



MICHIGAN

OFFICE OF THE AUDITOR GENERAL

AUDIT REPORT



THOMAS H. McTAVISH, C.P.A.
AUDITOR GENERAL

“...The auditor general shall conduct post audits of financial transactions and accounts of the state and of all branches, departments, offices, boards, commissions, agencies, authorities and institutions of the state established by this constitution or by law, and performance post audits thereof.”

– Article IV, Section 53 of the Michigan Constitution

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Michigan
Office of the Auditor General
REPORT SUMMARY

Financial Audit
Including the Provisions of the Single Audit Act

Report Number:
 23-100-05

Department of State

October 1, 2002 through September 30, 2004

Released:
 May 2005

A Single Audit is designed to meet the needs of all financial report users, including an entity's federal grantor agencies. The audit determines if the financial schedules and/or financial statements are fairly presented; considers internal control over financial reporting and internal control over federal program compliance; determines compliance with State compliance requirements material to the financial schedules and/or financial statements; and assesses compliance with direct and material requirements of the major federal programs.

Financial Schedules:

Auditor's Report Issued

We issued an unqualified opinion on the Department's financial schedules.

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Internal Control Over Financial Reporting

We did not report any findings related to internal control over financial reporting.

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**Noncompliance or Other Matters
 Material to the Financial Schedules**

We did not identify any instances of noncompliance or other matters applicable to the financial schedules that are required to be reported under *Government Auditing Standards*.

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Federal Awards:

Auditor's Reports Issued on Compliance

We audited one program as a major program and issued an unqualified opinion. The federal program audited as a major program is identified on the back of this summary.

~ ~ ~ ~ ~

Internal Control Over Major Programs

We did not report any findings related to internal control over major programs.

~ ~ ~ ~ ~

Required Reporting of Noncompliance

We did not identify any instances of noncompliance that are required to be reported in accordance with U.S. Office of Management and Budget (OMB) Circular A-133.

~ ~ ~ ~ ~

Systems of Accounting and Internal Control:

We determined that the Department was in substantial compliance with Sections 18.1483 - 18.1487 of the *Michigan Compiled Laws*. However, we did identify a reportable condition (Finding 1).

~ ~ ~ ~ ~

We audited the following program as a major program:

<u><i>CFDA Number</i></u>	<u><i>Program Title</i></u>	<u><i>Compliance Opinion</i></u>
39.011	Election Reform Payments	Unqualified

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



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THOMAS H. MCTAVISH, C.P.A.
AUDITOR GENERAL

May 12, 2005

The Honorable Terri Lynn Land
Secretary of State
Treasury Building
Lansing, Michigan

Dear Secretary Land:

This is our report on the financial audit, including the provisions of the Single Audit Act, of the Department of State for the period October 1, 2002 through September 30, 2004.

This report contains our report summary; our independent auditor's report on the financial schedules; and the Department of State financial schedules, notes to the financial schedules, and supplemental financial schedules. This report also contains our independent auditor's report on internal control over financial reporting and on compliance and other matters, our independent auditor's report on compliance with requirements applicable to each major program and on internal control over compliance in accordance with U.S. Office of Management and Budget Circular A-133, and our schedule of findings and questioned costs. In addition, this report contains the Department of State's summary schedule of prior audit findings, its corrective action plan, and a glossary of acronyms and terms.

Our finding and recommendation are contained in Section II of the schedule of findings and questioned costs. The agency preliminary response is contained in the corrective action plan. 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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INDEPENDENT AUDITOR'S REPORT AND
FINANCIAL SCHEDULES



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THOMAS H. MCTAVISH, C.P.A.
AUDITOR GENERAL

Independent Auditor's Report on the Financial Schedules

The Honorable Terri Lynn Land
Secretary of State
Treasury Building
Lansing, Michigan

Dear Secretary Land:

We have audited the financial schedules of the Department of State for the fiscal years ended September 30, 2004 and September 30, 2003, as identified in the table of contents. These financial schedules are the responsibility of the Department's management. Our responsibility is to express an opinion on these financial schedules based on our audit.

We conducted our audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards* issued by the Comptroller General of the United States. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial schedules are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial schedules. An audit also includes assessing the accounting principles used and the significant estimates made by management, as well as evaluating the overall financial schedule presentation. We believe that our audit provides a reasonable basis for our opinion.

As described in Note 1, the financial schedules present only the revenues and transfers for the Department of State's General Fund, School Aid Fund, other special revenue funds, private purpose trust fund, and permanent fund accounts and the sources and disposition of authorizations for the Department of State's General Fund accounts, presented using the current financial resources measurement focus and the modified accrual basis of accounting. Accordingly, these financial schedules do not purport to, and do not, constitute a complete financial presentation of the Department or the

State's General Fund, School Aid Fund, other special revenue funds, private purpose trust funds, or permanent funds in conformity with accounting principles generally accepted in the United States of America.

In our opinion, the financial schedules referred to in the first paragraph present fairly, in all material respects, the revenues and transfers and the sources and disposition of authorizations of the Department of State for the fiscal years ended September 30, 2004 and September 30, 2003 on the basis of accounting described in Note 1.

In accordance with *Government Auditing Standards*, we have also issued a report dated March 4, 2005 on our consideration of the Department's internal control over financial reporting and on our tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements and other matters. The purpose of that report is to describe the scope of our testing of the internal control over financial reporting and compliance and the results of that testing and not to provide an opinion on the internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* and should be considered in assessing the results of our audit.

The schedule of expenditures of federal awards, required by U.S. Office of Management and Budget Circular A-133, *Audits of States, Local Governments, and Non-Profit Organizations*, and other supplemental financial schedules, as identified in the table of contents, are presented for purposes of additional analysis and are not a required part of the Department's financial schedules referred to in the first paragraph. Such information has been subjected to the auditing procedures applied in the audit of the financial schedules and, in our opinion, is fairly stated, in all material respects, in relation to the financial schedules taken as a whole.

AUDITOR GENERAL

March 4, 2005

DEPARTMENT OF STATE
Schedule of Revenues and Transfers
General Fund, School Aid Fund, Other Special Revenue Funds, Private Purpose Trust Fund, and Permanent Fund
For the Fiscal Years Ended September 30
(In Thousands)

	General Fund		School Aid Fund	
	2004	2003	2004	2003
REVENUES (Note 3)				
Taxes:				
Sales taxes	\$ 245,360	\$ 280,913	\$ 674,624	\$ 772,380
Use taxes	100,914	101,973	50,449	50,979
Resident motor vehicle taxes				
Nonresident motor vehicle taxes				
Total Taxes	<u>\$ 346,273</u>	<u>\$ 382,887</u>	<u>\$ 725,073</u>	<u>\$ 823,359</u>
From Federal Agencies	<u>\$ 3,123</u>	<u>\$ 0</u>	<u>\$ 0</u>	<u>\$ 0</u>
From Services:				
Commercial lookup fees	\$ 37,546	\$ 33,570	\$	\$
Other	55	63		
Total From Services	<u>\$ 37,601</u>	<u>\$ 33,633</u>	<u>\$ 0</u>	<u>\$ 0</u>
From Licenses and Permits:				
Motor vehicle operator and chauffeur licenses	\$ 53,527	\$ 35,233	\$	\$
Automobile repair facility and mechanic licenses	4,247	4,280		
Motor vehicle annual license transfer fee				
Motor vehicle title fees	16,069	6,649		
Watercraft registrations				
Fundraising plate donations				
Fundraising plate service fees	333			
Registration transaction fees (Note 3)	62,948			
Other	34,318	13,931		
Total From Licenses and Permits	<u>\$ 171,442</u>	<u>\$ 60,094</u>	<u>\$ 0</u>	<u>\$ 0</u>
Miscellaneous	<u>\$ 1,649</u>	<u>\$ 1,285</u>	<u>\$</u>	<u>\$</u>
Total Revenues	<u>\$ 560,088</u>	<u>\$ 477,898</u>	<u>\$ 725,073</u>	<u>\$ 823,359</u>
TRANSFERS (Note 3)				
From Special Revenue Funds:				
Michigan Transportation Fund (Note 3)	\$ 20,000	\$ 88,873	\$	\$
Marine Safety Fund	1,048	1,048		
State Casino Gaming Fund		885		
Assigned Claims Facility and Plan Fund	690	678		
Total From Special Revenue Funds	<u>\$ 21,738</u>	<u>\$ 91,483</u>	<u>\$ 0</u>	<u>\$ 0</u>
Total Transfers	<u>\$ 21,738</u>	<u>\$ 91,483</u>	<u>\$ 0</u>	<u>\$ 0</u>
Total Revenues and Transfers	<u>\$ 581,826</u>	<u>\$ 569,382</u>	<u>\$ 725,073</u>	<u>\$ 823,359</u>

The accompanying notes are an integral part of the financial schedules.

Other Special Revenue Funds		Private Purpose Trust Fund		Permanent Fund		Totals (Memorandum Only)	
2004	2003	2004	2003	2004	2003	2004	2003
\$	\$	\$	\$	\$	\$	\$ 919,984	\$ 1,053,294
						151,363	152,952
878,391	791,462					878,391	791,462
55,295	53,117					55,295	53,117
<u>\$ 933,686</u>	<u>\$ 844,579</u>	<u>\$ 0</u>	<u>\$ 0</u>	<u>\$ 0</u>	<u>\$ 0</u>	<u>\$ 2,005,033</u>	<u>\$ 2,050,825</u>
\$ 0	\$ 0	\$ 0	\$ 0	\$ 0	\$ 0	\$ 3,123	\$ 0
\$	\$	\$	\$	\$	\$	\$ 37,546	\$ 33,570
						55	63
<u>\$ 0</u>	<u>\$ 0</u>	<u>\$ 0</u>	<u>\$ 0</u>	<u>\$ 0</u>	<u>\$ 0</u>	<u>\$ 37,601</u>	<u>\$ 33,633</u>
\$ 13,605	\$ 12,952	\$	\$	\$	\$	\$ 67,131	\$ 48,185
						4,247	4,280
9,639	9,869					9,639	9,869
35,066	36,084					51,135	42,733
9,647	9,569					9,647	9,569
225	214					225	214
	439					333	439
						62,948	
6,626	10,249					40,944	24,180
<u>\$ 74,807</u>	<u>\$ 79,376</u>	<u>\$ 0</u>	<u>\$ 0</u>	<u>\$ 0</u>	<u>\$ 0</u>	<u>\$ 246,249</u>	<u>\$ 139,470</u>
\$ 85,206	\$ 73,696	\$ 159	\$ 159	\$ 198	\$ 200	\$ 87,212	\$ 75,341
<u>\$ 1,093,699</u>	<u>\$ 997,652</u>	<u>\$ 159</u>	<u>\$ 159</u>	<u>\$ 198</u>	<u>\$ 200</u>	<u>\$ 2,379,218</u>	<u>\$ 2,299,269</u>
\$	\$	\$	\$	\$	\$	\$ 20,000	\$ 88,873
						1,048	1,048
						885	885
						690	678
<u>\$ 0</u>	<u>\$ 0</u>	<u>\$ 0</u>	<u>\$ 0</u>	<u>\$ 0</u>	<u>\$ 0</u>	<u>\$ 21,738</u>	<u>\$ 91,483</u>
\$ 0	\$ 0	\$ 0	\$ 0	\$ 0	\$ 0	\$ 21,738	\$ 91,483
<u>\$ 1,093,699</u>	<u>\$ 997,652</u>	<u>\$ 159</u>	<u>\$ 159</u>	<u>\$ 198</u>	<u>\$ 200</u>	<u>\$ 2,400,956</u>	<u>\$ 2,390,752</u>

DEPARTMENT OF STATE
Schedule of Sources and Disposition of General Fund Authorizations
Fiscal Years Ended September 30
(In Thousands)

	<u>2004</u>	<u>2003</u>
SOURCES OF AUTHORIZATIONS (Note 2)		
General purpose appropriations	\$ 26,447	\$ 18,141
Balances carried forward (Note 2b.)	16,037	11,484
Restricted financing sources	<u>142,499</u>	<u>149,989</u>
Total	<u>\$ 184,983</u>	<u>\$ 179,614</u>
DISPOSITION OF AUTHORIZATIONS (Note 2)		
Expenditures and transfers out	<u>\$ 164,985</u>	<u>\$ 160,242</u>
Balances carried forward:		
Multi-year projects	\$ 5,775	\$ 2,516
Encumbrances	8,005	9,822
Restricted revenues - authorized	202	289
Restricted revenues - not authorized/used	<u>4,313</u>	<u>2,723</u>
Total balances carried forward (Note 2b.)	<u>\$ 18,296</u>	<u>\$ 15,351</u>
Balances lapsed	<u>\$ 1,701</u>	<u>\$ 4,021</u>
Total	<u>\$ 184,983</u>	<u>\$ 179,614</u>

The accompanying notes are an integral part of the financial schedules.

Notes to the Financial Schedules

Note 1 Significant Accounting Policies

a. Reporting Entity

The accompanying financial schedules report the results of the governmental operations of the Department of State for the fiscal years ended September 30, 2004 and September 20, 2003. The governmental operations of the Department are accounted for principally in the State's General Fund and are reported on in the *State of Michigan Comprehensive Annual Financial Report (SOMCAFR)*. In addition, the Department is responsible for collecting fees for various funds, as discussed in Note 3.

The notes accompanying these financial schedules relate directly to the Department of State. The *SOMCAFR* provides more extensive disclosures regarding the State's significant accounting policies; budgeting, budgetary control, and legal compliance; and pension benefits and other postemployment benefits.

b. Measurement Focus, Basis of Accounting, and Presentation

The financial schedules contained in this report are presented using the current financial resources measurement focus and the modified accrual basis of accounting, as provided by generally accepted accounting principles applicable to governments. Under the modified accrual basis of accounting, revenues are recognized as they become susceptible to accrual, generally when they are both measurable and available. Revenues are considered to be available when they are collected within the current period or soon enough thereafter to pay liabilities of the current period. Expenditures generally are recorded when a liability is incurred; however, certain expenditures related to long-term obligations are recorded only when payment is due and payable.

The accompanying financial schedules present only the revenues and transfers for the Department of State's General Fund, School Aid Fund, other special revenue funds, private purpose trust fund, and permanent fund accounts and the sources and disposition of authorizations for the

Department's General Fund accounts. Accordingly, these financial schedules do not purport to, and do not, constitute a complete financial presentation of the Department or the State's General Fund, School Aid Fund, other special revenue funds, private purpose trust funds, or permanent funds in conformity with generally accepted accounting principles.

Note 2 Schedule of Sources and Disposition of General Fund Authorizations

The various elements of the schedule of sources and disposition of General Fund authorizations are defined as follows:

- a. General purpose appropriations: Original appropriations and any supplemental appropriations that are financed by General Fund/general purpose revenues.
- b. Balances carried forward: Authorizations for multi-year projects, encumbrances, restricted revenues - authorized, and restricted revenues - not authorized/used that were not spent as of the end of the prior fiscal year. These authorizations are available for expenditure in the current fiscal year for the purpose of the carry-forward without additional legislative authorization, except for the restricted revenues - not authorized/used. The Department of State's balances carried forward line item in fiscal year 2003-04 includes \$686,000 from the Michigan Department of Education for the Motorcycle Safety Program.
- c. Restricted financing sources: Collections of restricted revenues, restricted transfers, and restricted intrafund expenditure reimbursements to finance programs as detailed in the appropriations act. These financing sources are authorized for expenditure up to the amount appropriated. Depending upon program statute, any amounts received in excess of the appropriation are, at year-end, either converted to general purpose financing sources and made available for general appropriation in the next fiscal year or carried forward to the next fiscal year as either restricted revenues - authorized or restricted revenues - not authorized/used.
- d. Multi-year projects: Unexpended authorizations for work projects and capital outlay projects that are carried forward to subsequent fiscal years for the completion of the projects. Significant carry-forwards of this type

for fiscal year 2003-04 were for the Business Application Modernization (\$3.5 million) and the Help America Vote Act (\$2.3 million). Significant carry-forwards of this type for fiscal year 2002-03 were for the Help America Vote Act (\$2.3 million) and the Uniform Commercial Code Standards (\$251,000).

- e. Encumbrances: Authorizations carried forward to finance payments for goods or services ordered in the old fiscal year but not received by fiscal year-end. These authorizations are generally limited to obligations funded by general purpose appropriations.
- f. Restricted revenues - authorized: Revenues that, by statute or the State Constitution, are restricted and authorized for use to a particular program or activity. Generally, these revenues may be expended upon receipt without additional legislative authorization. This line item also includes encumbrances that are financed with these restricted revenues. Significant carry-forwards of this type for fiscal year 2003-04 were for encumbrances funded by fees for the sale of Vehicle Code books (\$115,000) and for looking up driver and vehicle records (\$87,000). Significant carry-forwards of this type for fiscal year 2002-03 were for encumbrances funded by fees for the sale of Vehicle Code books (\$123,000) and for looking up driver and vehicle records (\$108,000).
- g. Restricted revenues - not authorized/used: Revenues that, by statute, are restricted for use to a particular program or activity. Generally, the expenditure of the restricted revenues is subject to annual legislative appropriation. A significant carry-forward of this type for fiscal year 2003-04 was for motorcycle safety fees (\$966,000).

The restricted revenues may also be used in subsequent years to finance expenditures for multi-year appropriations and encumbrances without additional legislative authorization. Significant carry-forwards of this type for fiscal year 2003-04 were for automobile repair facilities (\$1.5 million), personal identification card fees (\$800,000), and the Transportation Administration Collection Fund (\$462,000). Significant carry-forwards of this type for fiscal year 2002-03 were fees for automobile repair facilities (\$1.3 million), fees for looking up driver and vehicle records (\$574,000), and State services fees (\$523,000).

- h. Balances lapsed: Authorizations that were unexpended and unobligated at the end of the fiscal year. These amounts are available for legislative appropriation in the subsequent fiscal year.

Note 3 Schedule of Revenues and Transfers

The Department of State is responsible for collecting taxes and other revenues related to its own operations and those of certain other State departments. These revenues are accounted for in the General Fund, the School Aid Fund, other special revenue funds, a private purpose trust fund, and a permanent fund. The other special revenue funds include the Michigan Transportation Fund, State Trunkline Fund, Michigan State Waterways Fund, Marine Safety Fund, Michigan Nongame Fish and Wildlife Fund, Vietnam Veterans' Memorial Monument Fund, and Assigned Claims Facility and Plan Fund. The private purpose trust fund is the Gifts, Bequests, and Deposits Investment Fund. The permanent fund is the Children's Trust Fund. The amounts shown in the schedule of revenues and transfers represent only the amounts collected by the Department of State and do not represent total revenues and transfers for the funds.

Effective October 1, 2003, Section 257.810b of the *Michigan Compiled Laws* established the Transportation Administration Collection Fund within the State's General Fund. This Section statutorily required the deposit of certain Department of State fees into the Transportation Administration Collection Fund that were previously statutorily required to be deposited into the Michigan Transportation Fund. This resulted in a decrease in transfers from the Michigan Transportation Fund and an increase in the registration transaction fees revenue for the fiscal year ended September 30, 2004.

Note 4 Contingencies - Litigation

County Road Association of Michigan et al. v John M. Engler et al.: On March 6, 2002, the County Road Association of Michigan and the Chippewa County Road Commission filed a complaint in Ingham County Circuit Court challenging various provisions of Executive Order No. 2001-9. The complaint consisted of five counts, one of which alleged that the State violated Article IX, Section 9 of the State Constitution by unlawfully allowing the Department of State to bill the Michigan Department of Transportation for expenses in excess of those necessary to collect motor vehicle taxes and fees.

On December 23, 2002, the trial court determined that \$20 million of the disputed costs were not necessary collection expenses, and the court issued a preliminary injunction enjoining the transfer of that amount of the funds. On appeal, defendants challenged whether the trial court had abused its discretion when determining that the plaintiffs were likely to prevail on the merits and, thus, inappropriately issued the injunction. On December 10, 2003, the parties gave oral arguments in the Michigan Court of Appeals on the injunctions.

On January 13, 2004, the Michigan Court of Appeals directed the trial court on remand to modify the preliminary injunction at issue so that it applies to only the amount of \$7.3 million. This amount relates to costs associated with processing automobile dealer licenses and drivers' license appeals and operating driver improvement programs. The Michigan Court of Appeals concluded that the trial court properly determined that the plaintiffs were likely to prevail on the merits with respect to only the \$7.3 million of the \$20 million and, therefore, had a basis for issuing the injunction.

Based on information provided by the Department of Attorney General on May 19, 2004, the State has filed an application for leave to appeal in the Michigan Supreme Court. The State seeks to appeal the decision of the Court of Appeals that barred the State from paying \$7.3 million in necessary collection expenses. The County Road Association of Michigan has also filed an application for leave in the Michigan Supreme Court seeking to appeal the decision of the Michigan Court of Appeals that reversed the trial court and allowed the State to pay \$12.4 million in necessary collection expenses. If the Michigan Supreme Court does not grant leave to appeal for either party, the decision of the Michigan Court of Appeals will stand, which could result in the State repaying the Michigan Transportation Fund \$7.3 million.

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SUPPLEMENTAL
FINANCIAL SCHEDULES

DEPARTMENT OF STATE
Schedule of Revenues - Other Special Revenue Funds
Fiscal Years Ended September 30
(In Thousands)

	Michigan		State Trunkline Fund		Michigan State	
	Transportation Fund				Waterways Fund	
	2004	2003	2004	2003	2004	2003
REVENUES						
Taxes:						
Resident motor vehicle taxes	\$ 878,391	\$ 791,462	\$	\$	\$	\$
Nonresident motor vehicle taxes	55,295	53,117				
Total Taxes	<u>\$ 933,686</u>	<u>\$ 844,579</u>	<u>\$ 0</u>	<u>\$ 0</u>	<u>\$ 0</u>	<u>\$ 0</u>
From Licenses and Permits:						
Motor vehicle operator and chauffeur licenses	\$	\$	\$ 13,605	\$ 12,952	\$	\$
Motor vehicle annual license transfer fee	9,639	9,869				
Motor vehicle title fees	35,066	36,084				
Watercraft registrations					4,920	4,880
Fundraising plate donations						
Fundraising plate service fees		439				
Other	6,626	10,249				
Total From Licenses and Permits	<u>\$ 51,331</u>	<u>\$ 56,641</u>	<u>\$ 13,605</u>	<u>\$ 12,952</u>	<u>\$ 4,920</u>	<u>\$ 4,880</u>
Miscellaneous	<u>\$ 0</u>	<u>\$ 0</u>	<u>\$ 0</u>	<u>\$ 0</u>	<u>\$ 0</u>	<u>\$ 0</u>
Total Revenues	<u>\$ 985,017</u>	<u>\$ 901,221</u>	<u>\$ 13,605</u>	<u>\$ 12,952</u>	<u>\$ 4,920</u>	<u>\$ 4,880</u>

The amounts shown represent only the amounts collected by the Department of State and do not represent total revenues for the funds.

Marine Safety Fund		Michigan Nongame Fish and Wildlife Fund		Vietnam Veterans' Memorial Monument Fund		Assigned Claims Facility and Plan Fund		Total	
2004	2003	2004	2003	2004	2003	2004	2003	2004	2003
\$	\$	\$	\$	\$	\$	\$	\$	\$ 878,391	\$ 791,462
								55,295	53,117
<u>\$ 0</u>	<u>\$ 0</u>	<u>\$ 0</u>	<u>\$ 0</u>	<u>\$ 0</u>	<u>\$ 0</u>	<u>\$ 0</u>	<u>\$ 0</u>	<u>\$ 933,686</u>	<u>\$ 844,579</u>
\$	\$	\$	\$	\$	\$	\$	\$	\$ 13,605	\$ 12,952
								9,639	9,869
								35,066	36,084
4,727	4,689							9,647	9,569
		225	214					225	214
								439	
								6,626	10,249
<u>\$ 4,727</u>	<u>\$ 4,689</u>	<u>\$ 225</u>	<u>\$ 214</u>	<u>\$ 0</u>	<u>\$ 0</u>	<u>\$ 0</u>	<u>\$ 0</u>	<u>\$ 74,807</u>	<u>\$ 79,376</u>
<u>\$ 0</u>	<u>\$ 0</u>	<u>\$ 0</u>	<u>\$ 0</u>	<u>\$ 58</u>	<u>\$ 55</u>	<u>\$ 85,147</u>	<u>\$ 73,642</u>	<u>\$ 85,206</u>	<u>\$ 73,696</u>
<u>\$ 4,727</u>	<u>\$ 4,689</u>	<u>\$ 225</u>	<u>\$ 214</u>	<u>\$ 58</u>	<u>\$ 55</u>	<u>\$ 85,147</u>	<u>\$ 73,642</u>	<u>\$ 1,093,699</u>	<u>\$ 997,652</u>

DEPARTMENT OF STATE
Schedule of Revenues - Private Purpose Trust Fund
Fiscal Years Ended September 30
(In Thousands)

	Gifts, Bequests, and Deposits Investment Fund	
	2004	2003
REVENUES		
Miscellaneous:		
Fundraising plate fees	\$ 159	\$ 159
Total Revenues	\$ 159	\$ 159

The amounts shown represent only the amounts collected by the Department of State and do not represent total revenues for the fund.

DEPARTMENT OF STATE
 Schedule of Revenues - Permanent Fund
Fiscal Years Ended September 30
 (In Thousands)

	<u>Children's Trust Fund</u>	
	<u>2004</u>	<u>2003</u>
REVENUES		
Miscellaneous:		
Fundraising plate fees	\$ 198	\$ 200
Total Revenues	\$ 198	\$ 200

The amounts shown represent only the amounts collected by the Department of State and do not represent total revenues for the fund.

DEPARTMENT OF STATE
 Schedule of Expenditures of Federal Awards (1)
For the Period October 1, 2002 through September 30, 2004
 (In Thousands)

<u>Federal Agency/Program</u>	<u>CFDA (2) Number</u>	<u>For the Fiscal Year Ended September 30, 2003</u>		
		<u>Directly Expended</u>	<u>Distributed to Subrecipients</u>	<u>Total Expended and Distributed</u>
<u>U.S. Elections Assistance Commission</u>				
Direct Program:				
Election Reform Payments	39.011	\$	\$	\$
HAVA Requirements Payments (Section 251)	(3)			
Total U.S. Elections Assistance Commission		\$ 0	\$ 0	\$ 0
Total Expenditures of Federal Awards		\$ 0	\$ 0	\$ 0

(1) Basis of Presentation: This schedule includes the federal grant activity of the Department of State and is presented on the modified accrual basis of accounting. The information in this schedule is presented in accordance with the requirements of OMB Circular A-133, *Audits of States, Local Governments, and Non-Profit Organizations*. Therefore, some amounts presented in this schedule may differ from amounts presented in, or used in the preparation of, the financial schedules.

(2) CFDA is defined as *Catalog of Federal Domestic Assistance*.

(3) CFDA number not available for HAVA Requirements Payments (Section 251) per the U.S. Elections Assistance Commission.

<u>For the Fiscal Year Ended September 30, 2004</u>			<u>Total Expended and Distributed for the Two-Year Period</u>
<u>Directly Expended</u>	<u>Distributed to Subrecipients</u>	<u>Total Expended and Distributed</u>	
\$ 3,069	\$	\$ 3,069	\$ 3,069
54		54	54
\$ 3,123	\$ 0	\$ 3,123	\$ 3,123
<u>\$ 3,123</u>	<u>\$ 0</u>	<u>\$ 3,123</u>	<u>\$ 3,123</u>

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INDEPENDENT AUDITOR'S REPORTS ON INTERNAL CONTROL AND COMPLIANCE



STATE OF MICHIGAN
OFFICE OF THE AUDITOR GENERAL
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THOMAS H. MCTAVISH, C.P.A.
AUDITOR GENERAL

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

The Honorable Terri Lynn Land
Secretary of State
Treasury Building
Lansing, Michigan

Dear Secretary Land:

We have audited the financial schedules of the Department of State for the fiscal years ended September 30, 2004 and September 30, 2003, as identified in the table of contents, and have issued our report thereon dated March 4, 2005. We conducted our audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards* issued by the Comptroller General of the United States.

Internal Control Over Financial Reporting

In planning and performing our audit, we considered the Department's internal control over financial reporting in order to determine our auditing procedures for the purpose of expressing our opinion on the financial schedules and not to provide an opinion on the internal control over financial reporting. Our consideration of the internal control over financial reporting would not necessarily disclose all matters in the internal control that might be material weaknesses. A material weakness is a reportable condition in which the design or operation of one or more of the internal control components does not reduce to a relatively low level the risk that misstatements caused by error or fraud in amounts that would be material in relation to the financial schedules being audited may occur and not be detected within a timely period by employees in the normal course of performing their assigned functions. We noted no matters involving the internal control over financial reporting and its operation that we consider to be material weaknesses.

Compliance and Other Matters

As part of obtaining reasonable assurance about whether the Department's financial schedules are free of material misstatement, we performed tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements, noncompliance

with which could have a direct and material effect on the determination of financial schedule amounts. However, providing an opinion on compliance with those provisions was not an objective of our audit, and accordingly, we do not express such an opinion. The results of our tests disclosed no instances of noncompliance or other matters that are required to be reported under *Government Auditing Standards*.

This report is intended solely for the information and use of the State's management, the Legislature, and federal awarding agencies and is not intended to be and should not be used by anyone other than these specified parties. However, this report is a matter of public record and its distribution is not limited.

AUDITOR GENERAL

March 4, 2005



STATE OF MICHIGAN
OFFICE OF THE AUDITOR GENERAL
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THOMAS H. MCTAVISH, C.P.A.
AUDITOR GENERAL

Independent Auditor's Report on Compliance With
Requirements Applicable to Each Major Program
and on Internal Control Over Compliance in
Accordance With OMB Circular A-133

The Honorable Terri Lynn Land
Secretary of State
Treasury Building
Lansing, Michigan

Dear Secretary Land:

Compliance

We have audited the compliance of the Department of State with the types of compliance requirements described in the U.S. Office of Management and Budget (OMB) *Circular A-133 Compliance Supplement* that are applicable to each major federal program for the two-year period ended September 30, 2004. The Department's major federal program is identified in the summary of auditor's results section of the accompanying schedule of findings and questioned costs. Compliance with the requirements of laws, regulations, contracts, and grants applicable to each major federal program is the responsibility of the Department's management. Our responsibility is to express an opinion on the Department's compliance based on our audit.

We conducted our audit of compliance in accordance with auditing standards generally accepted in the United States of America; the standards applicable to financial audits contained in *Government Auditing Standards* issued by the Comptroller General of the United States; and OMB Circular A-133, *Audits of States, Local Governments, and Non-Profit Organizations*. Those standards and OMB Circular A-133 require that we plan and perform the audit to obtain reasonable assurance about whether noncompliance with the types of compliance requirements referred to in the previous paragraph that could have a direct and material effect on a major federal program occurred. An audit includes examining, on a test basis, evidence about the Department's compliance with those requirements and performing such other procedures as we considered necessary in the circumstances. We believe that our audit provides a reasonable basis for our

opinion. Our audit does not provide a legal determination of the Department's compliance with those requirements.

In our opinion, the Department of State complied, in all material respects, with the requirements referred to in the first paragraph that are applicable to each major federal program for the two-year period ended September 30, 2004.

Internal Control Over Compliance

The management of the Department is responsible for establishing and maintaining effective internal control over compliance with the requirements of laws, regulations, contracts, and grants applicable to federal programs. In planning and performing our audit, we considered the Department's internal control over compliance with requirements that could have a direct and material effect on a major federal program in order to determine our auditing procedures for the purpose of expressing our opinion on compliance and to test and report on the internal control over compliance in accordance with OMB Circular A-133.

Our consideration of the internal control over compliance would not necessarily disclose all matters in the internal control that might be material weaknesses. A material weakness is a reportable condition in which the design or operation of one or more of the internal control components does not reduce to a relatively low level the risk that noncompliance with the applicable requirements of laws, regulations, contracts, and grants caused by error or fraud that would be material in relation to a major federal program being audited may occur and not be detected within a timely period by employees in the normal course of performing their assigned functions. We noted no matters involving the internal control over compliance and its operation that we consider to be material weaknesses.

This report is intended solely for the information and use of the State's management, the Legislature, and federal awarding agencies and is not intended to be and should not be used by anyone other than these specified parties. However, this report is a matter of public record and its distribution is not limited.

AUDITOR GENERAL

March 4, 2005

SCHEDULE OF FINDINGS AND QUESTIONED COSTS

Section I: Summary of Auditor's Results

Financial Schedules

Type of auditor's report issued:	Unqualified*
Internal control* over financial reporting:	
Material weaknesses* identified?	No
Reportable conditions* identified that are not considered to be material weaknesses?	None reported
Noncompliance or other matters material to the financial schedules?	No

Federal Awards

Internal control over major programs:	
Material weaknesses identified?	No
Reportable conditions identified that are not considered to be material weaknesses?	None reported
Type of auditor's report issued on compliance for major programs:	Unqualified
Any audit findings disclosed that are required to be reported in accordance with U.S. Office of Management and Budget (OMB) Circular A-133, Section 510(a)?	No

Identification of major programs:

<u>CFDA Number</u>	<u>Name of Federal Program</u>
39.011	Election Reform Payments

Dollar threshold used to distinguish between type A and type B programs:	\$300,000
Auditee qualified as a low-risk auditee*?	No

* See glossary at end of report for definition.

Section II: Findings Related to the Financial Schedules

FINDING (230501)

1. Internal Auditor Independence

The Department of State's internal auditor was not organizationally independent, which can impact the internal auditor's ability to evaluate the Department's controls.

Section 18.1486(2) of the *Michigan Compiled Laws* requires each department's internal auditor to report to and be under the general supervision of the department head.

In December 2003, the Department of State organized a new bureau to manage the internal audit responsibilities set forth in the *Michigan Compiled Laws*. The new bureau director, who serves as the Department's internal auditor, reports functionally to the chief operating officer and three administration directors (Customer Services Administration, Department Services Administration, and Legal and Regulatory Services Administration). These directors are responsible for the majority of the Department's operations, including the oversight of accounting, budgeting, financial reporting, and human resource activities. We believe that functional reporting to any of the administration directors impairs the internal auditor's independence and can potentially impact the independent internal audit assessment of the Department's internal controls and activities.

The Department noted in the summary schedule of prior audit findings that it had realigned the internal auditor reporting structure to provide organizational independence. However, this realignment did not provide for adequate internal auditor independence.

RECOMMENDATION

WE AGAIN RECOMMEND THAT THE DEPARTMENT PROVIDE FOR ORGANIZATIONAL INDEPENDENCE FOR ITS INTERNAL AUDITOR.

The status of the findings related to the financial schedules that were reported in prior Single Audits is disclosed in the summary schedule of prior audit findings.

Section III: Findings and Questioned Costs* Related to Federal Awards

We did not report any findings related to federal awards.

* See glossary at end of report for definition.

OTHER SCHEDULES

DEPARTMENT OF STATE
Summary Schedule of Prior Audit Findings
As of September 30, 2004

PRIOR AUDIT FINDINGS RELATED TO THE FINANCIAL SCHEDULES

Audit Findings Not Corrected or Partially Corrected:

Audit Period: October 1, 2000 through September 30, 2002

Finding Number: 230301

Finding Title: Internal Auditor Independence

Finding: The Department of State's internal auditor was not organizationally independent.

Comments: The Department has realigned the internal auditor reporting structure to provide organizational independence. In 2003, a new bureau was organized that is now responsible for the internal audit responsibilities set forth in the Department of Management and Budget Act. The bureau is assigned certain investigative responsibilities and continuously monitors critical controls related to information security. The new bureau director, who serves as the Department's internal auditor, is under the general supervision of the Secretary of State by functionally reporting to her chief operating officer and three administration directors. Administratively, the position is aligned in the Legal and Regulatory Services Administration.

PRIOR AUDIT FINDINGS RELATED TO FEDERAL AWARDS

There were no findings related to federal awards in the prior Department of State Single Audit.

DEPARTMENT OF STATE
Corrective Action Plan
As of April 15, 2005

FINDINGS RELATED TO THE FINANCIAL SCHEDULES

Finding Number: 230501
Finding Title: Internal Auditor Independence

Management Views: The internal auditor has been and will remain under the general supervision of the Secretary of State and there are no reported instances in which the Department's historical arrangement negatively impacted the internal auditor's ability to evaluate Department controls. However, to address this continuing concern, the Department will further enhance the internal auditor's organizational independence by revising the formalized organizational reporting structure for the functional responsibilities of the internal auditor.

Corrective Action: The Department will realign the internal auditor to functionally report to the chief operating officer.

Anticipated Completion Date: Completed

Responsible Individual: Brian DeBano, Chief of Staff and Chief Operating Officer

FINDINGS RELATED TO FEDERAL AWARDS

There were no findings related to federal awards for the two-year period ended September 30, 2004.

GLOSSARY

Glossary of Acronyms and Terms

<i>CFDA</i>	<i>Catalog of Federal Domestic Assistance.</i>
financial audit	An audit that is designed to provide reasonable assurance about whether the financial schedules and/or financial statements of an audited entity are fairly presented in conformity with the disclosed basis of accounting.
HAVA	Help America Vote Act.
internal control	A process, effected by management, designed to provide reasonable assurance regarding the reliability of financial reporting, effectiveness and efficiency of operations, and compliance with applicable laws and regulations.
low-risk auditee	As provided for in OMB Circular A-133, an auditee that may qualify for reduced federal audit coverage if it receives an annual Single Audit and it meets other criteria related to prior audit results. In accordance with State statute, this Single Audit was conducted on a biennial basis; consequently, this auditee is not considered a low-risk auditee.
material misstatement	A misstatement in the financial schedules and/or financial statements that causes the schedules and/or statements to not present fairly the financial position or the changes in financial position or cash flows in conformity with the disclosed basis of accounting.
material noncompliance	Violations of laws and regulations that could have a direct and material effect on major federal programs or on financial schedule and/or financial statement amounts.
material weakness	A reportable condition related to the design or operation of internal control that does not reduce to a relatively low level the risk that either misstatements caused by error or fraud in

amounts that would be material in relation to the financial schedules and/or financial statements or noncompliance with applicable requirements of laws, regulations, contracts, and grants that would be material in relation to a major federal program being audited may occur and not be detected within a timely period by employees in the normal course of performing their assigned functions.

OMB

U.S. Office of Management and Budget.

questioned cost

A cost that is questioned by the auditor because of an audit finding: (1) which resulted from a violation or possible violation of a provision of a law, regulation, contract, grant, cooperative agreement, or other agreement or document governing the use of federal funds, including funds used to match federal funds; (2) where the costs, at the time of the audit, are not supported by adequate documentation; or (3) where the costs incurred appear unreasonable and do not reflect the actions a prudent person would take in the circumstances.

reportable condition

A matter coming to the auditor's attention relating to a significant deficiency in the design or operation of internal control that, in the auditor's judgment, could adversely affect the entity's ability to (1) initiate, record, process, and report financial data consistent with the assertions of management in the financial schedules and/or financial statements or (2) administer a major federal program in accordance with applicable requirements of laws, regulations, contracts, and grants.

Single Audit

A financial audit, performed in accordance with the Single Audit Act Amendments of 1996, that is designed to meet the needs of all federal grantor agencies and other financial report users. In addition to performing the audit in accordance with the requirements of auditing standards

generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards* issued by the Comptroller General of the United States, a Single Audit requires the assessment of compliance with requirements that could have a direct and material effect on a major federal program and the consideration of internal control over compliance in accordance with OMB Circular A-133.

SOMCAFR

State of Michigan Comprehensive Annual Financial Report.

subrecipient

A nonfederal entity that expends federal awards received from another nonfederal entity to carry out a federal program.

unqualified opinion

An auditor's opinion in which the auditor states that:

- a. The financial schedules and/or financial statements presenting the basic financial information of the audited agency are fairly presented in conformity with the disclosed basis of accounting; or
- b. The financial schedules and/or financial statements presenting supplemental financial information are fairly stated in relation to the basic financial schedules and/or financial statements. In issuing an "in relation to" opinion, the auditor has applied auditing procedures to the supplemental financial schedules to the extent necessary to form an opinion on the basic financial schedules and/or financial statements, but did not apply auditing procedures to the extent that would be necessary to express an opinion on the supplemental financial schedules taken by themselves; or
- c. The audited agency complied, in all material respects, with the cited requirements that are applicable to each major federal program.

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