Treasury and DTMB acknowledged that DTMB staff were granted the potential of unsupervised access to the secured room when the card readers were installed in fiscal year 2010-11. The Department of Treasury and DTMB indicated that there is a business need for DTMB couriers to have supervised access to the secured room. The DTMB couriers daily deliver to the secured room bank deposits prepared by other State agency cashier offices located throughout the Lansing area. OFS is responsible for the safe delivery of these deposits to the State's primary banking partner. The Department of Treasury and DTMB informed us that DTMB courier access authorization and card access reports were reviewed and validated in fiscal year 2011-12 and fiscal year 2012-13, revealing no unusual or suspicious activity.

* See glossary at end of report for definition.

The Department of Treasury acknowledges that DTMB first responder staff also were unknowingly granted the potential of unsupervised access rights to the secured room when the card readers were installed in fiscal year 2010-11. However, the Department of Treasury informed us that card access reports reviewed in fiscal years 2011-12 and 2012-13 had no record of any of the first responders ever attempting to access the secured room.

The Department of Treasury indicated that, after it became fully aware of the situation with the DTMB first responders, it immediately coordinated with DTMB to remove access rights to all DTMB first responder staff. In addition, the Department of Treasury informed us that it has eliminated the potential for unsupervised access to the secured room for the DTMB couriers by installing a telephone for courier usage and subsequently removing access for all DTMB couriers.

The Department of Treasury and DTMB have informed us that they will coordinate the review and validation of card access reports and access rights semiannually.

PROPER AND TIMELY RECORDING OF RECEIPTS

COMMENT

Audit Objective: To assess the effectiveness of OFS's efforts to ensure that receipts are recorded in a proper and timely manner.

Audit Conclusion: We concluded that OFS was effective in its efforts to ensure that receipts are recorded in a proper and timely manner. Our audit report does not include any reportable conditions related to this audit objective.

SAFEGUARDING OF WARRANT PAPER STOCK

COMMENT

Audit Objective: To assess the effectiveness of OFS's efforts in ensuring that the State of Michigan's warrant paper stock is properly safeguarded.

Audit Conclusion: We concluded that OFS was effective in its efforts to ensure that the State of Michigan's warrant paper stock is properly safeguarded. Our audit report does not include any reportable conditions related to this audit objective.

REASONABLENESS OF COMPENSATING BALANCES

COMMENT

Audit Objective: To assess the effectiveness of OFS's efforts to ensure that compensating balances are reasonable.

Audit Conclusion: We concluded that OFS was effective in its efforts to ensure that compensating balances are reasonable. Our audit report does not include any reportable conditions related to this audit objective.

GLOSSARY

Glossary of Acronyms and Terms

| | |
|---------------------------------|---|
| Attestation of Compliance | An affirmation of compliance with the Data Security Standard (DSS). All companies that accept, store, process, or transmit credit card information are required to report compliance with DSS. The State of Michigan must use a third party organization to validate and attest to compliance with these standards. |
| compensating balance | The amount of money a bank requires a customer to maintain in a non-interest bearing account, in exchange for which the bank provides otherwise free services. |
| DTMB | Department of Technology, Management, and Budget. |
| earnings credit | The earnings on collected balances in a commercial account. The earnings credit is not deposited to the account as interest earned. It is solely used to offset account analysis fees. |
| effectiveness | Success in achieving mission and goals. |
| electronic funds transfer (EFT) | Any transfer of funds that is initiated by electronic means. |
| first responders | The DTMB executives, managers, and some response personnel who receive access to all doors on the DTMB-managed enterprise access system with the exception of areas designated as high security. |
| internal control | The plan, policies, methods, and procedures adopted by management to meet its mission, goals, and objectives. Internal control includes the processes for planning, organizing, directing, and controlling program operations. It |

includes the systems for measuring, reporting, and monitoring program performance. Internal control serves as a defense in safeguarding assets and in preventing and detecting errors; fraud; violations of laws, regulations, and provisions of contracts and grant agreements; or abuse.

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| lockbox | A post office box that is established by a bank to receive checks for another organization. Lockboxes are utilized to accelerate deposits into the bank by eliminating internal processing by an organization. |
| Michigan Administrative Information Network (MAIN) | The State's automated administrative management system that supports accounting, purchasing, and other financial management activities. MAIN consists of three major components: MAIN Enterprise Information System (EIS); MAIN Financial Administration and Control System (FACS); and MAIN Management Information Database (MIDB). |
| OFS | Office of Financial Services. |
| OIP | Office of Infrastructure Protection. |
| Payment Card Industry Data Security Standard (PCI DSS) | A widely accepted set of policies and procedures intended to optimize the security of credit, debit, and cash card transactions and protect cardholders against misuse of their personal information. The PCI DSS was created jointly in 2004 by four major credit card companies: Visa, MasterCard, Discover, and American Express. |
| performance audit | An audit that provides findings or conclusions based on an evaluation of sufficient, appropriate evidence against criteria. Performance audits provide objective analysis to assist management and those charged with governance and oversight in using the information to improve program performance and operations, reduce costs, facilitate |

decision making by parties with responsibility to oversee or initiate corrective action, and contribute to public accountability.

reportable condition

A matter that, in the auditor's judgment, is less severe than a material condition and falls within any of the following categories: an opportunity for improvement within the context of the audit objectives; a deficiency in internal control that is significant within the context of the audit objectives; all instances of fraud; illegal acts unless they are inconsequential within the context of the audit objectives; significant violations of provisions of contracts or grant agreements; and significant abuse that has occurred or is likely to have occurred.

service organization

An entity (or segment of an entity) that provides services to a user organization that are part of the user organization's information system.

Statement on
Standards for
Attestation
Engagements No. 16
(SSAE 16)

Provides guidance for independent auditors who issue reports on the controls at a service organization.

