

PERFORMANCE AUDIT
OF THE
MICHIGAN STATE DISBURSEMENT UNIT

OFFICE OF CHILD SUPPORT
FAMILY INDEPENDENCE AGENCY

November 2001

EXECUTIVE DIGEST

MICHIGAN STATE DISBURSEMENT UNIT

INTRODUCTION

This report, issued in November 2001, contains the results of our performance audit* of the Michigan State Disbursement Unit* (MiSDU), Office of Child Support, Family Independence Agency (FIA).

AUDIT PURPOSE

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

In addition, Act 161, P.A. 1999 (specifically, Section 400.238 of the *Michigan Compiled Laws*), mandates that the OAG conduct an audit of MiSDU not less than one year, but within two years, after the effective date of Act 161, P.A. 1999, and not less than every two years after the initial audit.

BACKGROUND

The federal Personal Responsibility and Work Opportunity Reconciliation Act of 1996 revised Title IV-D of the Social Security Act to require that each state operate a state disbursement unit to centrally collect and disburse certain child support payments. Section 454B of the Social Security Act requires that state disbursement units provide one central location for the receipt and disbursement of all Title IV-D child support payments and for all private payments associated with a child support order* initially

* See glossary at end of report for definition.

issued on or after January 1, 1994 that include a court order for an employer to withhold income from the check of the noncustodial parent*. Sections 400.236 - 400.239 of the *Michigan Compiled Laws* (Act 161, P.A. 1999) authorized FIA to establish MiSDU as the State's centralized collection and disbursement unit for all child support payments.

The federal deadline for Michigan to have a fully operational state disbursement unit was October 1, 1999. However, FIA applied for and was granted a waiver to extend the deadline to October 1, 2001. The waiver was granted based on FIA's plan to process child support payments by linking local disbursement units through an automated information network. The State's Child Support Enforcement System (CSES), which was not fully implemented at the time of our review, is a critical component necessary for FIA to fully implement MiSDU. The waiver was further extended to April 1, 2002.

FIA entered into a five-year contract with Lockheed Martin IMS (contractor) to develop and operate MiSDU. Pending completion of CSES, MiSDU processed payments from employers and electronically transferred the funds to Friend of the Court offices* (FOCs) who were responsible for distributing the funds.

During May 2001, MiSDU received and transferred to FOCs for distribution approximately \$67.7 million. FIA expended approximately \$29.3 million to establish and operate MiSDU for the period October 1, 1999 through May 31, 2001.

As of May 31, 2001, the contractor and its subcontractors employed approximately 92 full-time equated staff. In

* See glossary at end of report for definition.

addition, 2 full-time FIA employees, 2 contracted employees, and 4 contracted quality assurance employees were assigned to MiSDU.

Effective August 24, 2001, Lockheed Martin, Inc., sold its wholly owned subsidiary, Lockheed Martin IMS (the primary contractor for MiSDU), to Affiliated Computer Services, Inc. ACS State and Local Solutions, Inc., is the new Affiliated Computer Services, Inc., subsidiary responsible for processing child support payments under the existing contractual agreement with FIA.

AUDIT OBJECTIVE,
CONCLUSION, AND
NOTEWORTHY
ACCOMPLISHMENTS

Audit Objective: To assess FIA's effectiveness and efficiency in establishing and operating MiSDU in accordance with State and federal laws and rules.

Conclusion: As a result of FIA's failure to fully implement a Statewide automated CSES, MiSDU did not have the ability to receive child support payments not made through an income withholding order* and to distribute child support payments directly to recipients. Excluding these deficiencies, **we concluded that FIA was generally effective and efficient in establishing and operating MiSDU in accordance with State and federal laws and rules.** However, our assessment disclosed one material condition*:

- FIA did not ensure that FOCs distributed child support payments within two business days after receipt at MiSDU as required by federal statute (Finding 1).

FIA responded that it agreed with the corresponding recommendation and will comply.

* See glossary at end of report for definition.

Our assessment also disclosed reportable conditions* related to compliance with contract requirements, courier bonding, use of interest income, and privatization project plan (Findings 2 through 5).

Noteworthy Accomplishments: FIA and the MiSDU contractor worked closely with employers and FOCs to provide for a smooth transition and to identify and resolve issues in a timely manner. As a result, FIA and the contractor developed and implemented an automated system that processed approximately \$65 million per month in employer-withheld child support payments from income withholding orders in less than nine months. This system distributed approximately 98% of all payments received at MiSDU to FOCs in one business day.

**AUDIT SCOPE AND
METHODOLOGY**

Our audit scope was to examine the program and other records of the Michigan State Disbursement Unit. 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 procedures included an examination of MiSDU and FIA records primarily for the period July 1999 through May 2001.

We performed a preliminary survey to obtain an understanding of the process MiSDU used to receive and disburse child support payments. We interviewed various MiSDU and FIA staff and reviewed pertinent federal and State laws, rules, policies, and procedures.

We assessed the status of program implementation based on requirements in the federal program waiver. Also, we

surveyed local FOCs to determine compliance with the two-day disbursement requirement.

We reviewed the bid process for the primary contractor and examined the contract in relation to program controls. Further, we reviewed FIA's and the quality assurance contractor's efforts to oversee the primary contractor's compliance with certain program requirements.

We reviewed the current status of MiSDU program implementation, including facility security and disaster recovery. Also, we tested a random sample of transactions for compliance with significant program requirements.

AGENCY RESPONSES

Our audit report contains 5 findings and 9 corresponding recommendations. FIA's preliminary response indicated that it generally agreed with 8 recommendations and did not agree with 1 finding and recommendation.

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November 2, 2001

Mr. Douglas E. Howard, Director
Family Independence Agency
Grand Tower
Lansing, Michigan

Dear Mr. Howard:

This is our report on the performance audit of the Michigan State Disbursement Unit, Family Independence Agency.

This report contains our executive digest; description of program; audit objective, scope, and methodology and agency responses; comment, findings, recommendations, and agency preliminary responses; and a glossary of acronyms and terms.

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.

AUDITOR GENERAL

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Description of Program

The Family Independence Agency (FIA) operates the Michigan State Disbursement Unit (MiSDU) to centrally collect and disburse child support payments as required by federal child support enforcement program requirements.

The federal Personal Responsibility and Work Opportunity Reconciliation Act of 1996 (commonly known as the federal Welfare Reform Act) revised Title IV-D of the Social Security Act to require that each state operate a state disbursement unit to centrally collect and disburse certain child support payments. Section 454B of the Social Security Act (Title 42, Section 654b of the *Code of Laws of the United States*), requires that state disbursement units provide one central location for the receipt and disbursement of all Title IV-D child support payments and for all private payments associated with a child support order initially issued on or after January 1, 1994 that include a court order for an employer to withhold income from the check of the noncustodial parent. Federal law requires that state disbursement units must be able to process all payments received with complete information within two business days after receipt if sufficient information identifying the payee is provided. Also, state disbursement units are required to use automated data processing to the greatest extent possible. Noncompliance with federal law could result in a substantial loss of federal funds for the State's child support enforcement program and the Temporary Assistance for Needy Families welfare block grant.

The federal deadline for Michigan to have a fully operational state disbursement unit was October 1, 1999. However, FIA applied for and was granted a waiver to extend the deadline to October 1, 2001. This waiver was granted based on FIA's plan to process child support payments by linking local disbursement units through an automated information network. The State's Child Support Enforcement System (CSES), which was not fully implemented at the time of our review, is a critical component necessary for FIA to fully implement MiSDU. Based on the waiver request, FIA projected full Statewide CSES implementation by September 30, 2000 and requested 6 months after that date to fully implement MiSDU. Michigan was granted an extension until October 1, 2001 to fully implement all requirements of this federally mandated central collection and disbursement process. The waiver was further extended to April 1, 2002.

Act 161, P.A. 1999 (specifically, Section 400.236 of the *Michigan Compiled Laws*), authorized FIA to establish MiSDU as the State's centralized collection and

disbursement unit for all child support payments. This enabling legislation mandated the Office of the Auditor General to conduct an audit of MiSDU not less than one year, but within two years, after the effective date of November 3, 1999 and not less than every two years after the initial audit.

Act 161, P.A. 1999, created MiSDU as the single location to which all payers of child support shall send support and fee payments, including payments from employers for income withholding orders, direct payments from noncustodial parents, and all other sources. In order to distribute child support payments, MiSDU needs to access information that is only available from CSES. However, because FIA had not fully implemented the Statewide CSES at the time of our review, FIA also had not fully implemented MiSDU as of the completion of our audit fieldwork and as of the date of this report. As a result, MiSDU did not perform several receipt and distribution functions. For example, MiSDU processed only child support payments received from employers through income withholding orders and did not process direct payments from noncustodial parents not subject to withholding orders. Also, MiSDU did not issue checks directly to custodial parents as required by federal statute.

FIA entered into a five-year contract with Lockheed Martin IMS (contractor) in September 1999 to develop and operate MiSDU. MiSDU began to receive child support payments via electronic fund transfer from employers in December 1999 and began receiving direct child support payments via payroll deductions from employers in July 2000. MiSDU plans to begin receiving direct payments from noncustodial parents who are not subject to income withholding orders approximately six months after CSES is fully operational. Also, FIA contracted with MAXIMUS, Inc., for quality assurance oversight during MiSDU's development and implementation phases (September 1999 through September 2001).

The contractor also operates the MiSDU call center to respond to employer and local Friend of the Court office (FOC) questions. When MiSDU is fully operational, the call center will answer questions from both custodial* and noncustodial parents.

As of May 31, 2001, MiSDU processed approximately 75% of child support payments from income withholding orders Statewide, allocated the payments based on information supplied by the employers, and electronically transferred funds to FOCs for distribution to the recipients of support.

* See glossary at end of report for definition.

Effective August 24, 2001, Lockheed Martin, Inc., sold its wholly owned subsidiary, Lockheed Martin IMS (the primary contractor for MiSDU), to Affiliated Computer Services, Inc. ACS State and Local Solutions, Inc., is the new Affiliated Computer Services, Inc., subsidiary responsible for processing child support payments under the existing contractual agreement with FIA.

MiSDU received, processed, and electronically transferred or held in suspense* the following transactions and amounts of child support payments, and it maintained the following average daily balances:

Month/Year	Amount and Number of Transactions Processed				Average Daily Balance	
	Receipts		Distributed to FOCs		Suspense	Out-of-Balance*
	Amount	Number	Amount	Number		
December 1999	\$ 6,111	61	\$ 6,111	61		
January 2000	\$ 8,136	125	\$ 8,136	125		
February 2000	\$ 622,528	2,979	\$ 622,528	2,979		
March 2000	\$ 1,896,859	8,901	\$ 1,896,859	8,901		
April 2000	\$ 1,332,822	6,242	\$ 1,332,822	6,242		
May 2000	\$ 1,344,669	6,292	\$ 1,344,669	6,292		
June 2000	\$ 1,364,428	6,444	\$ 1,364,428	6,444		
July 2000	\$ 1,495,131	7,491	\$ 1,491,824	7,456	\$ 5,219	
August 2000	\$ 3,345,590	21,129	\$ 3,328,569	21,011	\$ 21,929	\$ 407
September 2000	\$ 3,666,810	28,616	\$ 3,682,370	28,941	\$ 30,915	\$ 476
October 2000	\$ 4,208,925	33,794	\$ 4,207,425	33,812	\$ 2,747	\$ 2,293
November 2000	\$ 9,301,801	77,510	\$ 9,222,965	77,215	\$ 26,197	\$ 13,579
December 2000	\$ 16,118,413	132,464	\$ 16,106,090	132,760	\$ 49,338	\$ 39,802
January 2001	\$ 28,124,976	226,498	\$ 28,045,188	226,458	\$ 125,879	\$ 139,703
February 2001	\$ 41,891,405	329,895	\$ 41,638,059	329,016	\$ 232,134	\$ 317,464
March 2001	\$ 59,856,183	476,140	\$ 59,872,081	477,761	\$ 476,499	\$ 160,811
April 2001	\$ 64,379,817	519,664	\$ 64,488,815	519,608	\$ 268,294	\$ 163,212
May 2001	\$ 67,668,115	546,914	\$ 67,721,210	549,840	\$ 159,080	\$ 201,468

MiSDU collected approximately \$15.1 million (1.0%) of the approximately \$1.46 billion in child support payments collected in the State of Michigan during the fiscal year ended September 30, 2000. Through May 31, 2001, MiSDU collections had increased to approximately \$291.5 million, and MiSDU referred \$28,344 in not sufficient funds checks and \$28,196 in stop payment checks to the Department of Treasury for collection.

* See glossary at end of report for definition.

FIA paid the contractor approximately \$6.2 million for the purchase of hardware and software and to acquire and prepare office space for MiSDU. In addition, FIA paid the contractor approximately \$18.9 million for ongoing operations during the period October 1, 1999 through May 31, 2001. FIA paid approximately \$2.9 million for quality assurance oversight during the same period. In total, FIA expended approximately \$29.3 million to establish and operate MiSDU for the period October 1, 1999 through May 31, 2001.

As of May 31, 2001, the contractor and its subcontractors employed approximately 92 full-time equated staff to process child support payments. In addition, 2 full-time FIA employees, 2 contracted employees, and 4 contracted quality assurance employees were assigned to MiSDU.

Audit Objective, Scope, and Methodology and Agency Responses

Audit Objective

The objective for our performance audit of the Michigan State Disbursement Unit (MiSDU), Family Independence Agency (FIA), was to assess FIA's effectiveness and efficiency in establishing and operating MiSDU in accordance with State and federal laws and rules.

Audit Scope

Our audit scope was to examine the program and other records of the Michigan State Disbursement Unit. 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.

Audit Methodology

Our audit procedures, performed from January through June 2001, included an examination of MiSDU and FIA records primarily for the period July 1999 through May 2001.

We performed a preliminary survey to obtain an understanding of the process MiSDU used to receive and disburse child support payments. We interviewed various MiSDU and FIA staff and reviewed pertinent federal and State laws, rules, policies, and procedures.

We assessed the status of program implementation based on requirements in the federal program waiver. Also, we surveyed local Friend of the Court offices to determine compliance with the two-day disbursement requirement.

We reviewed the bid process for the primary contractor and examined the contract in relation to program controls. Further, we reviewed FIA's and the quality assurance contractor's efforts to oversee the primary contractor's compliance with certain program requirements.

We reviewed the current status of MiSDU program implementation, including facility security and disaster recovery. Also, we tested a random sample of transactions for compliance with significant program requirements.

Agency Responses

Our audit report contains 5 findings and 9 corresponding recommendations. FIA's preliminary response indicated that it generally agreed with 8 recommendations and did not agree with 1 finding and recommendation.

The agency preliminary response that 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 Department of Management and Budget Administrative Guide procedure 1280.02 require FIA to develop a formal response to our audit findings and recommendations within 60 days after release of the audit report.

COMMENT, FINDINGS, RECOMMENDATIONS, AND AGENCY PRELIMINARY RESPONSES

EFFECTIVENESS AND EFFICIENCY IN ESTABLISHING AND OPERATING THE MICHIGAN STATE DISBURSEMENT UNIT (MiSDU)

COMMENT

Audit Objective: To assess the Family Independence Agency's (FIA's) effectiveness and efficiency in establishing and operating MiSDU in accordance with State and federal laws and rules.

Conclusion: As a result of FIA's failure to fully implement a Statewide automated Child Support Enforcement System (CSES), MiSDU did not have the ability to receive child support payments not made through an income withholding order and to distribute child support payments directly to recipients. Excluding these deficiencies, **we concluded that FIA was generally effective and efficient in establishing and operating MiSDU in accordance with State and federal laws and rules.** However, our assessment disclosed one material condition. FIA did not ensure that Friend of the Court offices (FOCs) distributed child support payments within two business days after receipt at MiSDU as required by federal statute.

Our assessment also disclosed reportable conditions related to compliance with contract requirements, courier bonding, use of interest income, and privatization project plan.

Noteworthy Accomplishments: FIA and the MiSDU contractor worked closely with employers and FOCs to provide for a smooth transition and to identify and resolve issues in a timely manner. As a result, FIA and the contractor developed and implemented an automated system that processed approximately \$65 million per month in employer-withheld child support payments from income withholding orders in less than nine months. This system distributed approximately 98% of all payments received at MiSDU to FOCs in one business day.

System and process improvements that facilitated a smooth transition included:

- (1) Holding biweekly telephone conferences with FOCs to identify issues, involve FOCs in implementing strategies, and maintain open communication lines.
- (2) Creating a validation database to facilitate verification of information submitted by employers to case information maintained by FOCs.
- (3) Focusing on reducing transactions that could not be processed by MiSDU in one day, including a significant reduction in transactions sent to FOCs for county research from approximately 8.0% to 2.4% and the number of transactions sent to suspense from approximately 2.0% to 0.8%.
- (4) Contacting employers who provided incorrect and incomplete case information within three days both to resolve the current issue and to avoid continuing incorrect payments.

FINDING

1. Timely Distribution of Child Support Payments

FIA did not ensure that FOCs distributed child support payments within two business days after receipt at MiSDU as required by federal statute.

Section 454B of the federal Social Security Act, as amended, requires that:

In general . . . the State disbursement unit shall distribute all amounts . . . within 2 business days after receipt from the employer or other source of periodic income, if sufficient information identifying the payee is provided.

For states, such as Michigan, that collect child support through local courts, the federal deadline to establish a state disbursement unit was October 1, 1999. However, FIA did not implement a Statewide Child Support Enforcement System (CSES) on a timely basis, which prevented FIA from establishing a centralized state disbursement unit by October 1, 1999. As a result, FIA applied for and was granted a time-limited waiver of federal requirements pending completion of the Statewide CSES. The waiver expired on October 1, 2001. However, the waiver did not exclude FIA from complying with the two-day distribution requirement.

At the time of our review, MiSDU processed child support payments received from employers that were withheld pursuant to an income withholding order. MiSDU distributed these child support payments back to FOCs, which were then responsible for issuing a check or making an electronic funds transfer to the custodial parent. Because of the lack of a Statewide CSES, MiSDU did not receive direct payments from noncustodial parents who were not subject to an income withholding order.

Prior to approving the federal waiver, the U.S. Department of Health and Human Services (HHS) requested that FIA specify how its proposed system would disburse all child support payments within two days after receipt at MiSDU. FIA stated that it would achieve a two-day disbursement by:

- a. Adopting a policy requiring a two-day disbursement from the time MiSDU receives the payment.
- b. Conducting training to heighten the awareness of this critical performance criteria among FOCs, adopting methods to achieve two-day turnaround, and following up with other communications to reinforce this awareness.
- c. Developing a sampling methodology to measure FOC disbursement performance.
- d. Working with those FOCs that did not achieve the performance requirement in order to develop and implement a corrective action plan.

MiSDU routinely processed payments and distributed funds to the 65 FOCs in one day. However, FOCs often did not distribute the funds in a timely manner. Based on responses to our survey from 44 (67.7%) of the 65 FOCs and phone discussions with 2 other FOCs, we determined that 17 (37.0%) of 46 FOCs did not distribute child support payments within two days after the date of receipt at MiSDU. Fifteen (88.2%) of these 17 FOCs did not meet the two-day requirement because either their banks held wire transferred funds for 1 to 2 days before releasing funds (5 FOCs) or they did not process child support payment checks on a daily basis (10 FOCs). Five of the 10 FOCs processed child support checks only one day per week. These 17 FOCs were responsible for distributing to custodial parents approximately 18.3% of the receipts processed by the child support program.

We reviewed 239 randomly selected payment transactions with sufficient information that MiSDU processed within one day and distributed to FOCs between December 2000 and March 2001. Our review disclosed that the FOCs did not distribute 66 (27.6%) payments to the custodial parent within the federally mandated two days after receipt at MiSDU. This included 50 payments disbursed in 3 days, 10 payments disbursed in 4 days, 1 payment disbursed in 5 days, and 5 payments disbursed in 6 days or more. These payments related to 20 (43.5%) of the 46 FOCs responsible for distributing the sampled transactions.

In addition, 25 (56.8%) and 42 (95.5%) of the 44 FOCs responding to our survey stated that FIA had not informed them of the two-day federal distribution requirement or provided training, respectively, as FIA had indicated to HHS. We determined that contrary to its waiver request, FIA had not adopted an FOC policy regarding a two-day disbursement, conducted training to heighten FOC awareness, measured FOC disbursement performance, or worked with FOCs to ensure that payments were routinely processed within two days after receipt.

FIA's failure to ensure compliance with the two-day distribution requirement could result in significant federal financial penalties.

RECOMMENDATION

We recommend that FIA ensure that FOCs distribute child support payments within two business days after receipt at MiSDU as required by federal statute.

AGENCY PRELIMINARY RESPONSE

FIA agreed with the recommendation and will comply. State statutes, as well as Office of Child Support (OCS) policies and Cooperative Reimbursement Agreements with each county, have required that child support disbursements comply with federal requirements. FIA informed us that this has been reiterated in annual contracts with the counties and self-assessment strategies. In addition, as part of the process of involving the counties in the establishment of MiSDU, the specific requirement for disbursement within two business days was reviewed with the counties as part of an ongoing dialogue with the counties.

FIA informed us that it established and operates a system that results in 99% of the transactions being disbursed to the counties within 24 hours. Although the magnitude of noncompliance on the part of the county FOCs was unknown by FIA

previously, the recent survey by the Office of the Auditor General (OAG) staff identified a genuine issue that requires resolution. FIA is taking steps to further reinforce the requirement of disbursement within two business days. This point was a key issue discussed by the director of OCS at the annual Statewide meeting of the Friend of the Court Association on July 10, 2001. FIA issued Action Transmittal 2001-024 on August 3, 2001 to clarify the timing requirements to the FOCs. OCS has made disbursement a key component of the State's Self-Assessment Process, which is currently being revised. In addition, the requirements will be discussed at the Annual Family Support Conference in October 2001.

FINDING

2. Compliance With Contract Requirements

FIA did not ensure that the MiSDU contractor complied with certain requirements of the contract.

The contract for the development and operation of MiSDU contains specific measurable contractor performance standards for use in determining that MiSDU processes child support payments in an effective and efficient manner. Additional contract requirements provide for the escrow of software and the development of a disaster recovery plan to help ensure ongoing operation of MiSDU if a catastrophic event occurs or the contractor defaults on the contract.

Our review of MiSDU operations disclosed three contract requirements that neither FIA nor the contractor had adequately addressed:

- a. Neither FIA nor the contractor had determined whether MiSDU processed child support payments in compliance with performance standards outlined in the contract.

The MiSDU contract established a number of performance standards that apply to processing child support payments. The contract states that FIA will monitor results and, if applicable, assess progressive discipline and penalties if the contractor fails to comply with the performance standards. The following

are examples of the more significant performance standards and discipline steps outlined in the contract:

Performance Standard	Progressive Penalty for Noncompliance
Resolve 95.0% of unidentifiable collections within 3 business days	First step: Warranty letter* Second step: Corrective action plan Third step: \$1,000 penalty per month
99.9% of receipts processed with bank by 3:00 p.m. daily	First step: Warranty letter Second step: Corrective action plan Third step: \$5,000 penalty per month
Receipts are downloaded to FOCs the same day as they are processed	First step: Warranty letter Second step: Corrective action plan Third step: \$100 per county correspondence
99.6% payments matched to correct case	First step: Warranty letter Second step: Corrective action plan Third step: \$1,000 per day fine
100.0% of properly submitted payments disbursed in 48 hours	First step: Warranty letter Second step: Corrective action plan Third step: \$5,000 per day fine
Data entry error rate less than 0.3%	First step: Warranty letter Second step: Corrective action plan Third step: \$2,500 per month fine

FIA staff informed us that both FIA and the contractor had differences of opinion regarding attainability of several of the performance standards. As a result, FIA had not attempted to assess compliance with the performance standards and the contractor had not voluntarily assessed compliance.

Without determining compliance with the performance standards stated in the contract, FIA had limited assurance that the contractor operated MiSDU in an effective and efficient manner in accordance with the contract. Also, determining compliance with the performance standards would allow FIA and/or the contractor to make applicable program changes and improvements.

- b. FIA did not require the contractor to provide a copy of the computer software necessary to operate MiSDU.

* See glossary at end of report for definition.

The MiSDU contract requires that the contractor provide a copy of the computer software used to process child support payments. The contract states:

A copy of all copyrightable specifications, source code, object code, test data, and documentation necessary for maintenance or modification of the application will be provided to the State to be held in escrow.

Escrow of software is necessary to allow FIA to continue processing child support payments in the event of default by the contractor. Failure to escrow software places FIA at risk of not being able to centrally process and distribute child support payments in accordance with federal requirements that could result in financial penalties.

- c. FIA did not obtain a comprehensive disaster recovery plan from the contractor as provided for in the contract.

The MiSDU contract requires that the contractor provide a full analysis and plan for disaster recovery within 45 days following the signing of the contract. The contract was signed in September 1999.

The contractor requested, but FIA did not provide, detailed information regarding the desired level of disaster recovery expected under the contract. Without detailed information needed to develop a comprehensive disaster recovery plan, the contractor prepared a disaster recovery plan providing general information on how it planned to address disaster recovery. This plan did not contain specific information outlining how, when, and where child support payments would be distributed in the event that the facility occupied by MiSDU was temporarily or permanently damaged or destroyed by a fire or other natural disaster.

The lack of a comprehensive disaster recovery plan could result in a significant delay in MiSDU's processing of child support payments in the event of a catastrophe.

- d. FIA did not conduct reviews of collateral pledged by the contractor.

The MiSDU contract requires that the contractor provide collateral to cover all monies in the MiSDU cash concentration account up to a maximum amount of \$15 million. The contract also requires that the pledged collateral be held in the name of the Michigan Department of Treasury at the Federal Reserve and that FIA review the amount of collateral quarterly.

FIA's quarterly reviews of collateral pledged by the contractor are necessary to ensure that sufficient funds are available to pay child support in the event of contractor default.

- e. FIA did not receive title to equipment purchased for MiSDU and did not record approximately \$5.4 million in equipment purchases in the State's general fixed assets inventory records.

Title 45, Part 74, section 74.34 of the *Code of Federal Regulations* requires that equipment purchased with federal funds become the property of the State and must be included in the State's general fixed assets inventory records. Failure to ensure State ownership of purchased assets is a violation of federal program rules.

Compliance with contract requirements will help ensure that MiSDU is operating in an effective and efficient manner. Also, compliance with contract requirements will help ensure that MiSDU is able to process child support payments in the event of a major catastrophe or contractor default and fully comply with federal program regulations.

RECOMMENDATIONS

We recommend that FIA:

- a. Determine whether MiSDU processed child support payments in compliance with performance standards outlined in the contract.
- b. Require the contractor to provide a copy of the computer software necessary to operate MiSDU.

- c. Obtain a comprehensive disaster recovery plan from the contractor as provided for in the contract.
- d. Conduct quarterly reviews of collateral pledged by the contractor.
- e. Provide for State ownership of equipment purchased for MiSDU.

AGENCY PRELIMINARY RESPONSE

FIA agreed with the recommendations and will comply. FIA has recognized these issues as contract deliverables or related State functions. As in any large volume new systems initiative, priorities must be established to provide the best return on limited resources. Emphasis has been on providing a stable, reliable processing environment.

- (a) During MiSDU implementation, it was determined that the performance factors defined in the contract were not applicable as originally envisioned. FIA informed us that it has developed replacement measures of performance and corresponding penalties that are more representative of the requirements for data accuracy, data timeliness, and problem resolution. A set of 11 key measures have been identified and are being implemented. These performance factors along with corresponding penalties will be submitted to the Office of Purchasing, Department of Management and Budget, for incorporation as a contract amendment.
- (b) FIA concurs that the contractor should place a copy of the computer software in escrow with a third party. FIA informed us that the contractor is at this time arranging for escrow placement.
- (c) FIA informed us that a disaster recovery plan is in place that includes procedures to provide for recovery and start-up in the event of a power outage or similar event in which the current site is intact and work can be resumed promptly. Data files, image files, and software are saved daily and stored offsite.

FIA also informed us that it has now provided the contractor with the information necessary to develop a comprehensive disaster recovery plan that will include procedures to move work off-site and resume operations in the

event the current site is no longer available. The contractor is in the process of evaluating potential sites and methods for implementing such a strategy.

- (d) FIA informed us that collateral has been placed with the Federal Reserve in the amount of \$3.75 million on behalf of the contractor. The contract requires quarterly review. FIA is developing an agreement with the Department of Treasury to conduct such a continuing quarterly review.
- (e) FIA recognizes that the State is to take title to the hardware. Discussions have been initiated with the contractor to pass equipment title to the State.

FINDING

3. Courier Bonding

FIA should revise the MiSDU contractual agreement to address courier bonding.

The MiSDU contract did not require the contractor to obtain a bond to cover loss or theft of child support payments while under the control of contracted couriers.

Title 45, Part 302, section 19 of the *Code of Federal Regulations* requires that the state shall ensure that every person who has access to or control over funds collected under the child support program, including employees of government and private entities, is covered by a bond against loss resulting from employee dishonesty.

The contractor hired a courier company to transport child support payments from the post office to MiSDU and from MiSDU to the bank. The contract did not require that the contractor obtain a fidelity bond and, therefore, the contractor did not obtain such a bond. A fidelity bond is a form of insurance coverage that would reimburse MiSDU for amounts lost or stolen while under the control of a contracted courier. Without a fidelity bond, the State is at risk of significant loss of child support funds transported by unbonded couriers. Obtaining a fidelity bond would hold the State harmless in the event of loss or theft by subcontracted courier employees.

RECOMMENDATION

We recommend that FIA revise the MiSDU contractual agreement to address courier bonding.

AGENCY PRELIMINARY RESPONSE

FIA basically agreed with the recommendation and has researched various options for cost effectiveness. FIA has revised the check endorsement, which has been accepted by the bank's legal department as a restrictive endorsement. This endorsement minimizes the risk of theft while transporting checks from MiSDU to the bank. FIA continues to review its options for the courier bonding for the transport of checks from the post office to MiSDU.

FINDING

4. Use of Interest Income

FIA did not ensure that accrued interest earned on funds held by MiSDU was properly used to help offset State and federal program costs as required by statute.

Section 400.238(2) of the *Michigan Compiled Laws* stipulates that interest that accrues on a child support payment after its receipt and before its disbursement from MiSDU is payable to the State General Fund to help offset program costs. Federal Office of Child Support Enforcement Information Memorandum 89-05 states that sound management practices emphasize that the State invest undistributed collections into interest-bearing accounts pending the timely disbursement of collections to the intended recipients. The information memorandum also states that the interest generated should be used to reduce state and federal program costs.

During initial discussions with legislative committees regarding the creation of MiSDU, FIA represented that accrued interest on funds held by MiSDU would be used to offset State and federal program expenditures. FIA informed members of the Legislature that interest earned on undistributed child support payments would be used to offset most of the State costs to operate MiSDU. FIA staff in the Office of Legislative and Liaison Services did not respond to repeated requests for background information on interest income projections that were provided to legislative committees during hearings to create MiSDU.

The MiSDU contract allows the contractor to use interest earnings to offset its banking expenses. As of May 2001, the contractor had inappropriately used earned interest totaling \$13,965 to offset its bank charges. This practice reduced the contractor's cost to operate the program, but it did not reduce or offset State or federal costs to operate the program.

FIA has projected that interest earnings on child support collections will range from \$500,000 to \$2.2 million annually when CSES and MiSDU are fully implemented. With such significant interest earnings, amending the MiSDU contract to require the deposit of interest earnings in the State's General Fund would not only provide for compliance with State statute, but would also appear to be in the best interest of the State.

RECOMMENDATION

We recommend that FIA ensure that accrued interest earned on funds held by MiSDU is properly used to help offset State and federal program costs as required by statute.

AGENCY PRELIMINARY RESPONSE

FIA agreed with the recommendation in part. FIA may seek an amendment to the statute to allow for an offset of the interest earned against program costs. FIA does believe that while it did not comply with the statute, the interest earned was utilized to offset program costs.

FINDING

5. Privatization Project Plan

FIA did not prepare a project plan or evaluation for the privatization of MiSDU as required by statute.

The Legislature has not defined the term "privatization." The U.S. General Accounting Office (GAO) has defined "privatization" as ". . . any process aimed at shifting functions and responsibilities, in whole or in part, from the government to the private sector."

FIA's appropriations acts for fiscal years 1998-99 (Section 225, Act 294, P.A. 1998), 1999-2000 (Section 222, Act 135, P.A. 1999), and 2000-01 (Section 207,

Act 294, P.A. 2000) have required FIA to submit a complete project plan to the House and Senate Appropriations Subcommittees and the House and Senate Fiscal Agencies 60 days before beginning any effort to privatize. The plan shall include the criteria under which the privatization initiative will be evaluated.

Prior to establishment of MiSDU, FOCs, which are an operational arm of the circuit courts, were responsible for the collection and distribution of child support payments. FIA completed its planning process and entered into a contract with the MiSDU contractor in September 1999 to develop and operate MiSDU. However, FIA did not prepare and submit a privatization project plan for MiSDU to the House and Senate Appropriations Subcommittees or the House and Senate Fiscal Agencies. As a result, the Legislature may not have been completely informed of FIA's intention and basis for privatizing the centralized collection and distribution of child support payments.

In addition to the statutory requirement, the long-term nature of MiSDU and corresponding contractual costs should have warranted FIA's preparation of an appropriate plan and subsequent evaluation for use by the Legislature and legislative fiscal agencies.

RECOMMENDATION

We recommend that for all future privatization projects FIA prepare and submit a project plan and subsequent evaluation as required by statute.

AGENCY PRELIMINARY RESPONSE

FIA disagreed with the finding and recommendation. To state that the Legislature may not have been completely informed of FIA's intention and basis for privatizing the centralized collection and distribution of child support payments is false. The Legislature discussed privatizing these services in numerous budget hearings and appropriated funds specifically to contract for these services.

FIA did not violate the statute. It is obvious that privatization in this context relates to privatizing functions currently performed by State employees. The OAG utilized a federal definition for privatization. Further, the OAG stated that it was unable to obtain a definition from the Department of Management and Budget, the House and Senate Fiscal Agencies, and the Department of Civil Service. FIA believes

that the legislative intent can be obtained from House Bill 4157 (February 3, 1999), which states:

'Privatization' means the delegation to a vendor or contractor of performance of a service or function currently provided by state employees or other service or function not currently provided by state employees that was formerly performed by state employees but eliminated after January 1, 1990 . . .

The receipting and disbursement function of MiSDU was not previously performed by State employees, rather this function was performed by the FOCs. Therefore, this would not meet the intention of House Bill 4157. Similar definitions were included in House Bill 6134 (September 17, 1998) and House Bill 6212 (September 24, 1998). It should be further noted that the GAO document states:

This glossary is intended to facilitate a better understanding of privatization-related terms as they are used in the federal government . . . Our objective was to describe the most commonly used practices and techniques currently employed to shift governmental functions and responsibilities, in whole or in part, from the federal government to the private sector.

FIA interpreted the cited statute requirement to include privatization of existing State functions. MiSDU is an effort, in response to federal requirements, to consolidate and centralize, under FIA direction, the child support receipt and disbursement functions that heretofore existed within individual county court operations. Therefore, the assumption that MiSDU is a privatization effort and thus subject to the requirements of the cited statute is erroneous. The OAG is attempting to apply a federal definition for federal functions to a State function for the lack of a better definition.

EPILOGUE

The House Bills referred to by FIA were not passed by the Legislature or enacted into law. As a result, the OAG does not believe that FIA can assume legislative intent from these bills.

The GAO developed its definitions for the cited report from existing literature including (1) Privatization: Meanings, Rationale, and Limits, Congressional Research Service, February 9, 1996; (2) An Action Agenda to Redesign State Government, National Governors' Association report 1993; (3) The Privatization

Primer, National Council for Public-Private Partnerships, 1996; and (4) Glossary, National Academy of Public Administration Foundation, 1995. Thus, the GAO definitions can be applied to both federal and state government operations.

Glossary of Acronyms and Terms

child support order	A written court order that provides for the periodic payment of money for the support of a child. An order may include other provisions, such as visitation, health insurance, and confinement expenses (hospital and birthing costs of the mother).
contractor	Lockheed Martin IMS.
CSES	Child Support Enforcement System.
custodial parent	The individual having legal custody over a child and with whom the child lives; usually, the parent to whom child support is owed.
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.
FIA	Family Independence Agency.
Friend of the Court offices (FOCs)	An operational arm of the circuit court responsible for enforcement of child support orders. There are 65 FOCs Statewide in the 57 circuit courts.
GAO	U.S. General Accounting Office.
HHS	U.S. Department of Health and Human Services.
income withholding order	A written court order that provides for the deduction of support payments from the noncustodial parent's paycheck or some other source of income.

material condition	A serious reportable condition that could impair the ability of management to operate a program in an effective and efficient manner and/or could adversely affect the opinion of an interested person concerning the effectiveness and efficiency of the program.
Michigan State Disbursement Unit (MiSDU)	The centralized collection, processing, and disbursement unit for child support payments in Michigan.
noncustodial parent	The individual not having legal custody over a child; usually, the parent who owes child support.
OAG	Office of the Auditor General.
OCS	Office of Child Support.
out-of-balance	Child support payments submitted by an employer where the detailed withholding amounts identified on the employer document do not equal the payment submitted by the employer. The contractor must contact the employer to reconcile detailed withholding amounts to the payment before these funds can be disbursed to the appropriate FOC.
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.
reportable condition	A matter coming to the auditor's attention that, in the auditor's judgment, should be communicated because it represents either an opportunity for improvement or a significant deficiency in management's ability to operate a program in an effective and efficient manner.

suspense

Child support payments submitted by an employer that cannot be distributed to a specific case because there is no case number, social security number, and county designated. The contractor must contact the employer to obtain additional information before these funds can be disbursed to the appropriate FOC.

warranty letter

Notice to the vendor that contractually required performance criteria have not been achieved, putting the vendor on notice of contractual requirements. This is the first step taken to require the contractor to comply with contractual requirements.