

PERFORMANCE AUDIT
OF THE
BUREAU OF COMMERCIAL SERVICES
DEPARTMENT OF CONSUMER AND INDUSTRY SERVICES

April 2003



Michigan
Office of the Auditor General
REPORT SUMMARY

Performance Audit

Report Number:
 63-431-02

Bureau of Commercial Services

*Department of Consumer and Industry
 Services*

Released:
 April 2003

The Bureau of Commercial Services (BCS) is composed of three divisions. The Licensing Division provides licensing, registration, and certification for certain professions and occupations. The Enforcement Division is responsible for the investigation of and prosecution related to complaints filed against individuals or businesses licensed by BCS, as well as inspections and other special functions. The Corporations Division facilitates the formation of new business entities and maintains a record of documentation filed by these business entities.

Audit Objectives:

1. To assess BCS's effectiveness and efficiency in administering its licensing functions.
2. To assess BCS's effectiveness and efficiency in administering its enforcement functions.
3. To assess BCS's effectiveness and efficiency in providing services related to the formation and development of business entities and ensuring compliance with reporting and registration requirements.

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Audit Conclusions:

1. We concluded that BCS was generally effective and efficient in administering its licensing functions.
2. We concluded that BCS was generally effective and efficient in administering its enforcement functions.

3. We concluded that BCS was effective and efficient in providing services related to the formation and development of business entities and ensuring compliance with reporting and registration requirements.

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Noteworthy Accomplishments:

BCS has expanded its Web site to include many useful features for individuals and businesses. Customers can verify a license; read disciplinary action reports; conduct a business search; and access public forms, publications, applications, laws and regulations, board meeting minutes, and other useful information.

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Reportable Conditions:

BCS should improve its controls over licensing carnival and amusement companies and special inspectors (Finding 1).

BCS should improve its documentation of the monitoring of examination contracts (Finding 2).

BCS did not ensure that new cosmetology licensees met minimum education requirements and did not maintain documentation of compliance with the requirements on file (Finding 3).

BCS did not ensure that Real Estate Appraisers Board members who participated in complaint investigations abstained from voting on the final determination for those complaints (Finding 4).

BCS did not always begin and complete complaint investigations on a timely basis (Finding 5).

BCS did not always document that a detailed inspection of new carnival and amusement rides was completed (Finding 6).

BCS should ensure that drug test results are properly documented and that boxing

event promoters provide documentation of required insurance coverage (Finding 7).

BCS did not perform annual inspections of barber and cosmetology shops (Finding 8).

BCS needs to improve its controls to ensure that accounts receivable are properly recorded in the State's accounting system, that appropriate collection efforts are made, and that uncollectible amounts are properly written off (Finding 9).

BCS, in conjunction with the Department of Information Technology, should establish more effective database access controls (Finding 10).

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Agency Response:

Our audit report contains 10 findings and 10 corresponding recommendations. BCS's preliminary response indicated that it agrees with all of our findings and that it has taken or will take steps to comply with all of the recommendations.

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A copy of the full report can be obtained by calling 517.334.8050 or by visiting our Web site at: www.state.mi.us/audgen/



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AUDITOR GENERAL

April 9, 2003

Mr. David C. Hollister, Director
Department of Consumer and Industry Services
G. Mennen Williams Building
Lansing, Michigan

Dear Mr. Hollister:

This is our report on the performance audit of the Bureau of Commercial Services, Department of Consumer and Industry Services.

This report contains our report summary; description of agency; audit objectives, scope, and methodology and agency responses and prior audit follow-up; comments, findings, recommendations, and agency preliminary responses; three summary schedules, presented as supplemental information; 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 response 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 Agency

The mission* of the Bureau of Commercial Services (BCS), Department of Consumer and Industry Services, is to protect the health, welfare, and safety of Michigan citizens and to encourage the growth of business in Michigan, while at the same time protecting consumers. BCS is composed of three divisions:

1. The Licensing Division is responsible for the licensing, registration, and certification of individuals who engage in the practice of certain professions and occupations. The Licensing Division determines eligibility for examination and licensure, monitors licensees' compliance with continuing education requirements, administers examinations to individuals in those professions that have an examination requirement, and provides administrative support to the various occupational boards. The Licensing Division administers the following Acts: Occupational Code (Act 299, P.A. 1980, as amended), Ski Area Safety Act of 1962 (Act 199, P.A. 1962, as amended), Carnival-Amusement Safety Act of 1966 (Act 225, P.A. 1966, as amended), and sections of other acts.

The Licensing Division had a total of 319,363 active licensees as of June 30, 2002. A summary schedule of licenses issued by license type as of June 30, 2002 is presented as supplemental information.

2. The Enforcement Division is responsible for the investigation of and prosecution related to complaints filed against individuals or businesses licensed or regulated by BCS. Also, the Enforcement Division audits the financial records of licensees who maintain trust or escrow accounts; inspects barber, cosmetology, and funeral establishments; and performs safety inspections of ski areas and amusement rides. In addition, the Enforcement Division is responsible for the oversight and licensing of professional boxing events in the State.

During fiscal year 2000-01, the Enforcement Division issued 776 final orders as a result of complaints filed against individuals and businesses and assessed fines totaling \$1,442,628. A summary schedule of enforcement statistics by license type during fiscal year 2000-01 is presented as supplemental information.

* See glossary at end of report for definition.

3. The Corporations Division is responsible for facilitating the formation of new business entities in Michigan. It provides services that enable corporations, limited partnerships, limited liability companies, and limited liability partnerships to be formed and foreign entities to obtain a certificate of authority to transact business in the State. The Corporations Division maintains a record of the documents filed by these business entities and makes this information available to the public. In addition, the Corporations Division is responsible for administering the following acts: Business Corporation Act (Act 284, P.A. 1972), Nonprofit Corporation Act (Act 162, P.A. 1982), Professional Service Corporation Act (Act 192, P.A. 1962, as amended), Michigan Revised Uniform Limited Partnership Act (Act 213, P.A. 1982), Michigan Limited Liability Company Act (Act 23, P.A. 1993), Trademarks and Service Marks Act (Act 242, P.A. 1969), as amended; Registration of Names and Insignia Act (Act 281, P.A. 1927), and sections of numerous other acts.

The Corporations Division registered 54,217 and 54,865 new businesses in fiscal years 2000-01 and 1999-2000, respectively. As of June 2002, the Corporations Division had 498,660 active business entities and 456,126 inactive business entities on record. A summary schedule of the status of Michigan business entities is presented as supplemental information.

In fiscal year 2000-01, BCS expended approximately \$11.0 million and generated revenue of approximately \$22.5 million. As of June 30, 2002, BCS had 143 employees.

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

Audit Objectives

Our performance audit* of the Bureau of Commercial Services (BCS), Department of Consumer and Industry Services, had the following objectives:

1. To assess BCS's effectiveness* and efficiency* in administering its licensing functions.
2. To assess BCS's effectiveness and efficiency in administering its enforcement functions.
3. To assess BCS's effectiveness and efficiency in providing services related to the formation and development of business entities and ensuring compliance with reporting and registration requirements.

Audit Scope

Our audit scope was to examine the program and other records of the Bureau of Commercial Services. 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, conducted from April through August 2002, included examination of BCS's records and activities primarily for the period October 1, 1999 through June 30, 2002.

We conducted a preliminary review of BCS's operations to formulate a basis for defining the audit objectives and scope. Our review included interviewing BCS personnel, reviewing applicable statutes and regulations, analyzing available data and statistics, and reviewing BCS policies and procedures to obtain an understanding of BCS's operational activities.

* See glossary at end of report for definition.

To assess BCS's effectiveness and efficiency in administering its licensing functions, we tested license applications for proper verification of education, experience, and examination requirements; proper assessment of applicable fees; and timeliness of processing. Also, we reviewed testing services provided by BCS and contractors and evaluated BCS's oversight and monitoring of examination contractors. In addition, we assessed BCS's procedures for monitoring and recording continuing education requirements.

To assess BCS's effectiveness and efficiency in administering its enforcement functions, we reviewed the procedures for responding to consumer complaints about licensees, including preliminary review, investigation, prosecution, sanction, and compliance. Also, we analyzed the timeliness of BCS's processing of complaints through each of these stages. In addition, we assessed BCS's procedures for completing required inspections and audits of licensees. Further, we reviewed BCS's oversight of professional boxing events.

To assess BCS's effectiveness and efficiency in providing services related to the formation and development of business entities and ensuring compliance with reporting and registration requirements, we reviewed the procedures for examining and filing articles of incorporation, certificates of limited partnership, articles of organization, and articles of amendment for domestic and foreign corporations, limited partnerships, limited liability companies, and limited liability partnerships. We also reviewed the procedures for processing annual reports. In addition, we assessed BCS's procedures for providing information about registered business entities to the public and helping customers who have questions about setting up a new business entity. Further, we reviewed the procedures for registering trademarks and service marks.

Agency Responses and Prior Audit Follow-Up

Our audit report contains 10 findings and 10 corresponding recommendations. BCS's preliminary response indicated that it agrees with all of our findings and that it has taken or will take steps to comply with all of the recommendations.

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 the Department of Consumer and Industry Services to develop a formal response to our audit findings and recommendations within 60 days after release of the audit report.

BCS complied with 2 of the 5 prior audit recommendations included within the scope of our current audit. The other 3 prior audit recommendations were rewritten for inclusion in this report.

COMMENTS, FINDINGS, RECOMMENDATIONS, AND AGENCY PRELIMINARY RESPONSES

EFFECTIVENESS AND EFFICIENCY IN ADMINISTERING LICENSING FUNCTIONS

COMMENT

Audit Objective: To assess the Bureau of Commercial Services' (BCS's) effectiveness and efficiency in administering its licensing functions.

Conclusion: We concluded that BCS was generally effective and efficient in administering its licensing functions. However, we noted reportable conditions* related to carnival and amusement licensing, examination contracts, cosmetology education requirements, and real estate appraisers board member involvement in disciplinary actions.

Noteworthy Accomplishments: BCS has expanded its Web site to include many useful features for individuals and businesses. Customers can verify a license; read disciplinary action reports; conduct a business entity search; and access forms, publications, applications, laws and regulations, board meeting minutes, and other useful information. Also, BCS recently began allowing on-line renewal of real estate salespersons' and brokers' licenses over the Internet. The availability of this information on the Web site has improved BCS's ability to provide services to its customers and significantly reduced the number of telephone calls it receives.

FINDING

1. Carnival and Amusement Licensing

BCS should improve its controls over licensing carnival and amusement companies and special inspectors.

The Carnival-Amusement Safety Act of 1966 provides BCS with the responsibility for licensing and regulating carnival and amusement rides to provide for the safety of the public using the rides. We reviewed BCS's procedures for licensing carnival

* See glossary at end of report for definition.

and amusement companies and special inspectors and noted the following deficiencies:

- a. BCS did not ensure that all owners or operators of carnival and amusement rides had the required insurance coverage.

Section 408.666 of the *Michigan Compiled Laws* requires that a carnival and amusement operator must not operate a ride unless the operator has obtained the minimum bond or insurance required by the statute.

We reviewed the license application files for 12 of 205 carnival and amusement companies licensed in the State as of June 30, 2002. BCS did not have proof of insurance on file for all or a portion of the period from October 1, 1999 through June 30, 2002 for 6 (50%) of the 12 companies.

- b. BCS did not ensure that applications for special inspectors were properly completed and approved by the owner or operator prior to issuing a license.

BCS issues licenses to employees of carnival and amusement companies to serve as special inspectors. *Michigan Administrative Code R 408.887* requires that a special inspector must be present on the premises whenever a ride is being operated. A special inspector is authorized to perform the required daily inspections of a carnival or amusement ride and to maintain a daily inspection log. These functions are necessary to ensure the safe operation of the rides.

We reviewed the applications of 100 special inspectors who worked for 5 carnival and amusement companies during our audit period. We noted that 32 (32%) of the applications were not signed by the owner or operator. Six of the 32 applications were not signed at all and 26 were signed by the applicant instead of the owner or operator. An application for a special inspector license requires the owner or operator of a carnival or amusement company to attest that the applicant has been properly trained and is competent and capable of performing the duties and functions of a special inspector. Without the owner's or operator's attestation, BCS has no assurance that the applicant meets the qualifications for a special inspector.

RECOMMENDATION

We recommend that BCS improve its controls over licensing carnival and amusement companies and special inspectors.

AGENCY PRELIMINARY RESPONSE

BCS agrees and informed us that it has instructed staff to verify (during the permit application process) that applicants provide proof of insurance that covers the entire duration that the permit is active. Also, BCS will revise the application for special inspectors to add instructions to clarify who should sign and will make a concerted effort to ensure that appropriate signatures are on file. In addition, the licensing administrator will continue to monitor the application process for compliance with laws and rules.

BCS noted, however, that many of the ride companies are issued annual permits even though they do not operate their rides in Michigan year-round. In some cases, ride permits remain active after the company has left the State. In these instances, lapsed insurance (outside of the active period) does not present a risk.

FINDING

2. Examination Contracts

BCS should improve its documentation of the monitoring of examination contracts.

Department of Management and Budget (DMB) Administrative Guide policy 0610 requires that departments manage their contracts in a manner that is fiscally responsible and to ensure that vendors meet their contractual obligations.

BCS contracted with three testing service providers during our audit period to administer licensing examination for the following professions: barbers, cosmetologists, residential builders, real estate agents, and real estate appraisers. The term of each of these contracts was for five years. Contractors are compensated solely through the examination fees, which they collect directly from the applicants.

Our review of BCS's management of these three contracts disclosed:

- a. BCS did not perform an overall contract performance review on any of the three vendors to ensure that contracted services were fulfilled in a responsible manner. BCS's contract agreement with these vendors states that the Department of Consumer and Industry Services may conduct an annual evaluation and review of the total service quality. Although BCS did not perform formal annual reviews, BCS informed us that it used alternative means, such as ongoing communication with contractors, to monitor contractor performance.
- b. BCS did not retain evaluation score sheets for 1 of the 3 requests for contract proposals. This documentation is evidence that fair consideration was given to all bidders.

Proper monitoring of contractors helps to ensure that quality services are provided.

RECOMMENDATION

We recommend that BCS improve its documentation of the monitoring of examination contracts.

AGENCY PRELIMINARY RESPONSE

BCS agrees and will consider implementing annual reviews for future test contractors. Also, BCS will implement procedures to ensure that documentation of evaluation scores is maintained.

FINDING

3. Cosmetology Education Requirements

BCS did not ensure that new cosmetology licensees met minimum education requirements and did not maintain documentation of compliance with the requirements on file.

We reviewed the application materials of 50 licensees from various professions and noted that 5 (10%) of the files did not include proper documentation to support completion of the minimum education requirements. All 5 files were for licensed cosmetologists.

To be issued a cosmetologist license, Section 339.1207 of the Michigan Compiled Laws requires the applicant either to have completed not less than a 1,500-hour course of study in a licensed school of cosmetology or to have served as an apprentice for not less than two years in a licensed cosmetology establishment. The cosmetology licensure examination was administered by a contract agency, which was responsible for verifying that the applicant met the minimum education requirements. Prior to the examination, the applicant was required to submit an affidavit, signed by an authorized school official, attesting to the completion of the required course of study. The contractor manually compared the signatures to copies of authorized school signatures kept on file. No further verification of compliance with education requirements was performed by BCS prior to the issuance of a license.

Michigan Administrative Code R 338.2135 requires that cosmetology schools report the names of students, along with their accumulated hours of credit and enrollment status, to BCS on a monthly basis. At the time of our audit, this information was not sent to BCS in a consistent manner by all of the cosmetology schools. Some schools sent hard copy reports, and some sent reports electronically. This information could be used by BCS to verify that the education reported by cosmetology license applicants was legitimate. However, BCS staff informed us that they do not use these monthly reports as it would be too labor-intensive to enter students' names into the computer system manually. BCS is planning to implement a system that would require all schools to submit the monthly reports electronically. This would enable BCS to use an electronic tape match to verify that a license applicant's name appears on a valid school report and that the applicant has met the education requirements.

Verifying and documenting that a licensee has met the minimum education requirements would help ensure that all licensees are qualified.

RECOMMENDATION

We recommend that BCS ensure that new cosmetology licensees meet minimum education requirements and that BCS maintain documentation of compliance with the requirements on file.

AGENCY PRELIMINARY RESPONSE

BCS agrees and is currently working with technical support staff to create a means of receiving school reports via electronic data transfer for the purpose of verifying that applicants have achieved educational requirements. When completed, this system will also produce and maintain documentation of compliance with educational requirements.

FINDING

4. Real Estate Appraisers Board Member Involvement in Disciplinary Actions

BCS did not ensure that Real Estate Appraisers Board members who participated in complaint investigations abstained from voting on the final determination for those complaints.

Section 339.201 of the *Michigan Compiled Laws* authorizes BCS to investigate complaints against licensees. Because of the technical nature of real estate appraisal complaints, BCS typically requests the assistance of a member of the Board in these investigations. If the investigation discloses a violation, a final determination is presented for a vote at the next Board meeting. Section 339.514(3) of the *Michigan Compiled Laws* states that the Board members who participated in the investigation of a complaint shall not also participate in making a final determination in a proceeding on that complaint.

The Real Estate Appraisers Board typically meets twice a year. We reviewed the minutes for three Board meetings that took place during calendar years 2001 and 2002. At these meetings, the Board voted on final determinations for 38 complaints. Investigations for 34 of these complaints had been referred to a Board member for assistance. We noted that for 32 (94%) of the 34 complaints, the Board members who were involved in the investigation did not abstain from voting on the final determinations presented for those complaints. In the other two instances, the Board member was not present at the meeting when the final determination was voted on. Rather than voting on each case individually, the Board typically takes a single vote to approve all of the final determinations on the agenda. For all three meetings we reviewed, the Board voted unanimously to accept all of the final determinations, with no members abstaining. None of the final determinations were changed as a result of board members voting when they should not have voted.

BCS should emphasize to Board members the importance of abstaining from voting on complaints they have been involved in. Board members' participation in the investigation phase as well as the final determination of a complaint could result in biased decision making by the other Board members and provide the licensee with a valid reason to appeal the Board's decision. A Board member who has in-depth knowledge of a complaint investigation cannot act as an impartial judge when deciding disciplinary actions. Also, the Board member's vote may prejudice the outcome of the decision by influencing the other Board members' votes.

RECOMMENDATION

We recommend that BCS ensure that Real Estate Appraisers Board members who participate in complaint investigations abstain from voting on the final determination for those complaints.

AGENCY PRELIMINARY RESPONSE

BCS agrees and will institute a procedure to ensure that board members involved in the investigation process abstain from voting on the final determination. Continued board member training and education will be conducted. In addition, Enforcement Division staff will notify Licensing Division staff of specific board member involvement in the investigation process. Licensing Division staff will inform the board members that they must abstain from taking part in the final determination.

EFFECTIVENESS AND EFFICIENCY IN ADMINISTERING ENFORCEMENT FUNCTIONS

COMMENT

Audit Objective: To assess BCS's effectiveness and efficiency in administering its enforcement functions.

Conclusion: We concluded that BCS was generally effective and efficient in administering its enforcement functions. However, we noted reportable conditions related to complaint investigations, carnival and amusement ride inspections, professional boxing events, and barber and cosmetology shop inspections.

FINDING

5. Complaint Investigations

BCS did not always begin and complete complaint investigations on a timely basis.

BCS received 8,124 complaints during the period from October 1, 1999 through June 30, 2002. BCS' complaint process consists of several stages such as evaluation, mediation, investigation, board review, and sanction. Most complaints are resolved prior to reaching the board review and sanction stage. Our review of complaints disclosed:

- a. BCS received 694 complaints that completed the entire process, including board review and sanction, during the period October 1, 1999 through June 30, 2002. We reviewed 9 of these complaints and found that, for 2 complaints, it took BCS 181 days and 227 days to start the investigation. Additionally, we noted that the respondents in these 2 complaints were not notified on a timely basis that a complaint had been made against them. Notifying the respondent early in the investigation process may provide investigators with additional information needed to complete the investigation.

Section 339.502 of the *Michigan Compiled Laws* states that upon receipt of a complaint, the Department of Consumer of Industry Services shall immediately begin an investigation of the allegations of the complaint and shall open a correspondence file.

- b. BCS has established performance measures to complete 70% of investigations of nonbuilder complaints within 270 days and the remaining 30% within 365 days.

We analyzed the 1,644 nonbuilder complaints that went through the investigation stage during the period October 1, 1999 through June 30, 2002. Our analysis disclosed the following:

| Number of Days Complaints Were in the Investigation Stage | Number of Nonbuilder Complaints | Percentage of Complaints |
|---|------------------------------------|-----------------------------|
| 1 - 270 | 1,314 | 79.9% |
| 271 - 365 | 185 | 11.3% |
| 366 - 730 | 141 | 8.6% |
| More than 730 | 4 | 0.2% |
| | <u>1,644</u> | <u>100.0%</u> |

Although BCS achieved its performance measure of investigating 70% of the complaints in 270 days, not all complaints were investigated in 365 days. We noted that the investigation of 145 complaints took longer than 365 days. We selectively reviewed 14 of the complaints that took over 365 days. We found that 12 of these complaints were not actively investigated, which significantly contributed to the length of the investigation. We noted that these complaint investigations were inactive for 92 to 511 days at a time, and some of the complaints had lengthy inactive periods more than once during the investigation.

Unnecessary delay of the complaint investigation prolongs the resolution process for the complainant and the respondent. Although some complaints require more time to investigate than others, BCS should monitor investigations to ensure that complaints are being actively investigated so that they may be completed within a reasonable amount of time.

RECOMMENDATION

We recommend that BCS begin and complete complaint investigations on a timely basis.

AGENCY PRELIMINARY RESPONSE

BCS agrees and will more closely monitor outstanding complaints using reporting options in License2000 (BCS's new licensing database system). BCS informed us that this system can generate reports that indicate when work is not completed

within desired time intervals. BCS will instruct supervisors to review these reports and enter extension approvals (when necessary) to document the review and list reasons for the delay.

FINDING

6. Carnival and Amusement Ride Inspections

BCS did not always document that a detailed inspection of new carnival and amusement rides was completed.

Section 408.660 of the *Michigan Compiled Laws* requires that all carnival and amusement rides be inspected before they are put in operation and annually thereafter. *Michigan Administrative Code R 408.821* requires an owner or operator to furnish certified stress analysis and prints to BCS for new and existing rides upon request.

BCS generally requests and obtains copies of a ride's certified stress analysis and prints before it performs the initial inspection of the ride and maintains these documents on file. BCS informed us that it did not require these documents for a new ride when an identical version of the ride has already been approved for operation in the State, provided the new ride has not been structurally altered from the approved original version.

When BCS performs the initial inspection of carnival and amusement rides, it compares the ride to the certified stress analysis and prints already on file, verifying that no alterations have been made. These inspections are documented on the standard ride inspection form. However, for new rides that are identical versions of rides already approved, this form does not indicate whether the inspector compared the new rides to the certified stress analysis and prints of the approved original version.

We reviewed the applications for 10 new rides approved by BCS between October 1, 1999 and June 30, 2002. BCS excluded 4 of the 10 new rides from the certification requirements because an identical version of the ride had previously been approved. However, during the inspection process for these new rides, BCS did not document that its inspection included a comparison of the new ride with the

certified stress analysis and prints of the approved original version of the ride to ensure that it was the same ride and had not been structurally altered.

RECOMMENDATION

We recommend that BCS document that a detailed inspection of new carnival and amusement rides are completed.

AGENCY PRELIMINARY RESPONSE

BCS agrees and will implement a procedure that will include a section for a documenting signature on an existing form, supplemental form, or checklist. This signature will verify that the inspector has compared the new ride to the stress analysis and prints on file.

FINDING

7. Professional Boxing Events

BCS should ensure that drug test results are properly documented and that boxing event promoters provide documentation of required insurance coverage.

Sections 339.801 - 339.814 of the *Michigan Compiled Laws* charge BCS with the direction, management, and control of professional boxing events held within the State. We reviewed 22 of the 51 professional boxing events held from October 1, 1999 through June 30, 2002. Each event consisted of a main bout and 1 to 8 additional bouts. A total of 121 bouts were included in our review. We noted the following deficiencies:

- a. BCS did not always properly document the results of drug tests it administered.

Michigan Administrative Code R 339.3208 prohibits the use of drugs, stimulants, or nonprescription preparations by contestants during a boxing event. BCS's informal policy is to require drug tests from four contestants prior to each boxing event. Those four contestants typically include the two contestants fighting in the main bout, as well as the two contestants from one other randomly selected bout. *Michigan Administrative Code* R 339.3236 states that if a drug test results in a finding of the presence of a drug or alcohol, or if the boxer refuses to submit or is unable to provide a sample of

body fluids for a test, a complaint shall be made against the contestant. If the determination is made that the contestant is subject to disciplinary action, the boxer may be suspended for at least 90 days and ordered to submit a negative drug test before being allowed to box again. Also, if a boxer was subject to disciplinary action and was the winner of the contest, the boxer shall be disqualified and the decision of the contest shall be changed to "no contest." "No contest" means that neither contestant wins the contest.

In two instances, BCS did not file a formal complaint against boxers who were unable to provide a sufficient sample of body fluids needed to test for the presence of drugs. BCS did not document that these cases were reviewed prior to the determination not to pursue a complaint investigation. Because complaints were not filed, further sanctions that might be appropriate were not pursued. In addition, we noted one instance, which took place in June 2000, in which a boxer tested positive for the presence of a drug. BCS filed a complaint against the boxer; however, as of June 30, 2002 (more than two years after the fight), BCS had not yet imposed any penalty.

- b. BCS did not document that promoters of professional boxing events provided insurance for boxers.

Section 339.807 of the *Michigan Compiled Laws* requires a promoter of a boxing event to insure each contestant for not less than \$1,000 for medical and hospital expenses and not less than \$5,000 for death benefits to cover injuries and death resulting from the event.

Of the 22 professional boxing events we reviewed, BCS did not obtain proof of insurance from the promoter for 8 (36%) of the events. Although there is no formal policy, BCS recently created an event checklist that is used to document the receipt of proof of insurance from the promoter.

RECOMMENDATION

We recommend that BCS ensure that drug test results are properly documented and that boxing event promoters provide documentation of required insurance coverage.

AGENCY PRELIMINARY RESPONSE

BCS agrees and will implement training and revise its procedures to ensure that inspectors better document decisions and actions taken related to administering the results of drug tests. BCS noted that its investigation found that the inspectors acted properly (in the two instances cited) with regard to their decisions and actions taken. However, BCS recognizes that it failed to provide proper documentation.

Also, BCS informed us that it initiated a process for verifying that promoters provide adequate insurance prior to events. Evidence of receipt is now recorded on a check sheet used to verify various issues associated with each event.

FINDING

8. Barber and Cosmetology Shop Inspections

BCS did not perform annual inspections of barber and cosmetology shops.

Sections 339.1113 and 339.1218 of the *Michigan Compiled Laws* require that each barber and cosmetology shop be inspected annually. As of June 30, 2002, there were 2,095 licensed barber shops and 9,301 licensed cosmetology shops in the State. BCS inspectors are also responsible for performing complaint-based inspections, pre-licensure inspections for new barber and cosmetology shops, and biennial barber and cosmetology school inspections. BCS staff informed us that these other inspections are a higher priority and they do not have the resources to perform annual barber and cosmetology shop inspections.

We previously recommended that BCS review the need for annual inspections and request amendatory legislation to reduce inspection frequencies, if necessary. Alternatively, BCS could request legislation allowing for the assessment of an inspection fee or increase the annual license fee for barber and cosmetology shops. The additional revenue could then be used to offset the cost of hiring more inspectors.

RECOMMENDATION

We recommend that BCS pursue amendatory legislation either to reduce the required frequency of barber and cosmetology shop inspections or to increase related fees to offset the cost of hiring more inspectors.

AGENCY PRELIMINARY RESPONSE

BCS agrees and is not opposed to amendatory legislation (either to reduce the frequency of inspections or to increase annual license fees to fund additional inspectors). However, BCS feels that it would be more appropriate for the Legislature to initiate this process because it would be in a better position to determine the appropriate level of funding and the proper methodology for amending the statute. In addition, the occupation associations may also express an interest to the Legislature for appropriate amendments to the statute.

EFFECTIVENESS AND EFFICIENCY IN PROVIDING SERVICES RELATED TO THE FORMATION AND DEVELOPMENT OF BUSINESS ENTITIES

COMMENT

Audit Objective: To assess BCS's effectiveness and efficiency in providing services related to the formation and development of business entities and ensuring compliance with reporting and registration requirements.

Conclusion: **We concluded that BCS was effective and efficient in providing services related to the formation and development of business entities and ensuring compliance with reporting and registration requirements.** However, we noted reportable conditions related to accounts receivable and database access controls.

FINDING

9. Accounts Receivable

BCS needs to improve its controls to ensure that accounts receivable are properly recorded in the State's accounting system, that appropriate collection efforts are made, and that uncollectible amounts are properly written off.

BCS maintains records of documents filed by business entities and makes them available to the public. Customers may order certified and noncertified copies of these documents over the telephone, by fax, or by mail. BCS sends an invoice to the customer along with the completed order. The cost for these services varies depending upon the number of pages and type of documents requested. Revenues

from certification and copying fees were approximately \$1.7 million and \$1.5 million during in fiscal years 2000-01 and 1999-2000, respectively.

Our review of BCS's controls disclosed:

- a. BCS properly posted the certification and copying fee receivables on its subsidiary system, but did not have controls to ensure that fees that were uncollected as of the end of the fiscal year were properly recorded in the State's accounting system. As a result, revenues and accounts receivable were understated for fiscal years 2000-01 and 1999-2000.

DMB Administrative Guide procedure 1210.27 requires the recording of revenues in the period that they become susceptible to accrual and are measurable. Although BCS recorded the receivables in its subsidiary system, corresponding receivables were not recorded in the State's accounting system at year-end.

- b. BCS did not have efficient procedures for collecting overdue accounts receivable.

DMB Administrative Guide procedure 1210.27 requires departments to maintain adequate control procedures to ensure that receivables are collected.

If payment is not received, BCS does not have a procedure to send overdue notices in a timely manner. Prior to converting to a new computer system in 2001, invoices were automatically generated for overdue accounts. However, the new computer system did not have this capability, so BCS periodically sent out a mass billing for all outstanding accounts. BCS has sent out these mass billings twice in the last year and significantly reduced their receivables with each mailing. However, this was a time-consuming and inefficient process. Timely and consistent efforts to collect outstanding amounts due increase the likelihood of collection.

- c. BCS did not have controls to ensure that outstanding amounts were written off once it was determined that the amounts were no longer collectible.

BCS had outstanding receivables dating as far back as September 1997 on its books. DMB Administrative Guide procedure 1210.27 provides guidance to the departments regarding the write-off of uncollectible accounts receivable.

BCS informed us that it is working to eliminate all accounts receivable by implementing credit card terminals for all customer service staff, which will require all customers to pay for copies before they are delivered.

RECOMMENDATION

We recommend that BCS improve its controls to ensure that accounts receivable are properly recorded in the State's accounting system, that appropriate collection efforts are made, and that uncollectible amounts are properly written off.

AGENCY PRELIMINARY RESPONSE

BCS agrees and is working to establish controls to ensure that future uncollected amounts due to the State are properly recorded.

Also, BCS is in the process of implementing a requirement of accepting only credit card payments (made prior to delivery). This action will ensure payment and (in the near future) will eliminate the need for any collection actions associated with overdue accounts.

BCS informed us that it has addressed the outstanding accounts receivable that are currently overdue by initiating a (one-time) mass mailing of invoices to BCS accounts that potentially had outstanding balances. BCS also informed us that so far, over 66% of the amount that was identified as outstanding has been collected. BCS is still attempting to collect the remaining balance and will consider writing off those accounts which it determines to be no longer collectible.

FINDING

10. Database Access Controls

BCS, in conjunction with the Department of Information Technology, should establish effective database access controls. Effective controls would help prevent or detect inappropriate access to BCS's data, thereby protecting the data from unauthorized modification, loss, or disclosure.

BCS uses a comprehensive database to maintain records for all active and inactive business entities registered with the Corporations Division since 1978. The database is administered by Department of Information Technology staff. As of June 30, 2002, the database contained approximately 795,000 records. We reviewed the controls over this system and noted the following concerns:

- a. BCS should establish formal policies and procedures for managing its users' access and ensuring that users' capabilities do not exceed the levels necessary to perform their job functions. We identified 72 users with access to the Corporations Division's database. Of these users, 22 were no longer current employees of BCS. BCS did not have adequate policies and procedures to evaluate the propriety of the roles and privileges assigned to the current employees and to ensure that departed employees' access privileges were discontinued when they left BCS. Formal procedures for periodically reviewing users' access and for removing database access that is no longer needed would reduce the risk of unauthorized access.
- b. BCS did not have effective database password controls and other database log-in parameters. Effective password controls are one of the primary means to prevent unauthorized access to information resources.
- c. The Corporations Division's database administrators (DBAs) did not perform their work using a unique database administration account. At the time of our audit DBAs performed their work using a shared database administration account. DBAs need privileged access to perform administration activities. The sharing of accounts prevents management from effectively monitoring and assigning responsibility for these privileged activities.
- d. The developer of the Corporations Division's database had been granted privileged access to the production database. Sound internal control requires that access to production data and systems be restricted to end users. Developers should have access to only test data and systems. Restricting access to production systems and data or establishing compensating controls, such as a means to monitor activity performed by the developer, will help ensure the integrity of the system and data.
- e. BCS, in conjunction with Department of Information Technology, did not use database audit logs to monitor sensitive database activity. Audit logs can be

configured to automatically record privileged access, data corrections, or other sensitive activity for management review. Audit logs also provide management with the means to identify unauthorized activity.

RECOMMENDATION

We recommend that BCS, in conjunction with Department of Information Technology, establish effective database access controls.

AGENCY PRELIMINARY RESPONSE

BCS agrees and will instruct the Department of Information Technology to remove access for all employees who no longer require it. In addition, BCS will periodically monitor user access to ensure that only currently authorized individuals have access.

BCS has also (in conjunction with the Department of Information Technology) begun implementing procedures to strengthen its controls over database access. These include: 1) requiring the use of passwords, log-in controls, and unique DBA accounts; 2) restricting access to production systems and data to end-users; and 3) using database audit logs to monitor system activity.

BCS noted, however, that some of these matters are outside of its authority and that the Department of Information Technology's involvement and commitment are needed to achieve compliance.

SUPPLEMENTAL INFORMATION

LICENSING DIVISION, BUREAU OF COMMERCIAL SERVICES
 Department of Consumer and Industry Services
Summary Schedule of Licenses Issued by License Type

| <u>License Type</u> | <u>New Licenses Issued in Fiscal Year 2000-01</u> | <u>New Licenses Issued in Fiscal Year 1999-2000</u> | <u>Total Active Licensees as of June 30, 2002</u> |
|------------------------------------|---|---|---|
| Architect | 238 | 266 | 5,438 |
| Athletics (Boxing) | 255 | 301 | 574 |
| Barber | 437 | 465 | 9,351 |
| Carnival-Amusement | 596 | 507 | 2,619 |
| Cemetery | 1 | 6 | 264 |
| Certified public accountant | 574 | 650 | 17,196 |
| Collection agency | 177 | 178 | 1,053 |
| Cosmetologist | 4,065 | 3,727 | 105,408 |
| Forensic polygraph examiner | 2 | 7 | 118 |
| Forester | 12 | 6 | 243 |
| Hearing aid dealer | 104 | 97 | 758 |
| Landscape architect | 19 | 28 | 573 |
| Mortuary science | 82 | 133 | 2,988 |
| Nursing home administrator* | 43 | 102 | 1,153 |
| Ocularist | 1 | | 17 |
| Personnel agency | 9 | 3 | 159 |
| Prepaid funeral contractor | 27 | 32 | 572 |
| Professional community planner | 2 | 4 | 125 |
| Professional engineer | 938 | 841 | 19,890 |
| Professional surveyor | 42 | 47 | 1,011 |
| Real estate appraiser | 619 | 711 | 5,164 |
| Real estate broker and salesperson | 7,325 | 6,744 | 63,324 |
| Residential builder | 3,869 | 4,126 | 81,000 |
| Ski area safety | 4 | 9 | 365 |
| Total | 19,441 | 18,990 | 319,363 |

* Nursing home administrators were transferred to the Bureau of Health Services in November 2001.

ENFORCEMENT DIVISION, BUREAU OF COMMERCIAL SERVICES
 Department of Consumer and Industry Services
 Summary Schedule of Enforcement Statistics by License Type
Fiscal Year 2000-01

| <u>License Type</u> | <u>Number of Final Orders Issued</u> | <u>Amount of Fines Assessed</u> |
|------------------------------------|--|-------------------------------------|
| Architect | | \$ |
| Athletics (Boxing) | 10 | 8,550 |
| Barber | 5 | 4,000 |
| Carnival-Amusement | | |
| Cemetery | 2 | 1,500 |
| Certified public accountant | 12 | 42,500 |
| Collection agency | 15 | 35,000 |
| Cosmetologist | 52 | 78,100 |
| Forensic polygraph examiner | 2 | |
| Forester | | |
| Hearing aid dealer | | |
| Landscape architect | | |
| Mortuary science | | |
| Nursing home administrator | 1 | 3,000 |
| Ocularist | | |
| Personnel agency | | |
| Prepaid funeral contractor | | |
| Professional community planner | | |
| Professional engineer | 1 | 3,000 |
| Professional surveyor | 1 | 1,000 |
| Real estate appraiser | 30 | 22,700 |
| Real estate broker and salesperson | 93 | 111,000 |
| Residential builder | 552 | 1,132,278 |
| Ski area safety | | |
| | | |
| Total | <u>776</u> | <u>\$ 1,442,628</u> |

CORPORATIONS DIVISION, BUREAU OF COMMERCIAL SERVICES
 Department of Consumer and Industry Services
Summary Schedule of the Status of Michigan Business Entities

| <u>Type of Business Entity</u> | <u>New Entities Formed in Fiscal Year 2000-01</u> | <u>New Entities Formed in Fiscal Year 1999-2000</u> | <u>Total Active Entities as of June 30, 2002</u> |
|---|---|---|--|
| Domestic profit corporations | 21,323 | 22,899 | 263,262 |
| Domestic nonprofit corporations | 3,730 | 3,869 | 60,625 |
| Foreign corporations (profit and nonprofit) | 2,408 | 2,727 | 22,869 |
| Domestic limited liability companies | 25,367 | 24,040 | 128,223 |
| Foreign limited liability companies | 951 | 820 | 4,298 |
| Domestic limited partnerships | 315 | 370 | 17,041 |
| Foreign limited partnerships | 123 | 140 | 2,342 |
| Total | <u>54,217</u> | <u>54,865</u> | <u>498,660</u> |

Glossary of Acronyms and Terms

| | |
|-----------------------------|--|
| BCS | Bureau of Commercial Services. |
| DBA | database administrator. |
| DMB | Department of Management and Budget. |
| effectiveness | Program success in achieving mission and goals. |
| efficiency | Achieving the most outputs and outcomes practical with the minimum amount of resources. |
| mission | The agency's main purpose or the reason that the agency was established. |
| performance audit | An economy and efficiency audit or program audit that is designed to provide an independent assessment of the performance of a government 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 that, in the auditor's judgment, represents either an opportunity for improvement or a significant deficiency in management's ability to operate a program in an effective and efficient manner. |