

Office of the Auditor General
Report on Internal Control, Compliance, and Other Matters

State of Michigan
Comprehensive Annual Financial Report
State Budget Office

Fiscal Year Ended September 30, 2015

State of Michigan Auditor General
Doug A. Ringler, CPA, CIA

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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Office of the Auditor General

Report Summary

Report on Internal Control, Compliance, and Other Matters

State of Michigan Comprehensive Annual Financial Report (SOMCAFR)

State Budget Office

Fiscal Year Ended September 30, 2015

**Report Number:
071-0010-16**

**Released:
March 2016**

Generally accepted government auditing standards require an auditor to report on internal control over financial reporting; compliance with provisions of laws, regulations, contracts, or grant agreements that have a material effect on the financial statements; and other matters coming to the attention of the auditor during the completion of a financial audit. We are issuing this report in conjunction with our independent auditor's report on the *SOMCAFR* dated December 31, 2015.

Findings Related to Internal Control, Compliance, and Other Matters	Material Condition	Reportable Condition	Agency Preliminary Response
The Department of Treasury and the Office of Financial Management (OFM), within the State Budget Office, should enhance internal control to prevent, or detect and correct, misstatements and ensure the reasonableness and accuracy of the tax accruals (<u>Finding #1</u>).	X		Agree
OFM, in conjunction with State departments, should continue to improve internal control to ensure the validity and reasonableness of estimated receivable and payable amounts reported within the <i>SOMCAFR</i> (<u>Finding #2</u>).		X	Agree
The Michigan Department of Health and Human Services, in conjunction with OFM, should strengthen internal control to improve the accuracy of the AIDS Drug Assistance Program receivable (<u>Finding #3</u>).		X	Agree
The Michigan Department of Transportation, in conjunction with OFM, should improve internal control to ensure that activity reported within the <i>SOMCAFR</i> is properly accounted for in accordance with generally accepted accounting principles (<u>Finding 4</u>).		X	Agree

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

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

Doug A. Ringler, CPA, CIA
Auditor General

Laura J. Hirst, CPA
Deputy Auditor General



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Doug A. Ringler, CPA, CIA
Auditor General

March 11, 2016

Mr. John S. Roberts, State Budget Director
State Budget Office
George W. Romney Building
Lansing, Michigan

Dear Mr. Roberts:

We have audited the financial statements of the governmental activities, the business-type activities, the aggregate discretely presented component units, each major fund, and the aggregate remaining fund information of the State of Michigan principally as of and for the fiscal year ended September 30, 2015, which collectively comprise the State's basic financial statements, and have issued a separate report thereon dated December 31, 2015. In planning and performing our audit of the financial statements, we considered the State's internal control over financial reporting and compliance and other matters. This report on internal control, compliance, and other matters is being issued in conjunction with our financial audit of the *State of Michigan Comprehensive Annual Financial Report* for the fiscal year ended September 30, 2015.

Certain findings included in this report specifically relate to other State agencies. Although the Office of Financial Management, State Budget Office, may not be directly responsible for these functions, we have addressed these findings to you for corrective action, consistent with your responsibility for financial accounting and reporting under Sections 18.1141 and 18.1421 of the *Michigan Compiled Laws*.

The Office of Financial Management provided preliminary responses to the recommendations at the end of our fieldwork. The *Michigan Compiled Laws* and administrative procedures require an audited agency to develop a plan to comply with the recommendations and submit it within 60 days of the date above 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,

Doug Ringler
Auditor General

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INDEPENDENT AUDITOR'S REPORT ON INTERNAL CONTROL AND COMPLIANCE



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Doug A. Ringler, CPA, CIA
Auditor General

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

Mr. John S. Roberts, State Budget Director
State Budget Office
George W. Romney Building
Lansing, Michigan

Dear Mr. Roberts:

We have audited, in accordance with the 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, the financial statements of the governmental activities, the business-type activities, the aggregate discretely presented component units, each major fund, and the aggregate remaining fund information of the State of Michigan principally as of and for the fiscal year ended September 30, 2015 and the related notes to the financial statements, which collectively comprise the State's basic financial statements, and have issued our report thereon dated December 31, 2015. Our report includes a reference to other auditors who audited the financial statements of the:

- State Lottery Fund (a major fund)
- Michigan Unemployment Compensation Funds (a major fund)
- Michigan Employment Security Act - Administration Fund
- Unemployment Obligation Trust Fund
- State Building Authority - Debt Service Fund
- State Building Authority - Capital Projects Fund
- Attorney Discipline System
- State Sponsored Group Insurance Fund
- Michigan Education Savings Program
- Michigan State Housing Development Authority
- Farm Produce Insurance Authority
- Mackinac Bridge Authority
- Mackinac Island State Park Commission
- Michigan Early Childhood Investment Corporation
- State Bar of Michigan
- Venture Michigan Fund
- Western Michigan University
- Central Michigan University
- Eastern Michigan University
- Ferris State University
- Grand Valley State University
- Lake Superior State University
- Michigan Technological University
- Northern Michigan University
- Oakland University
- Saginaw Valley State University

This report does not include the results of the other auditors' testing of internal control over financial reporting or compliance and other matters that are reported on separately by those auditors.

Internal Control Over Financial Reporting

In planning and performing our audit of the basic financial statements, we considered the State's internal control over financial reporting (internal control) to determine the audit procedures that are appropriate in the circumstances for the purpose of expressing our opinions on the basic financial statements, but not for the purpose of expressing an opinion on the effectiveness of the State's internal control. Accordingly, we do not express an opinion on the effectiveness of the State's internal control.

Our consideration of internal control was for the limited purpose described in the preceding paragraph and was not designed to identify all deficiencies in internal control that might be material weaknesses or significant deficiencies and, therefore, material weaknesses or significant deficiencies may exist that were not identified. However, as described in the body of our report, we

identified certain deficiencies in internal control that we consider to be material weaknesses and other deficiencies that we consider to be significant deficiencies.

A deficiency in internal control exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent, or detect and correct, misstatements on a timely basis. A material weakness is a deficiency, or a combination of deficiencies, in internal control such that there is a reasonable possibility that a material misstatement of the entity's basic financial statements will not be prevented, or detected and corrected, on a timely basis. We consider the deficiency described in Finding 1 to be a material weakness.

A significant deficiency is a deficiency, or a combination of deficiencies, in internal control that is less severe than a material weakness, yet important enough to merit attention by those charged with governance. We consider the deficiencies described in Findings 2 through 4 to be significant deficiencies.

Compliance and Other Matters

As part of obtaining reasonable assurance about whether the State's basic financial statements are free from 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 statement 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*.

Office of Financial Management's Response to Findings

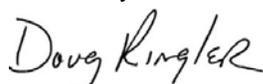
Certain findings included in this report specifically relate to other State agencies. Although the Office of Financial Management, State Budget Office, may not be directly responsible for these functions, we have addressed these findings to you for corrective action, consistent with your responsibility for financial accounting and reporting under Sections 18.1141 and 18.1421 of the *Michigan Compiled Laws*.

The Office of Financial Management's preliminary responses to the findings identified in our audit are included in the body of our report. The responses were not subjected to the auditing procedures applied in the audit of the basic financial statements and, accordingly, we express no opinion on them.

Purpose of This Report

The purpose of this report is solely to describe the scope of our testing of internal control and compliance and the results of that testing, and not to provide an opinion on the effectiveness of the entity's internal control or on compliance. This report is an integral part of an audit performed in accordance with *Government Auditing Standards* in considering the entity's internal control and compliance. Accordingly, this communication is not suitable for any other purpose.

Sincerely,



Doug Ringler
Auditor General
December 31, 2015

FISCAL YEAR 2015
FINDINGS, RECOMMENDATIONS, AND
AGENCY PRELIMINARY RESPONSES

FINDING #1

Improvements needed to processes for establishing tax receivables and payables.

The Department of Treasury (Treasury) and the Office of Financial Management (OFM), within the State Budget Office, should enhance internal control* to prevent, or detect and correct, misstatements and ensure the reasonableness and accuracy of the tax accruals.

We identified a total of 16 separate issues related to tax accruals during the *State of Michigan Comprehensive Annual Financial Report (SOMCAFR)* audit. The deficiencies in internal control resulted in the following misstatements, which were corrected prior to the *SOMCAFR*'s issuance:

	<u>Corrected Misstatements (in millions)</u>
General Fund:	
Assets	Overstated \$267.7
Liabilities	Understated \$ 21.9
Deferred Inflows of Resources	Overstated \$247.7
Revenues	Overstated \$ 41.9
Fund Balance	Overstated \$ 41.9
School Aid Fund:	
Assets	Overstated \$139.7
Liabilities	Understated \$ 3.3
Deferred Inflows of Resources	Overstated \$ 94.6
Revenues	Overstated \$ 48.4
Fund Balance	Overstated \$ 48.4
Governmental Activities of the Government-wide Financial Statements:	
Assets	Overstated \$407.5
Liabilities	Understated \$ 25.2
Revenues	Overstated \$432.7
Net Position	Overstated \$432.7

Following are 6 examples of the significant misstatements that Treasury and OFM corrected:

- a. Treasury and OFM did not identify sales, use, and withholding (SUW) tax data anomalies used in the Governmental Accounting Standards Board* (GASB) 34 accrual basis estimated receivable calculations and determine if they were reasonable. As a result, assets and deferred inflows of resources were overstated by \$239.2 million in the General Fund. In addition, assets and deferred inflows of resources were overstated by \$88.2 million in the School Aid Fund and assets, revenues, and net position were overstated by \$327.4 million in the governmental activities of the government-wide financial statements.

* See glossary at end of report for definition.

During the year-end closing process, Treasury's Office of Revenue and Tax Analysis (ORTA) provides information to OFM relating to tax receivable amounts on the accrual basis of accounting. The amounts are derived from complex calculations involving estimated percentages of fiscal year 2015 taxpayer liability expected to be collected by the State at some point in the future. The estimated percentages are developed using historical tax return data and collection pattern assumptions.

During our review of the SUW summary collection data, we identified a significant change in the reported historical collections. Treasury's data historically reported that between \$5.4 million and \$10.3 million was received by Treasury in annual withholding tax return filings in the next fiscal year for fiscal tax liability years 2002 through 2013. However, the amount of collections in fiscal year 2015 used by ORTA applicable to fiscal tax year 2014 was \$2.7 billion.

The bulk of the \$2.7 billion figure was obtained by ORTA from a summary-level SAP system report newly designed during the fiscal year 2015 closing process. ORTA had no means to validate the report totals because it is not given access to the underlying detail records. OFM received the ORTA report showing the data anomalies but did not identify/question the validity. The data anomalies are not readily apparent within the portions of the report OFM uses to calculate the entries.

ORTA concurred with us that the figures from the SAP system report were invalid and ultimately reran its calculations to include only the figures presented within the established reports from Treasury's SUW mainframe system.

- b. Treasury and OFM did not ensure that SUW tax cash collections were properly recorded in fiscal year 2015. As a result, assets, revenues, and fund balance/net position were overstated in the General Fund and the School Aid Fund by \$21.6 million and \$9.6 million, respectively, and by \$31.3 million in the governmental activities of the government-wide financial statements.

During fiscal year 2015, Treasury began processing SUW return and payment activity within both its SAP system and its existing SUW mainframe system. Treasury's plan was for activity relating to tax years 2014 and prior to 2014 to continue to be handled within the SUW mainframe system, while activity for tax years 2015 and beyond was to be processed and maintained within the SAP system. Treasury established

automated "sweep" programs to transfer records between the two systems.

Records initially interfaced to the SUW mainframe system, but subsequently transferred to the SAP system, were improperly included within both reports used by Treasury in estimating the accrual. This resulted in the double counting of cash remittances. Treasury had not established a process to ensure that records were not being double counted.

- c. Treasury and OFM did not follow the established methodology or develop a valid alternative methodology for calculating the "to be assessed" component of tax year 2015 SUW receivables. As a result, assets were overstated by \$42.3 million, deferred inflows of resources were overstated by \$7.3 million, and revenues and fund balance were overstated by \$35.0 million in the General Fund. In addition, assets were overstated by \$24.2 million, deferred inflows of resources were overstated by \$5.6 million, and revenues and fund balance were overstated by \$18.7 million in the School Aid Fund and assets, revenues, and net position were overstated by \$66.5 million in the governmental activities of the government-wide financial statements.

Under the established methodology, Treasury identifies tax delinquencies that it has issued in the months of October and November, pertaining to tax periods ended prior to October 1. Treasury applies collectibility percentages to these assessments and includes the receivable in the "to be assessed" component of the tax accruals. Because of technical issues within the SAP system, no computed SUW tax assessments were determined and interfaced to the State Treasury Accounts Receivable System for tax year 2015. In addition, Treasury had not yet sent, or established a date that it would send, letters of its intent to assess potential tax delinquencies to the taxpayers. Consequently, because the assessments were not computed and issued, if Treasury had followed the established methodology, it would not have recorded a receivable for this component of the accrual.

However, in December 2015, Treasury determined that it would record receivables to be assessed using the computed SUW delinquency population relating to tax year 2013. We do not consider this a valid alternative methodology because it is not based on actual 2015 activity and no assessments had been issued by the end of November.

- d. Treasury and OFM did not ensure that liabilities relating to the Michigan Business Tax (MBT) were properly recorded. As a result, payables were understated and revenues and fund balance/net position were overstated by \$20.1 million in the General Fund and the governmental activities of the government-wide financial statements.

Treasury records a liability at the end of the fiscal year for:

- (1) MBT and Corporate Income Tax (CIT) refunds issued during October and November of the subsequent fiscal year.
- (2) Processed MBT and CIT tax returns claiming a refund for which Treasury has not yet issued the refund as of November 30.
- (3) Unprocessed MBT and CIT returns received by November 30 claiming a refund.

Treasury determines the amounts to record for each component of the liability from separate reports generated from its automated SAP system.

Treasury's established methodology is to include 100% of the refund amounts in the recorded payable associated with the first two items in the preceding list and an amount less than 100% of total unprocessed refund returns. The amount included within the payable for unprocessed refund returns is determined by Treasury based on manual evaluation of the returns consisting primarily of inquiry to various divisions within Treasury as to the current status of the returns. Based on established methodology, returns currently subject to an audit by Treasury, or under bankruptcy, are excluded from the payable as the potential amount of the refund is considered immeasurable.

Our review of unprocessed MBT and CIT returns identified four MBT tax returns that Treasury improperly excluded from the year-end liability. Treasury mistakenly considered three of these returns as within Treasury's hearings process for which the outcome was not presently determinable. The fourth return was in audit status at the time of Treasury's evaluation but transitioned out of audit, and the refund was paid to the taxpayer in mid-December 2015.

- e. Treasury and OFM did not ensure that use tax collections remitted by Medicaid health maintenance organizations (HMOs) and Prepaid Inpatient Health Plans (PIHPs) in October 2015 were properly evaluated

for exclusion from the accrued receivable. As a result, assets, revenues, and fund balance/net position were overstated in the General Fund and the School Aid Fund by \$23.3 million and \$11.7 million, respectively, and by \$35.0 million in the governmental activities of the government-wide financial statements.

Treasury manually compiles the use tax amounts received from HMOs and PIHPs within a spreadsheet. Based on statutory filing requirements, the taxpayers are required to submit a projected payment to Treasury by the 20th day of the current month and a reconciling payment equal to the difference between the tax liability for the month minus the amount of tax previously paid for that month by the 20th day of the following month. When determining the October 2015 collection amounts to accrue for tax liability periods through September 30, 2015, Treasury mistakenly included the projected payments received in October applicable to the October 2015 taxpayer liability. Only the collections received in October 2015 relating to taxpayers' reconciliation payments of the September 2015 tax liability are allowed under generally accepted accounting principles* (GAAP) to be accrued to fiscal year 2015.

- f. Treasury internal control did not ensure that October 2015 business tax cash collections were properly recorded in fiscal year 2015. As a result, assets, revenues, and fund balance/net position were understated by \$60.8 million in the General Fund and the governmental activities of the government-wide financial statements.

Treasury records a receivable at fiscal year-end for MBT, CIT, and flow-through withholding tax collections received in October and November related to tax periods ending prior to October 1. Treasury identifies the amount of collections using reports from its automated SAP system. Based on the report information, Treasury manually assigns an accrual factor, based on an established schedule that takes into consideration the return type and filing period, to each individual collection amount to determine the total amount of the collections to accrue. When determining the amount of October collections to accrue relating to estimated, quarterly, and audit payments, Treasury mistakenly applied a factor of 66.67% instead of the established 100% factor.

* See glossary at end of report for definition.

RECOMMENDATION

We recommend that Treasury and OFM enhance internal control to prevent, or detect and correct, misstatements and ensure the reasonableness and accuracy of the tax accruals.

**AGENCY
PRELIMINARY
RESPONSE**

OFM provided us with the following response:

Treasury and OFM agree that internal control related to tax accruals should be improved but would like to emphasize that all misstatements identified in the audit finding were corrected prior to issuance of the SOMCAFR. Treasury and OFM have already met to discuss needed improvements and have developed a plan for implementing them. Treasury and OFM will continue to meet periodically to discuss and monitor the status of the implementation plan.

FINDING #2

Monitoring of receivables and payables needs improvement.

OFM, in conjunction with State departments, should continue to improve internal control to ensure the validity and reasonableness of estimated receivable and payable amounts reported within the *SOMCAFR*.

Effective internal control over accrued receivables and payables should include a comparison of the accounting estimates with subsequent activity to assess the reliability of the processes used to develop the estimates. In its approval of accrual methodologies, OFM instructs the State departments that it is important to evaluate the reliability of the estimated accruals in the subsequent year and adjust the estimation methodology accordingly.

Two significant accruals established annually based on estimation methodologies are taxes receivable and payable within Treasury and Medicaid accruals within the Michigan Department of Health and Human Services (MDHHS). Our review of these two accruals for fiscal year 2015 disclosed:

- a. Treasury had not developed a process to compare and evaluate significant accounting estimates with subsequent activity for several tax accrual components. The estimates for the assessed taxes receivable, receivables to be assessed, business taxes payable backlog, and individual income tax payable backlog of the year-end tax accruals are not compared to subsequent activity to assess the reliability of the process used to develop the estimates.

We initially commented on this issue during the fiscal year 2013 *SOMCAFR* audit. Although OFM and Treasury agreed with our prior audit recommendation, they indicated that the level of detail necessary to track the information was not available within existing mainframe systems.

- b. MDHHS had not revised its established estimation methodology for components of the Medicaid accrual despite significant variances between the estimate and subsequent activity, in some instances going back several fiscal years.

MDHHS continued its considerable efforts to compile subsequent activity data and document an analysis of the prior estimates to subsequent activity for the more than 25 unique components of the Medicaid accrual. However, MDHHS should be using the results of the process to revise estimation methodologies on a more timely basis. MDHHS's tracking results for 4 components that we reviewed showed significant variations in relation to the estimates recorded in fiscal year 2013. For 3 of the 4 components, significant variances also existed for fiscal years 2011 and 2012. However, MDHHS did not revise

its existing methodologies for these components when determining the estimated amounts to record at the end of fiscal year 2015.

RECOMMENDATION

We recommend that OFM, in conjunction with State departments, continue to improve internal control to ensure the validity and reasonableness of estimated receivable and payable amounts reported within the *SOMCAFR*.

**AGENCY
PRELIMINARY
RESPONSE**

OFM provided us with the following response:

Regarding part a., Treasury and OFM agree that, when possible, significant accounting estimates should be compared with subsequent activity. However, for the tax accrual components identified by the auditors, the level of detail necessary to track this information is not available in the current State Treasury Accounts Receivable System. As part of Treasury's ongoing initiative to upgrade existing mainframe systems, it will include requirements to ensure the ability to track the information necessary to compare and evaluate accounting estimates to subsequent activity.

Regarding part b., MDHHS and OFM agree that material variances between estimates and subsequent activity should be analyzed to determine if the related estimation methodology requires adjustment. MDHHS will continue to track the various components of the Medicaid accrual for reasonableness and adjust estimation methodologies as needed.

FINDING #3

Improvements needed to the accuracy of the AIDS Drug Assistance Program receivable.

MDHHS, in conjunction with OFM, should strengthen internal control to improve the accuracy of the AIDS Drug Assistance Program (ADAP) receivable.

The State of Michigan Financial Management Guide (FMG) (Part II, Chapter 11, Section 100) requires agencies to record receivables in accordance with GAAP.

MDHHS participates in a drug pricing program that provides rebates on outpatient prescription drugs. MDHHS invoices the pharmaceutical manufacturers on a quarterly basis for rebates based on actual prescription drug purchases. MDHHS records a receivable at year-end for rebates that have been earned but are not expected to be collected until the next fiscal year.

In fiscal year 2015, MDHHS recorded an ADAP receivable of \$34.8 million. Because of data entry and calculation errors, the ADAP receivable included duplicate records for the same drug purchases, resulting in a \$7.2 million overstatement. In addition, MDHHS incorrectly omitted rebates that were received after year-end but had not yet been accounted for in fiscal year 2015, resulting in a \$1.2 million receivable understatement. As a result, the ADAP receivable was overstated by a net of \$6.0 million. MDHHS, in conjunction with OFM, corrected the identified overstatement prior to the issuance of the *SOMCAFR*.

We had identified similar errors in the ADAP receivable in fiscal years 2014 and 2013 and correcting entries were made. However, monitoring and review of the supporting documentation and calculations prior to processing the entry would help improve the accuracy and completeness of the initially recorded ADAP receivable.

RECOMMENDATION

We recommend that MDHHS, in conjunction with OFM, strengthen internal control to improve the accuracy of the ADAP receivable.

AGENCY PRELIMINARY RESPONSE

OFM provided us with the following response:

MDHHS and OFM agree with the recommendation. MDHHS will revise its internal control procedures to ensure that the data used in calculation of the ADAP receivable is complete and accurate.

FINDING #4

Improvements needed to MDOT's project and financial accounting practices.

The Michigan Department of Transportation (MDOT), in conjunction with OFM, should improve internal control to ensure that activity reported within the *SOMCAFR* is properly accounted for in accordance with GAAP. Our review disclosed:

- a. MDOT did not have sufficient internal control in place to ensure that project expenditures were charged to the proper fund at year-end.

The FMG (Part II, Chapter 1, Section 100) requires compliance with GAAP.

MDOT records advance construction projects in different funds based on the funding source of the expenditures. During fiscal year 2015, MDOT incorrectly recorded expenditures in the fund used to record projects with federal funding even though the federal financing source for these projects had exceeded the federal obligation by \$60.9 million. MDOT noted and corrected the issue on a project level in fiscal year 2016; however, it did not initially correct the financial accounting records in fiscal year 2015. MDOT should improve its monitoring to ensure that all changes made to advance construction project funds are also made to the supporting financial records in the appropriate fiscal years.

- b. MDOT, in conjunction with OFM, did not have sufficient internal control in place to evaluate the dates of service when processing contractor payments and liquidating prior year accounts payable estimates. Consequently, project expenditures may have been recorded in the wrong fiscal year.

The FMG (Part II, Chapter 14, Section 100) requires agencies to record payables for goods and services received by September 30.

MDOT project managers submit estimated accounts payable work sheets to MDOT's Contract Services Division for each outstanding project at the end of the fiscal year. The estimated payables are compiled by MDOT's Contract Services Division staff and recorded by MDOT's Accounting Services Division staff.

MDOT's practice is to apply all payments made during the current fiscal year against the estimated payable established at the end of the prior fiscal year until the payable balance is reduced to zero. The actual work completion date is not taken into consideration. If payments in the current year for a project are less than the estimated payable established in relation to that project at the end of the prior fiscal year, the remaining payable balance is written off. On average, MDOT wrote off 7.4% of the estimated payables established for fiscal

years 2014, 2013, and 2012. The write-off percentage is most likely understated because of MDOT's practice of applying all payments made during the current fiscal year against the estimated payable regardless of the work completion date.

We initially identified this issue during the fiscal year 2012 SOMCAFR audit. In the fiscal year 2014 report on internal control, compliance, and other matters, we reported that MDOT and OFM generally agreed with our recommendation but stated that given current resources and automated processes, MDOT did not believe that it would be cost effective to revise the current process. MDOT also indicated that it would consider inclusion of service dates as it developed requirements for a replacement contractor system.

While an automated solution would generally result in a more efficient process to identify service dates, MDOT could implement a manual process, similar to the process used to establish the payable, to document the appropriate liquidation of the prior year accounts payable.

RECOMMENDATION

We recommend that MDOT, in conjunction with OFM, improve internal control to ensure that activity reported within the SOMCAFR is properly accounted for in accordance with GAAP.

AGENCY PRELIMINARY RESPONSE

OFM provided us with the following response:

Regarding part a., MDOT and OFM agree that MDOT's procedures for year-end adjustments to project expenditures can be improved. As noted by the auditors, MDOT appropriately identified the need for an adjustment to project expenditures and recorded the necessary adjusting entries in fiscal year 2016, but not fiscal year 2015. MDOT has updated its procedures to ensure that prior fiscal years are analyzed and considered when making year-end adjustments.

Regarding part b., MDOT and OFM agree that evaluation of service dates might improve the precision of accounts payable calculations. However, MDOT does not believe that it would be cost effective to revise its current process or that any resulting improvements in precision would be material. MDOT will consider inclusion of service dates as it develops requirements for a replacement contractor system.

FISCAL YEAR 2014
REPORT ON INTERNAL CONTROL,
COMPLIANCE, AND OTHER MATTERS
FOLLOW-UP

Below is the status of the reported findings from the 2014 *SOMCAFR* report on internal control, compliance, and other matters:

Prior Audit Finding Number	Topic Area	Status	Current Finding Number
1a	Monitoring of Receivables and Payables - Tax Accruals	Repeated	2a
1b	Monitoring of Receivables and Payables - Medicaid Accruals	Rewritten	2b
1c	Monitoring of Receivables and Payables - Child Support Accrual	Complied	Not applicable
2	Evaluation of TPSO Control Report	Complied	Not applicable
3	MDOT Contractor Payments	Rewritten	4b
4	Reconciliation of CCDF Receivables	Complied	Not applicable

GLOSSARY OF ABBREVIATIONS AND TERMS

ADAP	AIDS Drug Assistance Program.
AIDS	acquired immune deficiency syndrome.
CCDF	Child Care and Development Fund.
CIT	Corporate Income Tax.
deficiency in internal control over financial reporting	The design or operation of a control that does not allow management or employees, in the normal course of performing their assigned functions, to prevent, or detect and correct, misstatements on a timely basis.
financial audit	An audit that is designed to provide reasonable assurance about whether the basic financial statements of an audited entity are presented fairly, in all material respects, in accordance with the applicable financial reporting framework.
FMG	State of Michigan Financial Management Guide.
generally accepted accounting principles (GAAP)	A technical accounting term that encompasses the conventions, rules, guidelines, and procedures necessary to define accepted accounting practice at a particular time; also cited as "accounting principles generally accepted in the United States of America."
Governmental Accounting Standards Board (GASB)	An arm of the Financial Accounting Foundation established to promulgate standards of financial accounting and reporting with respect to activities and transactions of state and local governmental entities.
HMO	health maintenance organization.
internal control	A process, effected by those charged with governance, management, and other personnel, designed to provide reasonable assurance about the achievement of the entity's objectives with regard to the reliability of financial reporting, effectiveness and efficiency of operations, and compliance with applicable laws and regulations.

material misstatement	A misstatement in the basic financial statements that causes the statements to not present fairly the financial position or the changes in financial position, and, where applicable, cash flows thereof, in accordance with the applicable financial reporting framework.
material weakness in internal control over financial reporting	A deficiency, or a combination of deficiencies, in internal control such that there is a reasonable possibility that a material misstatement of the basic financial statements will not be prevented, or detected and corrected, on a timely basis.
MBT	Michigan Business Tax.
MDHHS	Michigan Department of Health and Human Services.
MDOT	Michigan Department of Transportation.
OFM	Office of Financial Management.
ORTA	Office of Revenue and Tax Analysis.
PIHP	Prepaid Inpatient Health Plan.
significant deficiency in internal control over financial reporting	A deficiency, or a combination of deficiencies, in internal control that is less severe than a material weakness, yet important enough to merit attention by those charged with governance.
<i>SOMCAFR</i>	<i>State of Michigan Comprehensive Annual Financial Report.</i>
SUW	sales, use, and withholding.
TPSO	third party service organization.
Treasury	Department of Treasury.
unmodified opinion	The opinion expressed by the auditor when the auditor, having obtained sufficient appropriate audit evidence, concludes that the basic financial statements are presented fairly, in all material respects, in accordance with the applicable financial reporting framework.

