PERFORMANCE AUDIT
OF THE

OFFICE OF FINANCIAL MANAGEMENT

07-130-97

EXECUTIVE DIGEST

OFFICE OF FINANCIAL MANAGEMENT

INTRODUCTION

This report contains the results of our performance audit* of the Office of Financial Management (OFM), Department of Management and Budget (DMB).

AUDIT PURPOSE

This performance audit was conducted as part of the constitutional responsibility of the Office of the Auditor General. Performance audits are conducted on a priority basis related to the potential for improving effectiveness* and efficiency*.

BACKGROUND

DMB was created by the Executive Organization Act (Act 380, P.A. 1965). Sections 18.1101 - 18.1594 of the *Michigan Compiled Laws* define DMB's responsibilities.

OFM is located within DMB and is charged with maintaining a central accounting system and a Statewide internal control structure* . OFM has broad supervisory powers over all accounting and financial reporting activities within State agencies. OFM is divided into three divisions (the Financial Control Division; Financial Operations Division; and the Technical, Audit, and Business Services Division).

The Financial Control Division is responsible for developing and approving State accounting procedures and policies, publishing the *State of Michigan*

* *See glossary on page 37 for definition*.

Comprehensive Annual Financial Report (SOMCAFR), and providing accounting and financial reporting guidance to State agencies.

The Financial Operations Division is responsible for maintaining security over the Michigan Administrative Information Network* (MAIN), i.e., the State's financial management system; maintaining MAIN's central vendor/payee file*; and administering the State's employee payroll system.

The Technical, Audit, and Business Services Division is responsible for developing a biennial Statewide internal audit plan; planning, monitoring, and conducting internal audit engagements at State agencies; monitoring and evaluating the Statewide internal control structure; and following up agencies' responses to the audit reports of the Office of the Auditor General.

OFM had 39 employees as of September 6, 1997. OFM's expenditures for fiscal year 1996-97 were approximately $3.33 million.

AUDIT OBJECTIVES, CONCLUSIONS, AND NOTEWORTHY ACCOMPLISHMENTS

Audit Objective: To assess the effectiveness of OFM's oversight of the State's accounting and financial reporting processes.

Conclusion: We concluded that OFM was generally effective in its oversight of the State's accounting and financial reporting processes. However, we noted reportable conditions* related to OFM's accounting and financial reporting services provided to State agencies

* *See glossary on page 37 for definition*.

(Finding 1), controls over appropriation and operating transfers (Finding 2), and OFM's reporting on the State's compliance with constitutional requirements (Finding 3).

Noteworthy Accomplishments: OFM made significant progress during fiscal years 1995-96 and 1996-97 in the development of more effective and efficient year-end closing procedures and processes under MAIN. OFM issued the fiscal year 1995-96 *SOMCAFR* over two weeks prior to its statutory due date and over a month earlier than the previous year. Finally, the results of a survey we conducted of 30 State agencies' chief accountants indicated that users are generally satisfied with OFM's overall performance in providing accounting and financial reporting guidance and that OFM's performance had improved significantly during the last two years.

Audit Objective: To assess the effectiveness of OFM's administration of MAIN security and MAIN's central vendor/payee file.

Conclusion: We concluded that OFM was generally effective in its administration of MAIN security and MAIN's central vendor/payee file. However, we noted reportable conditions related to MAIN access controls (Finding 4), user security profiles* (Findings 5 and 6), selected user classes* (Findings 7 through 9), controls over payments to inactive vendors (Finding 10), and controls over vendor/payee file registrations (Finding 11).

Noteworthy Accomplishments: In October 1996, OFM developed and implemented security policies and procedures for the Data Collection and Distribution

* *See glossary on page 37 for definition*.

System, a component of MAIN used to process employee time and attendance information and to perform labor distribution. In addition, OFM successfully implemented new automated processes for reporting taxable payments made to State vendors/payees and for performing backup withholding. Finally, the results of a survey we conducted of 30 State agencies' chief accountants indicated that users are generally satisfied with OFM's overall performance in maintaining MAIN security.

Audit Objective: To assess the effectiveness of OFM's oversight of the Statewide internal control structure and the completion of internal audits.

Conclusion: Departmental budget reductions prior to our audit significantly restricted OFM's ability to maintain staffing levels sufficient to carry out its responsibilities for oversight of the Statewide internal control structure and the completion of internal audits. However, with the restoration of regular funding in fiscal year 1996-97 and the creation of the TABS Division, OFM made significant progress toward re-establishing its role of providing oversight for the Statewide internal control structure and the completion of internal audits. We will make an assessment of OFM's effectiveness in carrying out its responsibilities in a future audit.

AUDIT SCOPE AND METHODOLOGY

Our audit scope was to examine the program and other records of the Office of Financial Management. Our audit was conducted in accordance with *Government Auditing Standards* issued by the Comptroller General of the United States and, accordingly, included such tests of the records and such other auditing procedures as we considered necessary in the circumstances.

Our audit excluded the Personnel-Payroll Information System for Michigan, i.e., the State's employee payroll system, which we audit separately.

Our audit procedures were applied primarily to OFM's operations during the period October 1, 1995 through August 31, 1997.

To accomplish our objectives, we discussed the goals and objectives of OFM's three divisions with OFM personnel. Also, we examined various program records and interviewed OFM personnel. We surveyed key financial management personnel within State agencies to determine agency satisfaction with OFM's performance in providing accounting and financial reporting services and maintaining MAIN security. We reviewed and tested OFM's procedures and controls over its significant operating activities. In addition, we followed up applicable recommendations from our prior audit of OFM, our 1994-95 *SOMCAFR* management letter, and our 1996 financial related audit of MAIN.

AGENCY RESPONSES AND PRIOR AUDIT FOLLOW-UP

Our audit report includes 11 findings and 12 corresponding recommendations. OFM's preliminary response indicated that it agreed with all of the recommendations and that it has complied or will comply with them.

OFM has complied with 23 of the 29 prior audit recommendations included within the scope of our current audit. Five prior audit recommendations are repeated in this audit report, and 1 was combined with another recommendation in this report.

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Ms. Janet E. Phipps, Director
Department of Management and Budget
Lewis Cass Building
Lansing, Michigan

Dear Ms. Phipps:

This is our report on the performance audit of the Office of Financial Management, Department of Management and Budget.

This report contains our executive digest; description of agency; audit objectives, scope, and methodology and agency responses and prior audit follow-up; comments, findings, recommendations, and agency preliminary responses; and a glossary of acronyms and terms.

Our comments, findings, and recommendations are organized by audit objective. The agency preliminary responses were taken from the agency's responses subsequent to our audit fieldwork. 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.

Sincerely,

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

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DEPARTMENT OF MANAGEMENT AND BUDGET

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Description of Agency

The Department of Management and Budget (DMB) was created by the Executive Organization Act (Act 380, P.A. 1965). Sections 18.1101 - 18.1594 of the *Michigan Compiled Laws* define DMB's responsibilities. DMB's director is appointed by the Governor with the advice and consent of the Senate.

The Office of Financial Management (OFM) is located within DMB and is charged with maintaining a central accounting system and a Statewide internal control structure. OFM has broad supervisory powers over all accounting and financial reporting activities within State agencies. OFM is divided into three divisions: the Financial Control Division (FCD); Financial Operations Division (FOD); and Technical, Audit, and Business Services (TABS) Division.

FCD is responsible for developing and approving State accounting procedures and policies and publishing the *State of Michigan Comprehensive Annual Financial Report (SOMCAFR)*. In addition, FCD provides accounting and financial reporting guidance to State agencies.

FOD is responsible for maintaining security over the Michigan Administrative Information Network (MAIN), i.e., the State's financial management system, by approving and monitoring user access to the system. In addition, FOD is responsible for administering MAIN's central vendor/payee file and administering the State's employee payroll system.

The TABS Division is responsible for developing and maintaining a biennial Statewide internal audit plan. The TABS Division is also responsible for planning, monitoring, and conducting internal audit engagements at State agencies. In addition, the TABS Division is responsible for monitoring and evaluating the Statewide internal control structure and following up agencies' responses to the audit reports of the Office of the Auditor General. Further, the TABS Division is responsible for providing research and technical support in the development of policies and procedures related to internal control, MAIN technology, and audit issues.

OFM had 39 employees as of September 6, 1997. OFM's expenditures for fiscal year 1996-97 were approximately $3.33 million.

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

Audit Objectives

Our performance audit of the Office of Financial Management (OFM), Department of Management and Budget (DMB), had the following objectives:

1. To assess the effectiveness of OFM's oversight of the State's accounting and financial reporting processes.

2. To assess the effectiveness of OFM's administration of Michigan Administrative Information Network (MAIN) security and MAIN's central vendor/payee file.

3. To assess the effectiveness of OFM's oversight of the Statewide internal control structure and the completion of internal audits.

Audit Scope

Our audit scope was to examine the program and other records of the Office of Financial Management. Our audit was conducted in accordance with *Government Auditing Standards* issued by the Comptroller General of the United States and, accordingly, included such tests of the records and such other auditing procedures as we considered necessary in the circumstances.

Our audit excluded the Personnel-Payroll Information System for Michigan, i.e., the State's employee payroll system, which we audit separately.

Audit Methodology

Our audit procedures were applied primarily to OFM's operations during the period October 1, 1995 through August 31, 1997. Our work was performed between April and September 1997.

To accomplish our first objective, we discussed the goals and objectives of OFM's Financial Control Division (FCD) with OFM personnel. We examined various program records and interviewed OFM personnel. Also, we surveyed key financial management personnel within State agencies to determine agency satisfaction with FCD's performance in providing accounting and financial reporting services. In addition, we

followed up applicable recommendations from our prior audit of OFM and our 1994-95 *SOMCAFR* management letter.

To accomplish our second objective, we discussed the goals and objectives of OFM's Financial Operations Division (FOD) with OFM personnel. We tested selected FOD controls over its administration of MAIN security and MAIN's vendor/payee file. Also, we surveyed key financial management personnel within State agencies to determine agency satisfaction with FOD's performance in maintaining MAIN security. In addition, we followed up applicable recommendations from our 1996 financial related audit of MAIN.

To accomplish our third objective, we discussed the goals and objectives of OFM's Technical, Audit, and Business Services (TABS) Division with OFM personnel. We analyzed various agency records related to departmental budget reductions and staffing levels within the TABS Division.

Agency Responses and Prior Audit Follow-Up

Our audit report includes 11 findings and 12 corresponding recommendations. OFM's preliminary response indicated that it agreed with all of the recommendations and that it has complied with or will comply with them.

The agency preliminary response which follows each 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 DMB Administrative Guide procedure 1280.02 require DMB to develop a formal response to our audit findings and recommendations within 60 days after the release of the audit report.

OFM has complied with 23 of the 29 prior audit recommendations included within the scope of our current audit. Five prior audit recommendations are repeated in this audit report, and 1 was combined with another recommendation in this report.

COMMENTS, FINDINGS, RECOMMENDATIONS, AND AGENCY PRELIMINARY RESPONSES

OVERSIGHT OF ACCOUNTING AND FINANCIAL REPORTING PROCESSES

COMMENT

Background: The State's October 1, 1994 implementation of the Michigan Administrative Information Network (MAIN) resulted in significant changes in how State agencies' accounting personnel process financial transactions. Implementation of this automated Statewide financial management system required the Office of Financial Management (OFM) to develop completely new year-end closing schedules, procedures, and processes beginning with fiscal year 1994-95. In addition, OFM was integrally involved in developing, testing, and implementing expanded Statewide MAIN system functionality during fiscal years 1995-96 and 1996-97.

Audit Objective: To assess the effectiveness of OFM's oversight of the State's accounting and financial reporting processes.

Conclusion: We concluded that OFM was generally effective in its oversight of the State's accounting and financial reporting processes. However, we noted reportable conditions related to OFM's accounting and financial reporting services provided to State agencies, controls over appropriation and operating transfers, and OFM's reporting on the State's compliance with constitutional requirements.

Noteworthy Accomplishments: OFM made significant progress during fiscal years 1995-96 and 1996-97 in the development of more effective and efficient year-end closing procedures and processes under MAIN. OFM issued the fiscal year 1995-96 *State of Michigan Comprehensive Annual Financial Report* (*SOMCAFR*) over two weeks prior to its statutory due date and over a month earlier than the previous year. Finally, the results of a survey we conducted of 30 State agencies' chief accountants indicated that users are generally satisfied with OFM's overall performance in providing accounting and financial reporting guidance and that OFM's performance had improved significantly during the last two years.

FINDING

1. Accounting and Financial Reporting Services

OFM's Financial Control Division (FCD) had not provided timely and complete services to State agencies relating to guidance for the preparation of agency financial statements and schedules, the issuance of year-end closing policies and procedures, and reconciliation procedures for MAIN transactions.

FCD's primary functions include: providing accounting and financial reporting expertise for Statewide policy, procedure and system development; planning, coordinating, and issuing Statewide year-end closing policies and procedures; and planning and coordinating preparation of the State's annual financial report. We surveyed 30 State agencies' chief accountants regarding their satisfaction with these FCD services and received 23 responses. We reviewed the 23 agencies' responses and OFM documentation and noted the following:

a. FCD's formal goals and objectives include providing technical oversight of agency accounting practices. However, FCD had not provided formal written guidance or other assistance to agencies' accounting staffs on using MAIN for preparing fund-level, agency-level, and departmental financial statements and schedules, including the preparation of standardized footnote disclosures.

   Some agencies had been unable to prepare required financial statements that were consistent with the *SOMCAFR*. Thirteen (57%) of the 23 agencies that responded to our survey indicated that they needed guidance from FCD on the preparation of fund-level, agency-level, or departmental financial statements.

b. FCD's formal goals and objectives state that FCD will provide timely, high quality service. However, FCD had not issued written year-end closing policies and procedures in a timely manner. In addition, OFM had not addressed agency concerns regarding the need for more timely day-to-day assistance in the areas of accounting and financial reporting.

   FCD prepares and distributes to agencies detailed closing policies and procedures as sections of the Department of Management and Budget (DMB) Year-End Closing Guide. FCD is also responsible for addressing agencies'

questions relating to all closing policies and procedures, technical accounting and financial reporting issues, and MAIN processes. OFM did not issue the majority of the sections of the Year-End Closing Guides for fiscal years 1994-95 and 1995-96 until after September 30 of each year. In addition, 9 (39%) of the 23 agencies that responded to our survey were dissatisfied with OFM's responsiveness to day-to-day questions or concerns.

The completion of year-end closing processes by agencies is critical to the timely preparation and issuance of the *SOMCAFR.*

c. FCD had not provided timely guidance to agencies regarding procedures for performing reconciliations of MAIN transactions. Reconciliations are a critical control over the accuracy and completeness of accounting transactions recorded in the accounting system.

OFM issued general procedures to agencies for reconciling MAIN transactions in May 1995 and updated these procedures in draft form in August 1997. Considering that MAIN was implemented on October 1, 1994, these general procedures did not provide timely guidance to State agencies. In addition, the procedures were not sufficiently detailed to ensure that reconciliations were consistent and complete.

Only 13 (57%) of the 23 agencies that responded to our survey indicated that they were satisfied with OFM guidance on reconciliations. In addition, only 6 (26%) of the 23 agencies indicated that they performed daily reconciliations. Each agency used different procedures and sources of data for performing reconciliations. We also noted that some agencies were not performing any type of reconciliations, particularly for transactions entered by MAIN interface.

RECOMMENDATION

We recommend that OFM provide more timely and complete services to State agencies relating to guidance for the preparation of agency financial statements and schedules, the issuance of year-end closing policies and procedures, and reconciliation procedures for MAIN transactions.

AGENCY PRELIMINARY RESPONSE

OFM agreed with this recommendation and informed us that it will comply by September 30, 1999. OFM indicated that it has instituted several procedures and practices to improve its timeliness in releasing accounting guidance to agencies and that service levels now being provided to users are at unprecedented levels.

OFM informed us that, in fiscal year 1996-97, it released updates to the year-end closing guide more timely than it had in prior years. OFM also informed us that it developed, with extensive input from agencies, a comprehensive guide on reconciling MAIN transactions and released this guidance to agencies in October 1997. Finally, OFM indicated that it plans to begin a project in 1998 to review the needs of agencies regarding formal guidance for departmental financial statements, with a target completion date of September 30, 1999.

FINDING

2. Controls Over Appropriation and Operating Transfers

OFM, DMB-MAIN*, and DMB's Office of Budget Development and Information (OBDI) had not developed sufficient controls over appropriation and operating transfers to ensure that total transfers in and transfers out were equal.

Appropriation transfers are transactions used to transfer spending authority between appropriation line items within a department or between departments. Operating transfers are used to account for most of the routine transfers of resources between State funds, such as a transfer from a fund receiving revenue to the fund through which the resources are to be expended.

MAIN's Relational Standard Accounting and Reporting System* (R*STARS), i.e., the accounting and financial software package used by the State, provides for the use of companion transaction processing for recording appropriation and operating transfers. The use of companion transactions requires that both the transfer in and its related transfer out be recorded by the user; this serves as a

* *See glossary on page 37 for definition*.

control to ensure that such recorded amounts are equal. We noted the following conditions in our review of controls over appropriation and operating transfers:

a. Recorded appropriation transfers in have not equaled appropriation transfers out. General Fund appropriation transfers out for fiscal year 1995-96 were $23.2 million greater that appropriation transfers in. Neither OFM nor OBDI could explain the reason for this difference.

   OBDI, which is responsible for recording most appropriation transfer transactions in R*STARS, did not begin using companion transaction processing for appropriation transfers until fiscal year 1996-97. In addition, OBDI does not use companion transaction processing for appropriation transfers that result from executive order reorganizations. We did note that differences between appropriation transfers in and transfers out decreased significantly after OBDI began using companion transaction processing in fiscal year 1996-97. For example, as of September 1997, recorded appropriation transfers in for all funds exceeded transfers out by only $2.6 million. However, failure to record all appropriation transfers using companion transaction processing could result in spending authority being recorded inappropriately and in misstatements in the *SOMCAFR* or departmental financial statements.

b. For fiscal years 1994-95 and 1995-96, total operating transfers in for all funds were $13.4 million and $1.7 million more, respectively, than total operating transfers out. To correct these differences, OFM processed adjusting transactions to General Fund operating transfers in and to miscellaneous revenue. OFM could not determine the reason that operating transfers in and transfers out did not agree; therefore, it could not ensure that these correcting transactions were appropriate.

   The DMB Year-End Closing Guide, Chapter 16, requires agencies to record operating transfers using companion transaction processing to prevent differences between transfers in and transfers out. However, OFM informed us that some agencies recorded operating transfers without using companion transaction processing. In such cases, it is possible that only one agency's portion of the transfer would have been recorded.

In March 1997, OFM began monitoring the difference between operating transfers in and operating transfers out. As of August 1997, after excluding transfers involving component units that do not use R*STARS, total operating transfers in agreed with operating transfers out. However, monitoring by OFM will not prevent agencies from recording operating transfers without using companion transaction processing.

RECOMMENDATION

We recommend that OFM, DMB-MAIN, and OBDI develop sufficient controls over appropriation and operating transfers to ensure that total transfers in and total transfers out are equal.

AGENCY PRELIMINARY RESPONSE

OFM agreed with this recommendation and informed us that it has complied, based upon new control processes that were developed and implemented during fiscal year 1996-97. With regard to part a., OFM and OBDI developed comprehensive controls over the reconciliation of appropriations, including appropriation transfers in and out. All appropriation entries are now subject to periodic reconciliation. With regard to part b., OFM informed us that it did not believe that MAIN needed to be redesigned to ensure that companion transactions are always processed when an agency processes an operating transfer. OFM indicated that it has developed adequate compensating controls to reconcile all operating transfers on a monthly basis and to promptly follow up with any agency failing to process a companion transaction.

FINDING

3. Reporting on Compliance With Constitutional Requirements

DMB did not submit annual reports reflecting the extent of State compliance with Article 9, Sections 26 and 30 of the State Constitution to the Legislature in a timely manner.

Section 18.1350e of the *Michigan Compiled Laws* required DMB to submit to the Auditor General the Section 26 reports for fiscal years 1994-95 and 1995-96 by May 31, 1996 and May 31, 1997, respectively. This section also required DMB to publish these reports by submitting them to the Legislature no later than June 30,

1996 and June 30, 1997, respectively. For both fiscal years 1994-95 and 1995-96, OFM submitted information for the Section 26 report to the Auditor General after the May 31st deadline. In addition, DMB did not submit these reports to the Legislature until August 30, 1996 and July 15, 1997, respectively.

Section 18.1497 of the *Michigan Compiled Laws* required DMB to submit the Section 30 reports for fiscal years 1994-95 and 1995-96 to the Auditor General by May 31, 1996 and May 31, 1997, respectively. This section also required DMB to publish these reports by submitting them to the Legislature no later than June 30, 1996 and June 30, 1997, respectively. For both fiscal years 1994-95 and 1995-96, OFM submitted information for the Section 30 report to the Auditor General after the May 31st deadline. In addition, DMB did not submit these reports to the Legislature until December 4, 1996 and July 15, 1997, respectively.

Article 9, Section 26 of the State Constitution provides that, if total State revenue exceeds the revenue limit established by this section by 1% or more, the excess will be refunded to the taxpayers. Article 9, Section 30 requires the State to maintain the proportion of State spending to local governmental units in at least the proportion in effect for fiscal year 1978-79. Shortfalls in the required payments to local governmental units must be paid no later than the fiscal year following the fiscal year in which the shortfall is reported.

OFM determined that total State revenue for fiscal years 1994-95 and 1995-96 did not exceed the Section 26 limit by 1% or more and payments to local units of government did meet Section 30 requirements. As a result, refunds of excess revenues or additional local payments were not required. However, timely reporting of compliance with Section 26 and Section 30 requirements is imperative because such refunds or additional payments could have a significant impact on annual State budgets.

We included a similar finding for Section 30 reporting requirements in our prior audit of OFM. OFM stated that it would comply with our related recommendation when resources were available.

RECOMMENDATION

WE AGAIN RECOMMEND THAT OFM SUBMIT SECTION 26 AND SECTION 30 REPORTS WITHIN THE STATUTORY DEADLINES.

AGENCY PRELIMINARY RESPONSE

OFM agreed with this recommendation and informed us that it intends to publish the fiscal year 1996-97 Section 26 and Section 30 reports well within the statutory deadlines.

ADMINISTRATION OF MAIN SECURITY AND THE VENDOR/PAYEE FILE

COMMENT

Background: Security administration responsibilities for MAIN's Financial Administration and Control System* (FACS) were transferred from DMB-MAIN to OFM's Financial Operations Division (FOD) in May 1995.

FOD has the primary responsibility for maintaining Statewide user access security policies for MAIN and ensuring that established policies are effective. Agency security administrators* (ASA's) are responsible for reviewing, approving, and terminating access for specific users within their departments. ASA's are also responsible for forwarding approved security requests to FOD for input. FOD is responsible for processing changes to user security profiles, including additions of user classes; changes to the capabilities of existing user classes; and deletions of user classes.

In addition, FOD is responsible for administering MAIN's central vendor/payee file. The vendor/payee file is a central database of all individuals, businesses, and organizations that either provide goods or services to the State (vendors) or receive grants, financial assistance, or other payments from the State (payees). The vendor/payee file is used by FOD as the source of information for reporting payments to State vendors and other payees in accordance with Internal Revenue Service regulations.

* *See glossary on page 37 for definition*.

Audit Objective: To assess the effectiveness of OFM's administration of MAIN security and MAIN's central vendor/payee file.

Conclusion: We concluded that OFM was generally effective in its administration of MAIN security and MAIN's central vendor/payee file. However, we noted reportable conditions related to MAIN access controls, user security profiles, selected user classes, controls over payments to inactive vendors, and controls over vendor/payee file registrations.

Noteworthy Accomplishments: In October 1996, OFM developed and implemented security policies and procedures for the Data Collection and Distribution System, a component of MAIN used to process employee time and attendance information and to perform labor distribution. In addition, OFM successfully implemented new automated processes for reporting taxable payments made to State vendors/payees and for performing backup withholding. Finally, the results of a survey we conducted of 30 State agencies' chief accountants indicated that users are generally satisfied with OFM's overall performance in maintaining MAIN security.

FINDING

4. MAIN Access Controls

FOD did not periodically monitor the effectiveness of agency and DMB-MAIN control procedures over access to MAIN.

DMB-MAIN is responsible for administering Resource Access Control Facility (RACF) security through assignment of and control over users' access to MAIN's operating system environment. FOD serves as the central security administrator for MAIN and administers security for user access to specific MAIN applications, such as R*STARS and the Advanced Purchasing and Inventory Control System* (ADPICS), i.e., the purchasing software used by the State.

* *See glossary on page 37 for definition*.

We reviewed FOD's controls over user access to MAIN and noted that FOD did not perform periodic monitoring to ensure that:

a. ASA's and DMB-MAIN's staff, responsible for RACF security, assessed the continuing need for access to MAIN by employees within individual agencies. We identified 243 employees with active MAIN user status who had not used MAIN for over six months. This could indicate that these users did not need access to MAIN.

b. ASA's promptly requested FOD to remove the access rights to MAIN applications for employees who had left employment through retirement, layoff, resignation, or other forms of separation. We identified 372 employees who separated from State employment between October 1995 and May 1997 who still had access to MAIN applications as of June 30, 1997.

Our prior audit noted that OFM had not monitored the departments' controls over access by separated employees to the State's former accounting system. OFM had stated that it would comply with our related recommendation when resources were available. Also, our audit report on MAIN, dated August 31, 1996, noted that DMB-MAIN issued access to 1,899 users who did not use MAIN for over six months. DMB agreed with our corresponding recommendation and indicated that access controls were a responsibility that was shared by other State agencies and DMB.

We agree that it is each ASA's responsibility to ensure that MAIN access is limited to current employees with an ongoing need for such access. However, FOD, in its role as central security administrator, should periodically monitor the effectiveness of agency controls and DMB-MAIN's administration of RACF security. Properly limiting MAIN access to authorized users with an ongoing need for such access could help FOD reduce the risk of unauthorized transactions.

RECOMMENDATION

We recommend that FOD periodically monitor the effectiveness of agency and DMB-MAIN control procedures over access to MAIN.

AGENCY PRELIMINARY RESPONSE

OFM agreed with this recommendation and informed us that it will comply by September 30, 1998. With regard to part a., OFM noted that the 243 noncurrent MAIN users identified in our report represent a significant improvement from the 1,899 noncurrent users that we identified in our audit report on MAIN, dated August 31, 1996.

FINDING

5. User Security Profiles

FOD had not established control procedures sufficient to ensure the accuracy and completeness of the ADPICS and R*STARS user security profiles.

FOD controls ADPICS and R*STARS access and capabilities by assigning user class codes to each of the approximately 6,300 ADPICS and 7,000 R*STARS users. Each user class has an associated security profile that defines a user's capabilities. FOD defined the security profile associated with each ADPICS and R*STARS master user class. Our review of ADPICS and R*STARS user security profiles disclosed the following weaknesses:

a. FOD did not ensure that each user's security profile agreed with the master security profile established for a particular user class. We identified 60 ADPICS and 758 R*STARS users with security profiles that differed from the master security profiles.

   We determined that only 17 (28%) of the 60 ADPICS security profiles that deviated from the master profiles were substantiated by a written request from the agency. None of the 758 R*STARS profiles we identified that deviated from the master profiles were substantiated by such a request. In response to our finding, FOD corrected 37 of the 60 ADPICS profiles that differed from the master security profiles. In addition, FOD corrected 731 of the 758 R*STARS profiles that differed from the master security profiles and deleted the user identifications for 15 others.

To help ensure that users do not have more MAIN capabilities than intended, FOD should require that all user security profile deviations from the master security profiles be properly documented.

b. FOD had not documented its monitoring of users with multiple ADPICS access capabilities. We identified 131 users with multiple user identification codes (ID's). Some users require access to multiple agencies and need multiple user ID's. However, most users do not need such access.

Our audit report on MAIN, dated August 31, 1996, noted that OFM had not monitored users with multiple ID's. In response, FOD began reviewing existing users with multiple ADPICS access capabilities to determine whether such capabilities were necessary. However, FOD did not sufficiently document its review of existing users with multiple ADPICS access capabilities by justifying why such deviations were proper. FOD should properly document its monitoring activities to reduce the risk of users with inappropriate ADPICS access.

c. FOD had not accurately documented R*STARS user class security profiles on the R*STARS security spreadsheet. Agencies use the spreadsheet to determine user class capabilities when assigning user classes.

Our audit report on MAIN, dated August 31, 1996, noted master user class records that differed from the profile documented on the R*STARS security spreadsheet. In July 1997, FOD created an updated spreadsheet that corrected these differences. However, OFM had not issued this updated spreadsheet to agencies as of the end of our audit. FOD staff informed us that these changes were communicated to agencies through periodic publications issued to agencies by DMB-MAIN. In response to a survey we conducted of State agencies' chief accountants, 13 (57%) of 23 respondents indicated that they rely on the R*STARS security spreadsheet when assigning user classes to users. Inaccurate documentation of profiles on the spreadsheet could result in agencies assigning inappropriate user classes to agency staff.

FOD should verify the accuracy and completeness of the user security profiles to reduce the risk of improper access.

In response to our audit report on MAIN, dated August 31, 1996, OFM stated that it agreed with our recommendation to establish control procedures for user security profiles. OFM expected to complete documentation for the exceptions noted during our MAIN audit by December 31, 1996.

RECOMMENDATION

WE AGAIN RECOMMEND THAT FOD ESTABLISH MORE EFFECTIVE CONTROL PROCEDURES TO ENSURE THE ACCURACY AND COMPLETENESS OF ADPICS AND R*STARS USER SECURITY PROFILES.

AGENCY PRELIMINARY RESPONSE

OFM agreed with this recommendation and informed us that it will comply by September 30, 1998. With regard to part a., OFM noted that 6 of the ADPICS security profiles and 12 of the R*STARS security profiles that differed from the master security profile were for DMB-MAIN staff whose job functions required the capabilities provided for in their security profiles. With regard to part b., OFM informed us that it has eliminated 65 of the 131 users with multiple user ID's. OFM believes that the other 66 users with multiple user ID's do not represent an excessive level. With regard to part c., OFM informed us that the R*STARS security spreadsheets are now on the State's Intranet and are updated weekly. Also, OFM plans to issue hard copies of the R*STARS security spreadsheets to agencies on a quarterly basis.

FINDING

6. Security Profile Changes

FOD had not established sufficient internal control procedures over changes to user security profiles. These security profiles control user capabilities of applications within MAIN.

The MAIN FACS Security Manual requires that agencies initiate changes to security profiles. It also requires the agency security administrator and the

employee to sign the MAIN FACS security form for such changes. We tested 225 security profile changes. We determined that FOD had not retained the MAIN FACS security form, or other documentation supporting the change, for 72 (32%) of the 225 security changes we reviewed. Without this documentation, management cannot ensure that all changes made to security profiles were initiated by agency personnel and were processed appropriately.

Establishing sufficient internal control procedures over changes to user security profiles would help ensure that users do not have more MAIN system capabilities than needed.

In response to a similar finding in our audit report on MAIN, dated August 31, 1996, OFM informed us that it had been assigned responsibility for changes to security profiles and had established sufficient internal control procedures over such changes. However, our findings indicate that such control procedures have not been established.

RECOMMENDATION

WE AGAIN RECOMMEND THAT FOD ESTABLISH SUFFICIENT INTERNAL CONTROL PROCEDURES OVER CHANGES TO USER SECURITY PROFILES.

AGENCY PRELIMINARY RESPONSE

OFM agreed with this recommendation and informed us that it will comply by September 30, 1998.

FINDING

7. ADPICS User Class 17

FOD did not effectively monitor the assignment of ADPICS user class 17. This user class was created in response to agency requests for a user class with the capability to act as a one-person office.

User class 17 capabilities include requisitioning, receiving, purchasing, accounts payable processing, document cancellation, and change order processing. These capabilities could allow an individual to bypass established internal controls, such

as traditional separation of duties. FOD should monitor the assignment of user class 17 because of this risk.

Our audit report on MAIN, dated August 31, 1996, recommended that OFM effectively monitor the assignment of user class 17. In response, OFM informed us that it agreed, and it intended to comply with our recommendation by June 30, 1997. In December 1996, FOD began requiring agencies to submit a memorandum describing the staffing limitations necessitating the assignment of this user class and the compensating controls to be implemented. However, FOD informed us that it did not require such a memorandum from agencies with users who had been assigned user class 17 prior to December 1996.

We determined that 365 of the 370 users with user class 17 were assigned the user class prior to December 1996. FOD had not attempted to assess whether the assignment of user class 17 to these 365 users was justified by staffing limitations or whether compensating controls exist at the agencies. We also determined that FOD had not obtained agency memorandums for 4 of the 5 users who FOD assigned user class 17 after December 1996. In addition, we noted that the one memorandum that FOD had obtained did not describe compensating controls.

Properly monitoring all assignments of user class 17 could help FOD reduce the risk of unauthorized and improper transactions.

RECOMMENDATION

WE AGAIN RECOMMEND THAT FOD EFFECTIVELY MONITOR THE ASSIGNMENT OF ADPICS USER CLASS 17.

AGENCY PRELIMINARY RESPONSE

OFM agreed with this recommendation and informed us that it will develop effective monitoring procedures for ADPICS user class 17 by September 30, 1998. OFM also informed us that it will review current assignments of user class 17 to determine if the assignment of the user class is still appropriate.

FINDING

8. Controls Over Incompatible User Class Combinations

FOD's internal control procedures did not effectively control incompatible R*STARS user class combinations.

FOD is responsible for maintaining the MAIN FACS Security Manual. The Security Manual identifies user class combinations which FOD considers incompatible. It is designed to serve as a guide for agencies in making security decisions. The implementation of MAIN provided increased capabilities to monitor and control users. However, our review disclosed the following weaknesses:

a. FOD had not requested that agencies submit affirmation letters for all users with incompatible user classes. The MAIN FACS Security Manual states that each agency must submit a written affirmation to FOD for its users who possess conflicting user class combinations. The purpose of the affirmation letters is for the agency to acknowledge the increased risk associated with the assignment of incompatible user classes and accept responsibility for establishing compensating controls to reduce this risk.

   FOD requested affirmation letters for new users beginning in May 1995, when many of FOD's current responsibilities as central security administrator were transferred to FOD from DMB-MAIN. However, FOD has not requested or obtained affirmation letters for users who were assigned incompatible user classes by DMB-MAIN prior to May 1995.

b. FOD did not ensure that affirmation letters received from agencies for users with incompatible user classes assigned after May 1995 contained all required information. We tested 50 users who were assigned incompatible user classes after May 1995 and noted that FOD received affirmation letters for only 19 (38%) of the users. Eight of these 19 affirmation letters did not include a justification by the agency for the combination of user classes assigned. Also, 9 of the 19 affirmation letters did not state that the agency accepted responsibility for maintaining effective compensating internal controls.

c. FOD had not provided agencies with lists of users with incompatible user classes. Section 5.4.4 of the MAIN FACS Security Manual, issued in July 1995, states that FOD will periodically produce reports that identify users who have incompatible user class combinations and forward these to the agencies for review. Providing these listings would help agencies assess the need for users to possess incompatible user classes.

d. FOD did not update the MAIN FACS Security Manual on a timely basis for new user class combinations that FOD considered incompatible. Our audit report on MAIN, dated August 31, 1996, identified incompatible user class combinations which were not included in the MAIN FACS Security Manual. FOD agreed that the Security Manual listing needed to be updated. However, FOD did not issue a revision to the Security Manual that included these combinations or require agencies to submit written affirmations for users with these combinations. The MAIN FACS Security Manual should identify all user class combinations that are considered incompatible.

Adequately controlling incompatible R*STARS user class combinations could help FOD reduce the risk of users executing improper transactions.

In response to our audit report on MAIN, dated August 31, 1996, FOD indicated that it would complete its final review of incompatible user classes by December 31, 1996. However, we concluded that FOD has not sufficiently addressed the control weaknesses we have cited.

RECOMMENDATION

WE AGAIN RECOMMEND THAT OFM EFFECTIVELY CONTROL INCOMPATIBLE R*STARS USER CLASS COMBINATIONS.

AGENCY PRELIMINARY RESPONSE

OFM agreed with this recommendation and informed us that it is developing a matrix of R*STARS user classes to be used to identify incompatible user class combinations. OFM indicated that it will comply with our recommendation by June 30, 1998.

FINDING

9. Controls Over User Classes 48 and 49

FOD had not developed effective controls over the assignment and use of R*STARS user classes 48 and 49 by State agencies. User classes 48 and 49 are used to generate payments that bypass MAIN's vendor/payee file.

Individual agencies must obtain FOD's approval to assign user classes 48 and 49 to agency users so that they can make certain types of payments, such as witness fees, that are not reportable for federal tax purposes. FOD's approval identifies the specific types of transactions that an agency may process with these user classes and whether the related payments can exceed the $500 limit set forth in section 5.2.1 of the MAIN FACS Security Manual. Section 5.2.1 also requires agencies to submit a security request form for each specific user to be assigned these user classes. In addition, an explanation of the types of payments each user will process is to be submitted. The types of payments must be the same as those previously approved by FOD for use by the agency.

Our review of FOD's controls over the assignment and use of user classes 48 and 49 identified the following weaknesses:

a. FOD had not requested agencies to identify the types of payments to be processed by users assigned these user classes prior to August 1995. FOD required such explanations only from agencies for users assigned these classes after this date, the date when MAIN FACS Security Manual section 5.2.1 was issued. We determined that 1,045 users were assigned user class 48 or 49 capabilities prior to August 1995. FOD informed us that the majority of these user classes were assigned by DMB-MAIN prior to May 1995, when security responsibilities were transferred to FOD from DMB-MAIN.

   We also determined that FOD did not obtain payment type explanations for all users assigned user class 48 or 49 after August 1995. We reviewed FOD's documentation for 28 of the 73 users assigned user class 48 or 49 after August 1995. We determined that FOD did not obtain payment type explanations for 18 (64%) of these 28 users. FOD should ensure that the types of payments processed by these 18 users are consistent with those FOD previously approved.

b. FOD had not monitored agencies' use of user classes 48 and 49 to ensure that the payment types or the amounts processed were consistent with those approved by FOD. We reviewed FOD's documentation for 12 agencies that made individual payments greater than $500 with user class 48 or 49. We determined that 10 (83%) of the 12 agencies had not received FOD approval to process payments for more than $500. We also determined that 10 agencies processed payments that were not the types of payments previously approved by FOD.

FOD should develop controls to ensure that agencies process only the payment types and amounts approved by FOD. Failure to develop such controls may result in improper classification of payments to vendors/payees in FOD's annual federal reporting process.

RECOMMENDATION

We recommend that FOD develop effective controls over the assignment and use of R*STARS user classes 48 and 49 by State agencies.

AGENCY PRELIMINARY RESPONSE

OFM agreed with this recommendation and informed us that it will comply by September 30, 1998.

FINDING

10. Controls Over Payments to Inactive Vendors

FOD and DMB-MAIN had not corrected a MAIN weakness that allowed payments to vendors with identification codes (ID's) that FOD had inactivated on MAIN's vendor/payee file.

State agencies routinely request FOD to remove certain vendors from the vendor/payee file for various reasons, such as the vendor going out of business or no longer providing goods or services to the State. Vendors also frequently request removal from the vendor/payee file for various reasons, such as a change in the type of ownership for tax reporting purposes or a business combination with another entity that is already on the vendor/payee file. FOD informed us that MAIN

limitations did not allow FOD to delete vendors from the vendor/payee file. Instead, FOD inactivated the vendor ID's for obsolete vendors, based on MAIN system documentation that indicated this action would prevent further payments to such vendors.

We determined that FOD's inactivation of vendor ID's on the vendor/payee file did not always prevent payments from subsequently being made to the vendors. Specifically, payments generated through an R*STARS transaction are subject to MAIN's inactive vendor edit only if certain conditions are met. We identified 127 payments, generated through R*STARS during fiscal years 1995-96 and 1996-97, to 43 vendors which had vendor ID's that FOD had previously inactivated on the vendor/payee file. In some cases, payments were made more than two years after the date that FOD inactivated the vendor ID's.

We performed additional analyses on vendors whose ID's were inactivated and who received payments during fiscal years 1995-96 and 1996-97. We determined that the vendor ID's were inactivated by FOD; however, the vendors were subsequently activated under different ID's. We concluded that the continued payments to these vendors were proper and likely resulted from agencies inadvertently using the inactive vendor ID's, rather than the new active vendor ID's. However, in several cases, the active vendor ID had a different federal tax reporting status than the inactive ID used to process the payments to the vendor/payee. As a result, payments made to such vendor/payees would have been improperly classified for federal tax purposes in FOD's annual reporting process.

To help ensure that all payments to State vendors are properly classified for tax reporting purposes and to help reduce the risk of improper payments to inactive vendors, FOD and DMB-MAIN should ensure that MAIN system controls are developed to prevent making payments using inactive vendor ID's.

RECOMMENDATION

We recommend that FOD and DMB-MAIN correct the MAIN weakness that allows payments to vendors with ID's that FOD has inactivated on MAIN's vendor/payee file.

AGENCY PRELIMINARY RESPONSE

OFM agreed with this recommendation and informed us that it has complied as of March 30, 1998, with DMB-MAIN's implementation of MAIN Release 98-1.

FINDING

11. Controls Over Vendor/Payee File Registrations

FOD had not developed controls to ensure the validity of vendor/payee file registrations for State employees and members of State boards and commissions. Also, FOD had not developed controls to ensure that all additions to MAIN's master vendor/payee file were adequately documented.

Vendors doing business with the State and recipients of certain grants, financial assistance, or other payments from the State must be registered on MAIN's master vendor/payee file. FOD enters vendor information on the vendor/payee file from the vendor registration form and from the request for taxpayer identification number and certification form (Internal Revenue Service [IRS] W-9 form) submitted by each vendor. FOD also processes emergency vendor registration requests and registers State employees and members of State boards and commissions who receive nonpayroll payments, such as travel expense reimbursements.

We tested vendor/payee file registrations processed during the period October 1, 1995 through August 31, 1997:

a. FOD did not ensure that it accurately processed State employee registrations submitted by State agencies or that agencies submitted these registrations only for current employees. FOD processed approximately 8,640 such registrations.

   We compared vendor/payee file information for the 8,640 employee payees to the State employee payroll system, which is also administered by FOD. We identified approximately 330 payees whose identification numbers, created

using social security numbers, did not agree with a corresponding employee social security number on the payroll system. We noted the following from our review of these 330 payees:

(1) Approximately 150 of the payees were included on the State employee payroll system under a social security number that differed slightly from the identification number on the vendor/payee file. FOD informed us that these errors likely occurred when these employees were originally registered on the vendor/payee file and that it subsequently corrected these vendor numbers.

(2) Approximately 180 of the payees were not included on the State employee payroll system under a different social security number. FOD staff informed us that members of State boards and commissions who routinely receive travel expense reimbursements were coded on the vendor/payee file as employees, even though they were not included on the State employee payroll system. However, FOD had not verified that these 180 registrations were only for valid members of State boards and commissions.

Verifying that all registrations for employee payees represent current State employees or members of State boards and commissions would help FOD decrease the risk of making improper travel expense reimbursements or other nonpayroll payments to departed employees or similar payments to nonemployees.

b. FOD did not retain a vendor file registration form or the IRS W-9 form for any emergency vendor registrations. We identified in excess of 1,360 such vendor/payee registrations for which FOD had not retained the registration documentation.

Without vendor/payee documentation, FOD cannot ensure the accuracy of these registrations or the propriety of the IRS reporting designation applicable to these vendors/payees. This could result in payments to vendors/payees not being properly reported to the IRS.

RECOMMENDATIONS

We recommend that FOD develop controls to ensure the validity of vendor/payee file registrations for State employees and members of State boards and commissions.

We also recommend that FOD develop controls to ensure that all additions to MAIN's master vendor/payee file are adequately documented.

AGENCY PRELIMINARY RESPONSE

OFM informed us that it agreed with these recommendations. With regard to part a., OFM informed us that the implementation of MAIN Release 98-1 on March 30, 1998, which includes an interface between the Personnel-Payroll Information System for Michigan and MAIN's vendor file, will greatly help to ensure the validity of vendor/payee file registrations for State employees. With regard to part b., OFM informed us that it will develop controls to ensure that all additions to MAIN's master vendor/payee file are adequately documented. OFM further emphasized that control over improper payments is provided by the review and approval of payment transactions and that the existence of a vendor on the vendor file is only an ancillary factor.

OVERSIGHT OF THE STATEWIDE INTERNAL CONTROL STRUCTURE AND COMPLETION OF INTERNAL AUDITS

COMMENT

Background: OFM has been designated as the agency within DMB that is responsible for receipt and evaluation of biennial internal control assessments prepared by each principal State department in accordance with Section 18.1485(5) of the *Michigan Compiled Laws*. Also, DMB Administrative Guide procedure 1280.02 provides that OFM is responsible for following up agencies' responses to recommendations in the Office of the Auditor General audit reports. However, departmental budget reductions prior to our audit resulted in the elimination of virtually all OFM staff positions responsible for these duties. Regular funding was restored by DMB for fiscal year 1996-97 and OFM created the Technical, Audit, and Business Services (TABS) Division. In addition to following up departmental internal control assessments and

agencies' responses to the audit reports of the Office of the Auditor General, the TABS Division's major responsibilities include developing and maintaining a biennial Statewide internal audit plan; planning, monitoring, and conducting internal audit engagements at State agencies; and providing research and technical support in the development of policies and procedures related to internal control, MAIN technology, and audit issues.

Audit Objective: To assess the effectiveness of OFM's oversight of the Statewide internal control structure and the completion of internal audits.

Conclusion: Departmental budget reductions prior to our audit significantly restricted OFM's ability to maintain staffing levels sufficient to carry out its responsibilities for oversight of the Statewide internal control structure and the completion of internal audits. OFM was only able to perform limited evaluations and follow-up of the biennial internal control assessments submitted by the principal State departments and of the agency responses to the Auditor General's recommendations. In addition, OFM did not conduct State agency internal audits.

With the restoration of regular funding in fiscal year 1996-97 and the creation of the TABS Division, OFM made significant progress toward re-establishing its role of providing oversight for the Statewide internal control structure and the completion of internal audits. We will make an assessment of OFM's effectiveness in carrying out its responsibilities in a future audit.

Glossary of Acronyms and Terms

Advanced Purchasing and Inventory Control System (ADPICS)	The purchasing software used by the State; part of MAIN FACS.
agency security administrator (ASA)	An agency employee designated by the agency to manage all security matters in relation to MAIN FACS security.
DMB	Department of Management and Budget.
DMB-MAIN	The entity that DMB has established to administer MAIN.
effectiveness	Program success in achieving mission and goals.
efficiency	Achieving the most outputs and outcomes practical for the amount of resources applied or minimizing the amount of resources required to attain a certain level of outputs or outcomes.
FCD	Financial Control Division.
Financial Administration and Control System (FACS)	The system made up of all the software pieces that run on the IBM mainframe in Boulder, Colorado. FACS is the financial management component of MAIN.
FOD	Financial Operations Division.
ID's	identification codes.
internal control structure	The management control environment, management information system, and control policies and procedures established by management to provide reasonable assurance that goals are met; that resources are used in

	compliance with laws and regulations; and that valid and reliable performance related information is obtained and reported. .
IRS	Internal Revenue Service.
Michigan Administrative Information Network (MAIN)	A fully integrated automated financial management system for the State of Michigan.
OBDI	Office of Budget Development and Information.
OFM	Office of Financial Management.
performance audit	An economy and efficiency audit or a program audit that is designed to provide an independent assessment of the performance of a governmental entity, program, activity, or function to improve public accountability and to facilitate decision making by parties responsible for overseeing or initiating corrective action.
RACF	Resource Access Control Facility.
Relational Standard Accounting and Reporting System (R*STARS)	The accounting and financial software package used by the State; part of MAIN FACS.
reportable condition	A matter coming to the auditor's attention that, in his/her judgment, should be communicated because it represents either an opportunity for improvement or a significant deficiency in the design or operation of the internal control structure or in management's ability to operate a program in an effective and efficient manner.

security profile	Used to manage and define a user's access to MAIN FACS.
SOMCAFR	*State of Michigan Comprehensive Annual Financial Report.*
TABS	Technical, Audit, and Business Services Division.
user class	Defines a user's ability to access the system.
vendor/payee file	A central database of all individuals, businesses, or organizations that provide goods or services to the State (vendors) or receive grants, financial assistance, or other payments from the State (payees); a source of information for federal (form 1099) reporting.