



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:
51-100-06

Department of Military and Veterans Affairs

October 1, 2003 through September 30, 2005

Released:
June 2006

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 of Military and Veterans Affairs' (DMVA'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*. However, we did identify a reportable condition (Finding 1).

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Federal Awards:

Auditor's Reports Issued on Compliance

We audited 3 programs as major programs and issued 3 unqualified opinions. The federal programs audited as major programs are identified on the back of this summary.

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Internal Control Over Major Programs

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

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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.

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Systems of Accounting and Internal Control:

We determined that DMVA was in substantial compliance with Sections 18.1483 - 18.1487 of the *Michigan Compiled Laws*.

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We audited the following programs as major programs:

<u>CFDA Number</u>	<u>Program Title</u>	<u>Compliance Opinion</u>
12.401	National Guard Military Operations and Maintenance (O&M) Projects	Unqualified
64.014	Veterans State Domiciliary Care	Unqualified
64.015	Veterans State Nursing Home Care	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.
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THOMAS H. MCTAVISH, C.P.A.
AUDITOR GENERAL

June 30, 2006

Major General Thomas G. Cutler, Director
Department of Military and Veterans Affairs
2500 South Washington Avenue
Lansing, Michigan

Dear General Cutler:

This is our report on the financial audit, including the provisions of the Single Audit Act, of the Department of Military and Veterans Affairs (DMVA) for the period October 1, 2003 through September 30, 2005.

This report contains our report summary; our independent auditor's report on the financial schedules; and the DMVA financial schedules, notes to the financial schedules, and schedule of expenditures of federal awards. 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 DMVA'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's 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



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

Independent Auditor's Report on the Financial Schedules

Major General Thomas G. Cutler, Director
Department of Military and Veterans Affairs
2500 South Washington Avenue
Lansing, Michigan

Dear General Cutler:

We have audited the accompanying financial schedules of the Department of Military and Veterans Affairs for the fiscal years ended September 30, 2005 and September 30, 2004, 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 other financing sources and the sources and disposition of authorizations for the Department of Military and Veterans Affairs' 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 either the Department or the State's General Fund 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 other financing sources and the sources and disposition of authorizations of the Department of Military and Veterans Affairs for the fiscal years ended September 30, 2005 and September 30, 2004 on the basis of accounting described in Note 1.

In accordance with *Government Auditing Standards*, we have also issued our report dated March 10, 2006 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 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*, is presented for purposes of additional analysis and is 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 10, 2006

DEPARTMENT OF MILITARY AND VETERANS AFFAIRS
Schedule of General Fund Revenues and Other Financing Sources
Fiscal Years Ended September 30

	<u>2005</u>	<u>2004</u>
REVENUES		
Federal Revenues:		
National Guard Bureau	\$ 26,322,566	\$ 23,930,053
Veterans Administration State Home Program	17,177,933	16,794,919
Medicare and Medicaid	1,281,851	1,459,259
U.S. Department of Education	199,242	240,482
U.S. Department of Health and Human Services	54,999	60,000
Total Federal Revenues (Note 4)	<u>\$ 45,036,591</u>	<u>\$ 42,484,713</u>
Cost-of-care assessments	19,347,932	18,949,956
Armory Rental Program	104,723	174,476
Miscellaneous	647,012	471,360
Total Revenues	<u>\$ 65,136,258</u>	<u>\$ 62,080,505</u>
OTHER FINANCING SOURCES		
Proceeds from sale of capital assets - Armory sales	\$ 502,500	\$ 3,732,500
Less: Proceeds transferred to Department of Management and Budget capital outlay (Note 3)	<u>(502,500)</u>	<u>(690,653)</u>
Total Other Financing Sources	<u>\$ 0</u>	<u>\$ 3,041,847</u>
Total Revenues and Other Financing Sources	<u><u>\$ 65,136,258</u></u>	<u><u>\$ 65,122,352</u></u>

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

DEPARTMENT OF MILITARY AND VETERANS AFFAIRS
Schedule of Sources and Disposition of General Fund Authorizations
Fiscal Years Ended September 30

	<u>2005</u>	<u>2004</u>
SOURCES OF AUTHORIZATIONS (Note 2)		
General purpose appropriations (Note 1c)	\$ 36,656,600	\$ 36,328,800
Balances carried forward	8,332,607	5,705,408
Less: Transfer to Department of Management and Budget capital outlay (Note 3)	(856,132)	
Restricted financing sources	64,816,056	65,201,850
Budgetary adjustment	<u>263,560</u>	
 Total	 <u><u>\$ 109,212,691</u></u>	 <u><u>\$ 107,236,059</u></u>
 DISPOSITION OF AUTHORIZATIONS (Note 2)		
Expenditures and transfers out (Note 4)	<u>\$ 104,077,691</u>	<u>\$ 98,136,888</u>
Balances carried forward:		
Multi-year projects	\$	\$
Encumbrances	7,659	115,780
Restricted revenues - authorized	2,680,811	3,535,694
Restricted revenues - not authorized	<u>2,315,594</u>	<u>4,681,133</u>
Total balances carried forward	<u>\$ 5,004,064</u>	<u>\$ 8,332,607</u>
Balances lapsed	<u>\$ 130,936</u>	<u>\$ 766,563</u>
 Total	 <u><u>\$ 109,212,691</u></u>	 <u><u>\$ 107,236,059</u></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 financial transactions of the Department of Military and Veterans Affairs (DMVA) for the fiscal years ended September 30, 2005 and September 30, 2004. The financial transactions of DMVA are accounted for principally in the State's General Fund and are reported on in the *State of Michigan Comprehensive Annual Financial Report (SOMCAFR)*. The financial schedules do not include the financial activities of the Michigan Veterans' Trust Fund and the Military Family Relief Fund. These funds periodically receive separate financial and performance audits and are not included in the scope of this audit because they do not receive federal awards.

The notes accompanying these financial schedules relate directly to DMVA. 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 other financing sources and the sources and disposition of authorizations

for DMVA's General Fund accounts. Accordingly, these financial schedules do not purport to, and do not, constitute a complete financial presentation of either DMVA or the State's General Fund in conformity with generally accepted accounting principles.

c. Military Retirement Benefits

DMVA received annual appropriations for military retirement benefits for the Michigan National Guard members and special duty officers. These appropriations are made from the General Fund on a pay-as-you-go basis. Expenditures for the military retirement plan totaled \$2,804,468 for fiscal year 2004-05 and \$2,700,000 for fiscal year 2003-04. The actuarially determined unfunded liabilities for the military retirement plan as of September 30, 2005 totaled \$40.6 million.

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 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.
- 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. DMVA's

restricted financing sources include federal revenue and cost-of-care assessments.

- 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. In addition to the amounts recorded in the financial schedules, DMVA also had authorizations for large capital outlay projects that were accounted for by the Department of Management and Budget (DMB). Unexpended authorizations carried forward for projects accounted for by DMB totaled \$77,194,900 for fiscal year 2004-05 and \$59,615,971 for fiscal year 2003-04.
- 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. DMVA has restricted revenue from the sale of land and armories owned by DMVA.
- g. Restricted revenues - not authorized: 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. Significant carry-forwards of this type for fiscal year 2004-05 were for the U.S. Department of Veterans Affairs' federal assistance (\$1,625,413) and for revenues collected by the Grand Rapids and D.J. Jacobetti Homes for Veterans for cost-of-care assessments (\$391,441). Significant carry-forwards of this type for fiscal year 2003-04 were for the U.S. Department of Veterans Affairs' federal assistance (\$2,916,073) and for revenues collected by the Grand Rapids and D.J. Jacobetti Homes for Veterans for cost-of-care assessments (\$1,484,689).
- 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 DMVA's Armory Construction Fund

DMVA's Armory Construction Fund, within the General Fund, collects and maintains revenue restricted for funding State armory capital outlay projects with authorization to carry forward unspent revenue to the next fiscal year. Armory capital outlay projects are primarily appropriated within DMB's Office of Design and Construction (ODC) accounts. When DMVA receives proceeds from the sale of capital assets (land and armories), DMVA transfers cash to ODC to cover construction costs throughout the year. When DMVA's current year proceeds from the sale of capital assets is not sufficient to fund current year ODC expenditures, DMVA transfers cash from the Armory Construction Fund's restricted revenue carried forward. In fiscal year 2004-05, a transfer of \$856,132 is reported on the schedule of sources and dispositions of General Fund authorizations as a reduction to the balances carried forward.

Also, in fiscal year 2004-05, DMVA transferred \$502,500 of the proceeds from the sale of capital assets to ODC to fund additional current year construction costs.

In fiscal year 2003-04, DMVA transferred \$690,653 of the proceeds from the sale of capital assets to ODC to fund current year construction costs.

Note 4 Federal Revenues and Expenditures

The schedule of General Fund revenues and other financing sources and the schedule of sources and disposition of General Fund authorizations do not include the amounts expended by DMVA for federal Homeland Security programs administered by the Michigan Department of State Police (MSP). DMVA expended \$767,518 in fiscal year 2004-05 and \$168,951 in fiscal year 2003-04 related to these programs.

An expenditure credit was processed at DMVA and the associated revenue and expenditures were reported on MSP's financial schedules (Finding 1). The federal program expenditures are included on DMVA's schedule of expenditures of federal awards (see Note 4 of the notes to the schedule of expenditures of federal awards).

SUPPLEMENTAL
FINANCIAL SCHEDULE

DEPARTMENT OF MILITARY AND VETERANS AFFAIRS
Schedule of Expenditures of Federal Awards*
For the Period October 1, 2003 through September 30, 2005

Federal Agency/Program	CFDA** Number	For the Fiscal Year Ended September 30, 2004			Total Expended, Distributed, and In-Kind Assistance
		Directly Expended by Department	Distributed to Subrecipient	In-Kind Assistance (Note 1)	
<u>U.S. Department of Defense</u>					
Direct Programs:					
National Guard Military Operations and Maintenance (O&M) Projects:					
Appendix 1 Army National Guard Real Property Operations and Maintenance (Note 2)	12.401	\$ 34,950,173	\$	\$ 404,215	\$ 35,354,388
Appendix 2 Army National Guard Environmental and Integrated Training Area Resources Management	12.401	2,588,023		1,021,622	3,609,645
Appendix 3 Army National Guard Security Guard Activities	12.401	1,223,929			1,223,929
Appendix 4 Army National Guard Electronic Security System Operations and Maintenance	12.401	70,822			70,822
Appendix 5 Army National Guard Telecommunications	12.401	822,105			822,105
Appendix 6 Army National Guard Aviation Training Base Operations	12.401	52,420			52,420
Appendix 7 Army National Guard Range and Training Land Program	12.401	279,334			279,334
Appendix 9 Army National Guard Store Front Recruiting Office Lease	12.401	122,581			122,581
Appendix 21 Air National Guard Facilities Operations and Maintenance Activities	12.401	2,217,383		2,880,185	5,097,568
Appendix 22 Air National Guard Environmental Program Management	12.401	133,812			133,812
Appendix 23 Air National Guard Security Guard Services	12.401	1,430,836		37,827	1,468,663
Appendix 24 Air National Guard Fire Protection Activities	12.401	3,226,236		47,217	3,273,453
Appendix 40 Army National Guard Distance Learning Project	12.401	61,441			61,441
Total National Guard Military Operations and Maintenance (O&M) Projects		<u>\$ 47,179,095</u>	<u>\$ 0</u>	<u>\$ 4,391,066</u>	<u>\$ 51,570,161</u>
National Guard Civilian Youth Opportunities:					
Challenge Program	12.404	\$ 1,640,314	\$	\$	\$ 1,640,314
Starbase Program	12.404		621,481		621,481
Total National Guard Civilian Youth Opportunities		<u>\$ 1,640,314</u>	<u>\$ 621,481</u>	<u>\$ 0</u>	<u>\$ 2,261,795</u>
Total U.S. Department of Defense		<u>\$ 48,819,409</u>	<u>\$ 621,481</u>	<u>\$ 4,391,066</u>	<u>\$ 53,831,956</u>
<u>U.S. Department of Justice</u>					
Pass-Through Programs:					
Michigan Department of State Police (Note 5)					
State Domestic Preparedness Equipment Support Program (Note 4)	16.007	\$ 168,951	\$	\$	\$ 168,951
Urban Areas Security Initiative	16.011				0
Total U.S. Department of Justice		<u>\$ 168,951</u>	<u>\$ 0</u>	<u>\$ 0</u>	<u>\$ 168,951</u>
<u>U.S. Department of Veterans Affairs</u>					
Direct Programs:					
Veterans State Domiciliary Care	64.014	\$ 1,096,564	\$	\$	\$ 1,096,564
Veterans State Nursing Home Care	64.015	15,543,248			15,543,248
Total U.S. Department of Veterans Affairs (Note 3)		<u>\$ 16,639,812</u>	<u>\$ 0</u>	<u>\$ 0</u>	<u>\$ 16,639,812</u>
<u>U.S. Department of Education</u>					
Pass-Through Program:					
Michigan Department of Community Health (Note 5)					
Safe and Drug-Free Schools and Communities - State Grants	84.186	\$ 240,482	\$	\$	\$ 240,482
Total U.S. Department of Education		<u>\$ 240,482</u>	<u>\$ 0</u>	<u>\$ 0</u>	<u>\$ 240,482</u>

This schedule continued on next page.

For the Fiscal Year Ended September 30, 2005				Total Expended, Distributed, and In-Kind Assistance for the Two-Year Period
Directly Expended by Department	Distributed to Subrecipient	In-Kind Assistance (Note 1)	Total Expended, Distributed, and In-Kind Assistance	
\$ 31,907,278	\$	\$ 3,383,810	\$ 35,291,088	\$ 70,645,476
2,604,824		916,626	3,521,450	7,131,095
1,294,039			1,294,039	2,517,968
84,332			84,332	155,154
735,916			735,916	1,558,021
52,420			52,420	104,840
410,677			410,677	690,011
239,875			239,875	362,456
2,362,352		2,631,650	4,994,002	10,091,570
151,182			151,182	284,994
1,439,397		53,019	1,492,416	2,961,079
3,214,825		81,699	3,296,524	6,569,977
51,236			51,236	112,677
\$ 44,548,353	\$ 0	\$ 7,066,804	\$ 51,615,157	\$ 103,185,318
\$ 1,647,711	\$	\$	\$ 1,647,711	\$ 3,288,025
	864,000		864,000	1,485,481
\$ 1,647,711	\$ 864,000	\$ 0	\$ 2,511,711	\$ 4,773,506
\$ 46,196,064	\$ 864,000	\$ 7,066,804	\$ 54,126,868	\$ 107,958,824
\$ 262,748	\$	\$	\$ 262,748	\$ 431,699
150,000			150,000	150,000
\$ 412,748	\$ 0	\$ 0	\$ 412,748	\$ 581,699
\$ 1,217,361	\$	\$	\$ 1,217,361	\$ 2,313,925
17,246,718			17,246,718	32,789,966
\$ 18,464,079	\$ 0	\$ 0	\$ 18,464,079	\$ 35,103,891
\$ 199,414	\$	\$	\$ 199,414	\$ 439,896
\$ 199,414	\$ 0	\$ 0	\$ 199,414	\$ 439,896

DEPARTMENT OF MILITARY AND VETERANS AFFAIRS
Schedule of Expenditures of Federal Awards*
For the Period October 1, 2003 through September 30, 2005

Continued

Federal Agency/Program	CFDA** Number	For the Fiscal Year Ended September 30, 2004			Total Expended, Distributed, and In-Kind Assistance
		Directly Expended by Department	Distributed to Subrecipient	In-Kind Assistance (Note 1)	
<u>U.S. Department of Health and Human Services</u>					
Direct Program:					
Centers for Disease Control and Prevention - Investigations and Technical Assistance	93.283	\$ 60,000	\$	\$	\$ 60,000
Total U.S. Department of Health and Human Services		\$ 60,000	\$ 0	\$ 0	\$ 60,000
<u>U.S. Department of Homeland Security</u>					
Pass-Through Programs:					
Michigan Department of State Police (Note 5)					
State Domestic Preparedness Equipment Support Program	97.004	\$	\$	\$	\$ 0
Disaster Grants - Public Assistance (Presidentially Declared Disasters)	97.036				0
Homeland Security Grant Program	97.067				0
Total U.S. Department of Homeland Security		\$ 0	\$ 0	\$ 0	\$ 0
Total Expenditures of Federal Awards		\$ 65,928,654	\$ 621,481	\$ 4,391,066	\$ 70,941,201

* Basis of Presentation: This schedule includes the federal grant activity of the Department of Military and Veterans Affairs 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.

** CFDA is defined as the *Catalog of Federal Domestic Assistance*.

The accompanying notes are an integral part of this supplemental financial schedule.

For the Fiscal Year Ended September 30, 2005				Total Expended, Distributed, and In-Kind Assistance for the Two-Year Period
Directly Expended by Department	Distributed to Subrecipient	In-Kind Assistance (Note 1)	Total Expended, Distributed, and In-Kind Assistance	
\$ 54,999	\$	\$	\$ 54,999	\$ 114,999
\$ 54,999	\$ 0	\$ 0	\$ 54,999	\$ 114,999
\$ 54,344	\$	\$	\$ 54,344	\$ 54,344
295,577			295,577	295,577
4,849			4,849	4,849
\$ 354,770	\$ 0	\$ 0	\$ 354,770	\$ 354,770
\$ 65,682,074	\$ 864,000	\$ 7,066,804	\$ 73,612,878	\$ 144,554,079

Notes to the Schedule of Expenditures of Federal Awards

Note 1 In-Kind Assistance

As part of the National Guard Bureau Cooperative Agreement, the U.S. Department of Defense provided in-kind assistance in the form of direct federal payment for services and supplies for the military operations and maintenance projects.

Note 2 Transfers for Capital Outlay Projects

This schedule includes the cost of military operations and maintenance projects that are administered by the Office of Design and Construction, Department of Management and Budget (DMB). In accordance with State accounting policy, these costs are recorded as expenditures by DMB. The Department of Military and Veterans Affairs (DMVA) requests and receives reimbursement from the National Guard Bureau, U.S. Department of Defense, and transfers the related revenue to a DMB federal revenue account. However, because DMVA is responsible for federal compliance related to these projects, the expenditures have been recorded as directly expended by DMVA on this schedule. The transfers totaled \$25,510,838 in fiscal year 2003-04 and \$20,737,499 in fiscal year 2004-05.

Note 3 Medicare and Medicaid Revenue

The Grand Rapids Home for Veterans and the D.J. Jacobetti Home for Veterans received federal Medicare revenue totaling \$966,459 in fiscal year 2003-04 and \$771,529 in fiscal year 2004-05. The Grand Rapids Home for Veterans received federal Medicaid revenue totaling \$492,799 in fiscal year 2003-04 and \$510,322 in fiscal year 2004-05. Medicare and Medicaid revenue is not considered federal assistance, but rather a purchase of services provided by the Homes. Therefore, Medicare and Medicaid revenue is not included in this schedule.

Note 4 Homeland Security Program Expenditures

DMVA included federal program expenditures of \$168,951 (one program) in fiscal year 2003-04 and \$767,518 (five programs) in fiscal year 2004-05 on its schedule of expenditures of federal awards for U.S. Department of Homeland Security and U.S. Department of Justice programs administered by the Michigan Department of State Police (MSP).

DMVA incurred the initial expenditure and was responsible for the determination of federal compliance for these program expenditures. However, an expenditure credit was processed at DMVA and the associated revenue and expenditures were reported on MSP's financial schedules (Finding 1).

Note 5 Pass-Through Identification Numbers

The pass-through entities did not provide DMVA with pass-through identification numbers.

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

Major General Thomas G. Cutler, Director
Department of Military and Veterans Affairs
2500 South Washington Avenue
Lansing, Michigan

Dear General Cutler:

We have audited the financial schedules of the Department of Military and Veterans Affairs for the fiscal years ended September 30, 2005 and September 30, 2004, as identified in the table of contents, and have issued our report thereon dated March 10, 2006. 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*. However, we noted a reportable condition, which is described in Finding 1.

This report is intended solely for the information and use of the State's management, the Legislature, federal awarding agencies, and pass-through entities 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 10, 2006



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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

Major General Thomas G. Cutler, Director
Department of Military and Veterans Affairs
2500 South Washington Avenue
Lansing, Michigan

Dear General Cutler:

Compliance

We have audited the compliance of the Department of Military and Veterans Affairs 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, 2005. The Department's major federal programs are 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 Military and Veterans Affairs 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, 2005.

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, federal awarding agencies, and pass-through entities 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 10, 2006

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>
12.401	National Guard Military Operations and Maintenance (O&M) Projects
64.014	Veterans State Domiciliary Care
64.015	Veterans State Nursing Home Care

Dollar threshold used to distinguish between type A and type B programs:	\$3,000,000
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 (510601)

1. Expenditures and Federal Revenue Reporting

The Department of Military and Veterans Affairs (DMVA) did not comply with State accounting policies regarding the recording of expenditures and federal revenue for funds passed through from other State departments. As a result, DMVA understated expenditures and federal revenue for funds passed through from the Michigan Department of State Police (MSP).

DMVA received federal funds from MSP for one federal program in fiscal year 2003-04 and five federal programs in fiscal year 2004-05 totaling \$168,951 and \$767,518, respectively. These funds were included in DMVA's appropriations and DMVA was responsible for determining federal compliance for these program expenditures.

The Department of Management and Budget's Financial Management Guide, Chapter 16, Section 1(4) states that the agency responsible for determining compliance with federal regulations for a particular State program should recognize both the expenditures and related revenue. When passing federal funds between agencies, a revenue reduction should be recorded by the paying agency and revenue should be recognized by the receiving agency.

However, MSP periodically processed expenditures in MSP's accounting records and associated expenditure credits in DMVA's accounting records for these federal programs. As a result, the expenditures and related revenue were recorded on MSP's financial schedules rather than DMVA's financial schedules.

RECOMMENDATION

We recommend that DMVA comply with State accounting policies regarding the recording of expenditures and federal revenue for funds passed through from other State departments.

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.

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

** See glossary at end of report for definition.*

OTHER SCHEDULES

DEPARTMENT OF MILITARY AND VETERANS AFFAIRS
Summary Schedule of Prior Audit Findings
As of February 10, 2006

PRIOR AUDIT FINDINGS RELATED TO THE FINANCIAL SCHEDULES

Audit Findings That Have Been Fully Corrected:

Audit Period: October 1, 2001 through September 30, 2003

Finding Number: 510401

Finding Title: Recording of Expenditures

Finding: The Department of Military and Veterans Affairs' (DMVA's) internal control did not ensure that expenditures were recorded in the proper fiscal year and that supporting documentation was retained.

Comments: DMVA has recorded expenditures in the proper fiscal year and retained supporting documentation.

PRIOR AUDIT FINDINGS RELATED TO FEDERAL AWARDS

Audit Findings That Have Been Fully Corrected:

Audit Period: October 1, 2001 through September 30, 2003

Finding Number: 510402

Finding Title: Federal Payroll Costs

Finding: DMVA charged terminal leave costs for two federal programs and exceeded hourly federal pay rate limits for one federal program.

Comments: DMVA obtained written confirmation from the U.S. Property and Fiscal Office that terminal leave costs are an authorized expense through the National Guard Bureau Cooperative Agreement and will be honored for federal reimbursement.

Also, DMVA has implemented a procedure to evaluate, on a position-by-position basis, compliance with federal pay rate limits to ensure that the allowable federal maximums are not exceeded.

DEPARTMENT OF MILITARY AND VETERANS AFFAIRS

Corrective Action Plan

As of June 1, 2006

FINDINGS RELATED TO THE FINANCIAL SCHEDULES

Finding Number: 510601

Finding Title: Expenditures and Federal Revenue Reporting

Management Views: The Department of Military and Veterans Affairs (DMVA) does not agree with the finding.

DMVA exercised due diligence in attempting to properly record the subgrantee status at year-end for fiscal year 2004-05 and fiscal year 2003-04. At that time, DMVA understood that the correct treatment was for the Michigan Department of State Police (MSP) to reimburse DMVA through expenditure credit so as not to overstate federal revenue.

Subsequent to the completion of audit fieldwork, DMVA sought guidance from the Office of Financial Management (OFM), Department of Management and Budget (DMB), as to which agency should report the expenditures and revenue for the Homeland Security Grant Program. OFM recently issued a position paper stating in part that because MSP is the agency determining compliance, MSP should continue to record the expenditures and related revenue, with an expenditure credit given to DMVA as subgrantee.

Corrective Action: None required

Anticipated Completion Date: Not applicable

Responsible Individual: Joel A. Wortley, DMVA Chief Financial Officer

Auditor's Epilogue:

We have analyzed the OFM position paper and conclude that the application of the guidance would result in the reporting of federal revenue and the expenditure of these federal funds that is inconsistent with the reporting of similar accounting events. It remains our opinion that, because DMVA is considered a subrecipient of MSP, DMVA should have followed existing OFM policy and reported the federal revenue and expenditures in its financial schedules.

FINDINGS RELATED TO FEDERAL AWARDS

There were no findings related to federal awards for the two-year period ended September 30, 2005.

GLOSSARY

Glossary of Acronyms and Terms

<i>CFDA</i>	<i>Catalog of Federal Domestic Assistance.</i>
DMB	Department of Management and Budget.
DMVA	Department of Military and Veterans Affairs.
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.
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.
MSP	Michigan Department of State Police.
ODC	Office of Design and Construction.
OFM	Office of Financial Management.
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 the applicable requirements of laws, regulations, contracts,

and grants. Violations of State laws, regulations, contracts, and grant agreements that should be communicated to management but are not material to the financial schedules and/or financial statements may also be reported.

Single Audit

A financial audit, performed in accordance with the Single Audit Act Amendments for 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 and/or financial statements 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 and/or financial statements 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.

