



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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December 29, 2005

Mrs. Marianne Udow, Director
Department of Human Services
Grand Tower
Lansing, Michigan

Dear Mrs. Udow:

This is our report on our follow-up of the 5 material findings (Findings 1 through 5) and 6 corresponding recommendations reported in the performance audit of the Office of Internal Audit, Family Independence Agency. That audit report was issued and distributed in January 2003; however, additional copies are available on request or at <<http://www.audgen.michigan.gov>>. Subsequent to our original audit, Executive Order No. 2004-38 renamed the Family Independence Agency as the Department of Human Services.

Our follow-up disclosed that the Department of Human Services had complied with 4 recommendations and had substantially complied with 2 recommendations.

If you have any questions, please call me or Scott M. Strong, C.P.A., C.I.A., Deputy Auditor General.

AUDITOR GENERAL

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OFFICE OF INTERNAL AUDIT FAMILY INDEPENDENCE AGENCY FOLLOW-UP REPORT

INTRODUCTION

This report contains the results of our follow-up of the material findings and corresponding recommendations and the agency's preliminary response as reported in our performance audit of the Office of Internal Audit (OIA), Family Independence Agency (FIA) (#4312101), which was issued and distributed in January 2003. That audit report included 5 material conditions (Findings 1 through 5) and 2 other reportable conditions.

Subsequent to our original audit, Executive Order No. 2004-38 renamed the Family Independence Agency as the Department of Human Services (DHS).

PURPOSE OF FOLLOW-UP

The purpose of this follow-up was to determine whether DHS had taken appropriate corrective measures in response to the 5 material findings and 6 corresponding recommendations.

BACKGROUND

OIA is an internal audit agency within DHS. OIA defined its purpose in its charter policy:

The Office of Internal Audit was established to examine and evaluate the Family Independence Agency's [Department of Human Services'] activities and internal controls as a service to the agency's management. In part it is an internal control that functions by independently measuring and evaluating the effectiveness of the agency's control systems.

The Management and Budget Act (Act 431, P.A. 1984, as amended, specifically, Section 18.1486 of the *Michigan Compiled Laws*) provides for each principal

department to appoint an internal auditor who reports to and is placed under the general supervision of the department head. DHS's internal auditor served as OIA director and reported directly to the DHS director during our audit period.

All DHS operations are subject to audit by OIA. OIA is responsible for audit coverage of 115 local offices, 1,093 contract providers, central office functions, and other special programs. OIA is responsible for designing and implementing an annual plan for audit coverage of DHS's programs and activities; reviewing and evaluating DHS's activities and internal control in the financial, electronic data processing, and operating functions of DHS; making recommendations for improvement; providing written reports of audit findings and recommendations; providing liaison activities for all external audits and reviews; ensuring that professional standards and governmental requirements are adhered to for audits performed; and providing consultation to DHS management. Also, OIA is responsible for reviewing audit reports for all of DHS's subrecipients as required by U.S. Office of Management and Budget Circular A-133. OIA had 14 employees as of July 31, 2005.

SCOPE

Our fieldwork was conducted from May through July 2005. We interviewed DHS personnel. We reviewed the corrective action plan, policy and procedure changes, and a sample of audit working papers to determine whether the corrective actions that were taken to comply with the recommendations related to our material findings were working as OIA had intended.

FOLLOW-UP RESULTS

COMPLIANCE WITH AUDITING STANDARDS

RECOMMENDATIONS AND RESPONSE AS REPORTED IN JANUARY 2003

1. Audit Planning

RECOMMENDATIONS

We recommend that OIA enhance its audit planning process to help ensure that internal audit resources are used effectively and efficiently.

We also recommend that FIA reassess OIA's role in helping to ensure that FIA achieves its mission.

AGENCY PRELIMINARY RESPONSE

FIA agrees with items a. and b. of the finding and stated that it has complied with the first recommendation. FIA informed us that OIA catalogued FIA programs and activities in September 2001 and has assessed risk for each. This assessment was used in developing OIA's audit plan for fiscal year 2001-02. The assessment has been updated and is being used in the development of OIA's audit plan for fiscal year 2002-03.

FIA disagrees with item c. of the finding. FIA informed us that OIA consulted with FIA management in the development of the annual audit plan for the audit period and many years prior to that. OIA documented those contacts and included management's suggestions in the annual audit plans and will continue to do so.

FIA agrees and stated that it has complied with the second recommendation. FIA believes that through the development/implementation of the audit plan, OIA is helping FIA achieve its mission.

FOLLOW-UP CONCLUSION

We concluded that OIA had substantially complied with the first recommendation and that DHS had complied with the second recommendation.

OIA formally identified and cataloged auditable activities for fiscal year 2001-02 and has updated the list accordingly for each subsequent fiscal year. OIA also interviewed and surveyed many key personnel in fiscal year 2004-05 in order to identify what these personnel considered to be of high risk to DHS. This information was then used to complete a risk assessment and utilized in the development of the audit plan for fiscal year 2004-05. In addition to interviewing and surveying management and others, OIA should identify and analyze risk factors such as complexity or volatility of activities, adequacy and effectiveness of the system of internal control, and management judgments and accounting estimates. OIA incorporated many of these factors in the survey and interview with key personnel; however, questions were not always addressed or answered thoroughly.

RECOMMENDATION AND RESPONSE AS REPORTED IN JANUARY 2003

2. Working Paper Preparation and Review

RECOMMENDATION

WE AGAIN RECOMMEND THAT OIA COMPLY WITH ESTABLISHED INTERNAL CONTROL AND AUDITING STANDARDS IN ITS PREPARATION AND REVIEW OF WORKING PAPERS.

AGENCY PRELIMINARY RESPONSE

FIA agrees with items for a., b., c., d., g., and h. of the finding and stated that corrective action was implemented in October 2001.

FIA disagrees with item e. of the finding. FIA informed us that OIA determined that a study and evaluation of internal controls was not necessary for the items cited as exceptions.

FIA disagrees with item f. of the finding. FIA informed us that OIA disagrees that reconciliation to the Michigan Administrative Information Network (MAIN) is a necessary audit step for contract audits because the purpose of the audits was to determine that reported costs were appropriate and allowable in accordance with the terms of the contract. OIA is looking at a procedure for reconciling the contracts payment system to MAIN as part of a separate audit. OIA reconciled to MAIN for the year-end closing audit for fiscal year 2000-01.

FOLLOW-UP CONCLUSION

We concluded that OIA had substantially complied with the recommendation.

OIA developed a supervisor checklist that incorporates the auditing standards. The checklist is required to be completed before release of the audit report. We reviewed OIA working papers to assess compliance with items a. through h. of our finding and noted:

- a. OIA documented evidence of a supervisory/management review in its working papers with a supervisory checklist.
- b. OIA documented the matters discussed or conclusions reached at audit entrance and exit meetings.
- c. OIA documented the method used to select sample items. OIA did not document how sample sizes were determined. We noted that 3 (100%) of the 3 sets of working papers that we reviewed did not document how the sample size was determined.
- d. OIA developed and approved audit work plans in all 6 sets of working papers we reviewed.
- e. OIA sometimes documented the reported review and evaluation of internal control. We noted that 2 (40%) of the 5 applicable sets of working papers did not contain evidence of a review and evaluation of internal control.
- f. OIA audits issued during our follow-up were not of the nature to require audited financial populations to be reconciled to MAIN. As a result, we did not follow up this prior exception.
- g. OIA's working papers often contained a summary of the audit work performed. Of the 6 sets of working papers reviewed, 2 (33%) sets did not include the source of the information.
- h. OIA usually cross-referenced the audit report to the working papers. Of the 6 sets of working papers reviewed, 1 (17%) set did not contain a copy of the audit report cross-referenced to the working papers.

RECOMMENDATION AND RESPONSE AS REPORTED IN JANUARY 2003

3. Quality Assurance Process

RECOMMENDATION

WE AGAIN RECOMMEND THAT FIA ESTABLISH AND MAINTAIN A QUALITY ASSURANCE PROCESS.

AGENCY PRELIMINARY RESPONSE

FIA agrees and stated that it has complied. OIA has implemented an internal quality assurance process and is participating in a Statewide effort for all departments to comply with the external review requirement.

FOLLOW-UP CONCLUSION

We concluded that OIA had complied with the recommendation.

OIA has implemented and maintained a quality assurance process, including both an internal and external assessment. The internal assessment consists of an ongoing supervisory review of working papers and an annual internal peer review. A supervisory review checklist is completed by an OIA supervisor for all working papers. This method of ongoing review provides assurance that processes have been adopted by the audit activity. Also, an internal peer review is done annually to evaluate DHS's adherence to internal auditing standards. OIA staff auditors rotate each year and review approximately six sets of working papers and audit reports. The external assessment consists of an external peer review process with more than seven other departments. In this peer review process, each participating State department's internal audit function is reviewed based on the internal auditing standards at least once every five years. A committee has been formed to oversee the external peer review activity, and it has prepared a schedule detailing who the peer reviewers will be and what department will be reviewed each year. OIA stated that it was reviewed under this process in 2004.

RECOMMENDATION AND RESPONSE AS REPORTED IN JANUARY 2003

4. Audit Follow-Up and Corrective Action

RECOMMENDATION

We recommend that FIA develop an effective process to help ensure that OIA follows up audit findings and that FIA management initiates effective corrective action.

AGENCY PRELIMINARY RESPONSE

FIA agrees and will comply. FIA informed us that it is making organizational changes that will facilitate better monitoring of corrective action. FIA's revised procedures for corrective action monitoring and follow-up will be completed and documented in the Administrative Handbook by May 1, 2003.

FOLLOW-UP CONCLUSION

We concluded that DHS had complied with the recommendation.

DHS reassigned corrective action tracking responsibility to OIA in 2003. OIA revised Administrative Handbook item 1012-7, *Corrective Action Plans for Audits*, in December 2003. OIA is utilizing an audit findings database that includes audits issued by OIA, the Office of the Auditor General, federal funding sources, and other State agencies. OIA tracks and monitors the status of corrective action plans prepared by the applicable director or the director's designee. The director or the director's designee is required to enter onto the audit findings database a written corrective action plan, which includes a description of the action to be taken, target dates for implementation, and responsible individuals. OIA reviews the corrective action plan to determine if the actions to be taken will correct the finding. OIA performs follow-up audits when a material finding or findings are noted or when there are significant weaknesses in internal controls.

RECOMMENDATION AND RESPONSE AS REPORTED IN JANUARY 2003

5. Compliance With Statute

RECOMMENDATION

We recommend that OIA comply with Section 18.1486(5) of the *Michigan Compiled Laws*.

AGENCY PRELIMINARY RESPONSE

FIA disagrees with the finding. FIA stated that OIA followed appropriate auditing standards as required by Section 18.1486(5) of the *Michigan Compiled Laws*, although there were instances of noncompliance with the guidelines that directs auditors on following the standards. FIA also stated that corrective action taken by OIA for Findings 1 through 4 of this audit will result in improved compliance with those guidelines.

FOLLOW-UP CONCLUSION

We concluded that OIA had complied with the recommendation.

Section 18.1486(5) of the *Michigan Compiled Laws* (a section of the Management and Budget Act) states that each principal department shall appoint an internal auditor and each internal auditor shall adhere to appropriate professional and auditing standards in carrying out any financial or program audits or investigations.

This recommendation is related to Findings 1 through 4 and the 5 corresponding recommendations. We determined that OIA had complied or had substantially complied with all 5 recommendations.

