



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

Audit report information can be accessed at:

<http://audgen.michigan.gov>



Michigan
Office of the Auditor General
REPORT SUMMARY

Financial Audit
Including the Provisions of the Single Audit Act

Report Number:
231-0100-09

Department of State

October 1, 2006 through September 30, 2008

Released:
June 2009

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 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 State's financial schedules.

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Internal Control Over Financial Reporting

We identified a significant deficiency in internal control over financial reporting (Finding 1). We do not consider this significant deficiency to be a material weakness.

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**Noncompliance and 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 other noncompliance (Finding 2).

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Federal Awards:

Auditor's Reports Issued on Compliance

We audited 5 programs as major programs and issued 5 unqualified opinions. The Department of State expended a total of \$7.1 million in federal awards during the two-year period ended September 30, 2008. 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 federal program compliance.

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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 the Department of State 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 or Cluster Title</u>	<u>Compliance Opinion</u>
20.232	Commercial Driver License State Programs	Unqualified
20.605, 20.609, and 20.612	Highway Safety Cluster	Unqualified
39.011	Election Reform Payments	Unqualified
90.401	Help America Vote Act Requirements Payments	Unqualified
93.617	Voting Access for Individuals with Disabilities - Grants to States	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 23, 2009

The Honorable Terri Lynn Land
Secretary of State
Richard H. Austin 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, 2006 through September 30, 2008.

This report contains our report summary, our independent auditor's report on the financial schedules, and the Department of State 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 findings and recommendations are contained in Section II of the schedule of findings and questioned costs. The agency preliminary responses are 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
Richard H. Austin Building
Lansing, Michigan

Dear Secretary Land:

We have audited the accompanying financial schedules of the Department of State for the fiscal years ended September 30, 2008 and September 30, 2007, 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 the revenues and other financing sources for the Department of State's General Fund accounts and for the Assigned Claims Facility and Plan 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 either the Department or the State's General Fund and Assigned Claims Facility and Plan 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 State for the fiscal years ended September 30, 2008 and September 30, 2007 on the basis of accounting described in Note 1.

As disclosed in Note 1a. to the financial schedules, the information contained in the Department's schedule of revenues and other financing sources has been changed from prior years to better reflect the revenues that were collected and used for the Department's own operations.

In accordance with *Government Auditing Standards*, we have also issued our report dated June 10, 2009 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*, and the schedule of revenue collections by agency 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

June 10, 2009

DEPARTMENT OF STATE
Schedule of Revenues and Other Financing Sources
General Fund and Assigned Claims Facility and Plan Fund
For the Fiscal Years Ended September 30
(In Thousands)

	General Fund		Assigned Claims Facility and Plan Fund		Totals (Memorandum Only)	
	2008	2007	2008	2007	2008	2007
REVENUES (Note 1)						
Taxes:						
Sales taxes	\$ 198,477	\$ 192,878	\$	\$	\$ 198,477	\$ 192,878
Use taxes	73,207	83,602			73,207	83,602
Other taxes - penalty and interest	10,060	10,003			10,060	10,003
Motor vehicle registration tax	808	762			808	762
Total taxes	<u>\$ 282,552</u>	<u>\$ 287,245</u>	<u>\$ 0</u>	<u>\$ 0</u>	<u>\$ 282,552</u>	<u>\$ 287,245</u>
From federal agencies	\$ 1,381	\$ 5,745	\$ 0	\$ 0	\$ 1,381	\$ 5,745
From services:						
Registration transaction fees	\$ 43,136	\$ 44,549	\$	\$	\$ 43,136	\$ 44,549
Commercial lookup fees	40,622	40,073			40,622	40,073
Title services fees	10,018	9,895			10,018	9,895
Registration transfer fees	8,541	8,682			8,541	8,682
Uniform commercial code lien filing and search fees	4,078	4,120			4,078	4,120
Other	7,289	9,841			7,289	9,841
Total from services	<u>\$ 113,683</u>	<u>\$ 117,161</u>	<u>\$ 0</u>	<u>\$ 0</u>	<u>\$ 113,683</u>	<u>\$ 117,161</u>
From licenses and permits:						
Motor vehicle operator and chauffeur licenses	\$ 32,586	\$ 32,397	\$	\$	\$ 32,586	\$ 32,397
Other licenses and permits	4,179	4,648			4,179	4,648
Auto repair facility and mechanic licenses	3,847	3,883			3,847	3,883
Motor vehicle title fees - plates	1,521	1,512			1,521	1,512
Total from licenses and permits	<u>\$ 42,133</u>	<u>\$ 42,439</u>	<u>\$ 0</u>	<u>\$ 0</u>	<u>\$ 42,133</u>	<u>\$ 42,439</u>
Miscellaneous:						
Assigned claims facility assessments	\$	\$	\$ 146,909	\$ 133,742	\$ 146,909	\$ 133,742
Court fines, fees, and assessments	8,128	8,566			8,128	8,566
Other miscellaneous	949	1,928			949	1,928
Total miscellaneous	<u>\$ 9,078</u>	<u>\$ 10,494</u>	<u>\$ 146,909</u>	<u>\$ 133,742</u>	<u>\$ 155,986</u>	<u>\$ 144,236</u>
Total revenues	<u>\$ 448,827</u>	<u>\$ 463,085</u>	<u>\$ 146,909</u>	<u>\$ 133,742</u>	<u>\$ 595,735</u>	<u>\$ 596,827</u>
OTHER FINANCING SOURCES (Note 1)						
Transfers from Michigan Transportation Fund	\$ 20,000	\$ 20,000	\$	\$	\$ 20,000	\$ 20,000
Transfers from Assigned Claims Facility and Plan Fund	67	97			67	97
Total other financing sources	<u>\$ 20,067</u>	<u>\$ 20,097</u>	<u>\$ 0</u>	<u>\$ 0</u>	<u>\$ 20,067</u>	<u>\$ 20,097</u>
Total revenues and other financing sources	<u>\$ 468,893</u>	<u>\$ 483,182</u>	<u>\$ 146,909</u>	<u>\$ 133,742</u>	<u>\$ 615,802</u>	<u>\$ 616,924</u>

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

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

	<u>2008</u>	<u>2007</u>
SOURCES OF AUTHORIZATIONS (Note 2)		
General purpose appropriations	\$ 28,797	\$ 17,766
Balances carried forward	21,057	25,020
Restricted financing sources	<u>165,751</u>	<u>175,458</u>
 Total	 <u>\$ 215,605</u>	 <u>\$ 218,245</u>
 DISPOSITION OF AUTHORIZATIONS (Note 2)		
Expenditures and transfers out	<u>\$ 189,883</u>	<u>\$ 196,114</u>
Balances carried forward:		
Multi-year projects	\$ 8,059	\$ 5,668
Encumbrances	145	244
Restricted revenues - authorized	105	116
Restricted revenues - not authorized or used	<u>14,916</u>	<u>15,028</u>
Total balances carried forward	<u>\$ 23,225</u>	<u>\$ 21,057</u>
Balances lapsed	<u>\$ 2,497</u>	<u>\$ 1,074</u>
 Total	 <u>\$ 215,605</u>	 <u>\$ 218,245</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 State for the fiscal years ended September 30, 2008 and September 30, 2007. The financial transactions 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 taxes, fees, and other revenue for various State departments, as presented in the supplemental financial schedule of revenue collections by agency.

The information contained in the Department's schedule of revenues and other financing sources has been changed from prior years. For the fiscal years ended September 30, 2006 and September 30, 2005, the financial schedules reported revenues collected by and transferred to the Department for use by the Department and other State departments. These revenues were presented in the schedule of revenues and other financing sources based on amounts collected for the State's General Fund, School Aid Fund, other special revenue funds, and a private purpose trust fund. The amounts presented in the schedule of revenues and other financing sources for the fiscal years ended September 30, 2008 and September 30, 2007 represent only the revenues collected and used by the Department's General Fund and Assigned Claims Facility and Plan Fund. This change was made to better reflect the revenues that were collected and used for the Department's own operations, which are accounted for in the Department's General Fund. The revenues collected by the Department's Assigned Claims Facility and Plan Fund, which are used to provide personal protection insurance benefits to persons injured by uninsured motorists, were previously presented within the other special revenue funds column.

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; common cash; pension benefits; other postemployment benefits; leases; and contingencies and commitments.

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 accounting principles generally accepted in the United States of America. 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 the 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 for the Department's General Fund and the Assigned Claims Facility and Plan Fund, and the sources and disposition of authorizations for the Department of State's General Fund accounts. 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 or the Assigned Claims Facility and Plan Fund in conformity with accounting principles generally accepted in the United States of America.

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 or 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 or used.
- c. Restricted financing sources: Collections of restricted revenues, restricted transfers, and restricted intrafund expenditure reimbursements used 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 or used. Significant sources of this type for fiscal year 2007-08 were from the Transportation Administration Collection Fund (\$105.2 million), the Michigan Transportation Fund (\$20.0 million), and driver fees (\$17.2 million). Significant sources of this type for fiscal year 2006-07 were from the Transportation Administration Collection Fund (\$112.3 million), the Michigan Transportation Fund (\$20.0 million), and driver fees (\$16.6 million).
- 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 2007-08 were for the Business Application Modernization (\$7.0 million) and the Help America Vote Act (\$1.0 million). Significant carry-forwards of this type for fiscal year 2006-07 were for the Business Application Modernization (\$4.6 million) and the Help America Vote Act (\$1.1 million).
- e. Encumbrances: Authorizations carried forward to finance payments for goods or services ordered during the 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 Michigan 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.

- g. Restricted revenues - not authorized or 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.

However, those revenues that have been set aside to finance multi-year projects and encumbrances may be expended without additional legislative authorization for the purpose of the carry-forward. Significant carry-forwards of restricted revenues subject to annual legislative appropriation for fiscal year 2007-08 were for the Transportation Administration Collection Fund (\$1.1 million) and motorcycle safety fees (\$945,000). Significant carry-forwards of this type for fiscal year 2006-07 were for motorcycle safety fees (\$922,000) and the Transportation Administration Collection Fund (\$915,000).

Significant carry-forwards of restricted revenues that have been set aside to finance multi-year projects and encumbrances for fiscal year 2007-08 were for the Transportation Administration Collection Fund (\$5.3 million), driver fees (\$4.8 million), and personal identification card fees (\$2.4 million). Significant carry-forwards of this type for fiscal year 2006-07 were for the Michigan Transportation Fund (\$4.6 million), the Transportation Administration Collection Fund (\$3.7 million), driver fees (\$2.9 million), and personal identification card fees (\$1.6 million).

- 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 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 Michigan 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.

In April 2004, the State filed an application for leave to appeal in the Michigan Supreme Court. The State sought to appeal the decision of the Michigan Court of Appeals that barred the State from paying \$7.3 million in necessary collection expenses. The County Road Association of Michigan 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.

On January 30, 2006, the Michigan Supreme Court denied the State's application for leave to appeal. Therefore, the Michigan Court of Appeals'

decision stands, which could result in the State repaying the Michigan Transportation Fund \$7.3 million.

The remaining issues in the case were tried in the Ingham County Circuit Court in July 2007. On August 28, 2008, the Court issued an Opinion requiring the Department of State to transfer \$7.3 million from fiscal year 2000-01 and \$6.5 million from fiscal year 2001-02 back to the Michigan Transportation Fund, and ordering that "an appropriate cost allocation study be done for use in the future to reflect the current costs associated with the sales tax collection." Both parties have filed a claim of appeal in the Court of Appeals. The trial court's order has been stayed pending the outcome of the appeal. Because the status of this lawsuit remains pending and its outcome is uncertain, no liability is recorded in these financial schedules.

SUPPLEMENTAL
FINANCIAL SCHEDULES

DEPARTMENT OF STATE
Revenue Collections by Agency (1)
For the Fiscal Years Ended September 30

<u>Agency</u>	<u>2008</u>	<u>2007</u>
Michigan Department of Transportation	\$ 900,422,473	\$ 926,008,368
Michigan Department of Education	584,047,692	572,118,880
General Fund (2)	302,973,536	307,320,842
Department of State (2)	291,250,178	288,002,780
Michigan Department of State Police	27,825,445	28,260,892
Department of Natural Resources	11,998,709	12,003,624
Department of Environmental Quality	4,389,563	4,381,990
Supreme Court	3,178,727	3,247,099
Department of Energy, Labor & Economic Growth	1,815,777	1,926,120
Department of Agriculture	1,000,000	1,000,000
Department of Treasury	401,270	462,475
Department of Human Services	174,950	201,790
Department of History, Arts and Libraries	167,412	179,812
Department of Management and Budget	65,710	74,400
	<u>\$ 2,129,711,441</u>	<u>\$ 2,145,189,072</u>

- (1) The Department of State is responsible for collecting taxes, fees, and other revenue related to its own operations and those of certain other State departments. These revenues are collected by the Department of State and sent to the Departments of Transportation; Education; State Police; Natural Resources; Environmental Quality; Energy, Labor & Economic Growth; Agriculture; Treasury; Human Services; History, Arts and Libraries; Management and Budget; and the Supreme Court. The amounts shown represent only the amounts statutorily collected by the Department of State and do not represent total revenues or other financing sources for other departments.
- (2) The General Fund amounts include revenue that is collected by the Department of State for deposit into the General Fund. The Department of State amounts include revenue collected by the Department of State for its own use, including the General Fund and the Assigned Claims Facility and Plan Fund. The combined total revenues presented for the General Fund and Department of State differ from the total revenues presented in the Department's schedule of revenues and other financing sources because the amounts shown above do not include revenues collected by other State departments for the use of the Department of State.

DEPARTMENT OF STATE
Schedule of Expenditures of Federal Awards (1)
For the Period October 1, 2006 through September 30, 2008

Federal Agency/Program or Cluster	CFDA (2) Number	Pass-Through Identification Number	<u>For the Fiscal Year Ended September 30, 2007</u>		
			Directly Expended	Distributed to Subrecipients	Total Expended and Distributed
<u>U.S. Department of Transportation</u>					
Direct Program:					
Commercial Driver License State Programs	20.232		\$ 585,841	\$	\$ 585,841
Pass-Through Programs:					
Michigan Department of State Police					
Highway Safety Cluster:					
Safety Incentives to Prevent Operation of Motor Vehicles by Intoxicated Persons	20.605	TR-06-02	\$ 622,897	\$	\$ 622,897
Safety Belt Performance Grants	20.609	MC-08-01	\$	\$	0
Incentive Grant Program to Increase Motorcyclist Safety	20.612	MC-07-02	\$	\$ 79,464	\$ 79,464
Incentive Grant Program to Increase Motorcyclist Safety	20.612	MC-08-01	\$	\$	0
Total Incentive Grant Program to Increase Motorcyclist Safety Total Highway Safety Cluster			\$ 0	\$ 79,464	\$ 79,464
			\$ 622,897	\$ 79,464	\$ 702,361
Total U.S. Department of Transportation			\$ 1,208,738	\$ 79,464	\$ 1,288,202
<u>U.S. Elections Assistance Commission</u>					
Direct Programs:					
Election Reform Payments	39.011		\$ 236,224	\$	\$ 236,224
Help America Vote Act Requirements Payments	90.401		3,965,461	58,424	4,023,885
Total U.S. Elections Assistance Commission			\$ 4,201,685	\$ 58,424	\$ 4,260,109
<u>U.S. Department of Health and Human Services</u>					
Direct Program:					
Voting Access for Individuals with Disabilities - Grants to States	93.617		\$ 28,829	\$ 168,286	\$ 197,115
Total U.S. Department of Health and Human Services			\$ 28,829	\$ 168,286	\$ 197,115
Total Expenditures of Federal Awards			\$ 5,439,252	\$ 306,174	\$ 5,745,426

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

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

For the Fiscal Year Ended September 30, 2008

Directly Expended	Distributed to Subrecipients	Total Expended and Distributed	Total Expended and Distributed for the Two-Year Period
\$ 450,000	\$ _____	\$ 450,000	\$ 1,035,841
\$ _____	\$ _____	\$ 0	\$ 622,897
\$ _____	\$ 37,717	\$ 37,717	\$ 37,717
\$ _____	\$ _____	\$ 0	\$ 79,464
\$ _____	\$ 165,000	\$ 165,000	\$ 165,000
\$ 0	\$ 165,000	\$ 165,000	\$ 244,464
\$ 0	\$ 202,717	\$ 202,717	\$ 905,078
\$ 450,000	\$ 202,717	\$ 652,717	\$ 1,940,919
\$ 63,844	\$ _____	\$ 63,844	\$ 300,068
361,114	\$ _____	361,114	4,384,999
\$ 424,958	\$ 0	\$ 424,958	\$ 4,685,067
\$ 154,993	\$ 148,439	\$ 303,432	\$ 500,547
\$ 154,993	\$ 148,439	\$ 303,432	\$ 500,547
<u>\$ 1,029,951</u>	<u>\$ 351,156</u>	<u>\$ 1,381,107</u>	<u>\$ 7,126,533</u>

INDEPENDENT AUDITOR'S REPORTS ON INTERNAL CONTROL AND COMPLIANCE



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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
Richard H. Austin Building
Lansing, Michigan

Dear Secretary Land:

We have audited the financial schedules of the Department of State for the fiscal years ended September 30, 2008 and September 30, 2007, as identified in the table of contents, and have issued our report thereon dated June 10, 2009. 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 as a basis for designing our auditing procedures for the purpose of expressing our opinion on the financial schedules, but not for the purpose of expressing an opinion on the effectiveness of the Department's internal control over financial reporting. Accordingly, we do not express an opinion on the effectiveness of the Department's internal control over financial reporting.

Our consideration of internal control over financial reporting was for the limited purpose described in the preceding paragraph and would not necessarily identify all deficiencies in internal control over financial reporting that might be significant deficiencies or material weaknesses. However, as discussed in the next paragraph, we identified a deficiency in internal control over financial reporting that we consider to be a significant deficiency.

A control deficiency exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent or detect misstatements on a timely basis. A significant deficiency is a control deficiency, or combination of control deficiencies, that adversely affects the entity's ability to initiate, authorize, record, process, or report financial data reliably in accordance with generally accepted accounting principles such that there is more than a remote likelihood that a misstatement of the entity's financial schedules that is more than inconsequential will not be prevented or detected by the entity's internal control. We consider the deficiency described in Finding 1 in the accompanying schedule of findings and questioned costs to be a significant deficiency in internal control over financial reporting.

A material weakness is a significant deficiency, or combination of significant deficiencies, that results in more than a remote likelihood that a material misstatement of the financial schedules will not be prevented or detected by the entity's internal control.

Our consideration of internal control over financial reporting was for the limited purpose described in the first paragraph of this section and would not necessarily identify all deficiencies in internal control that might be significant deficiencies and, accordingly, would not necessarily disclose all significant deficiencies that are also considered to be material weaknesses. However, we believe that the significant deficiency described in the third paragraph of this section is not a material weakness.

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 other noncompliance as described in the accompanying schedule of findings and questioned costs as Finding 2.

The Department's responses to the findings identified in our audit are described in the accompanying corrective action plan. We did not audit the Department's responses and, accordingly, we express no opinion on them.

This report is intended solely for the information and use of management, the Secretary of State, others within the Department, 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

June 10, 2009



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
Richard H. Austin 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, 2008. 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 preceding 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 of its major federal programs for the two-year period ended September 30, 2008.

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, but not for the purpose of expressing an opinion on the effectiveness of internal control over compliance. Accordingly, we do not express an opinion on the effectiveness of the Department's internal control over compliance.

A control deficiency in an entity's internal control over compliance exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent or detect noncompliance with a type of compliance requirement of a federal program on a timely basis. A significant deficiency is a control deficiency, or combination of control deficiencies, that adversely affects the entity's ability to administer a federal program such that there is more than a remote likelihood that noncompliance with a type of compliance requirement of a federal program that is more than inconsequential will not be prevented or detected by the entity's internal control.

A material weakness is a significant deficiency, or combination of significant deficiencies, that results in more than a remote likelihood that material noncompliance with a type of compliance requirement of a federal program will not be prevented or detected by the entity's internal control.

Our consideration of internal control over compliance was for the limited purpose described in the first paragraph of this section and would not necessarily identify all deficiencies in internal control that might be significant deficiencies or material weaknesses. We did not identify any deficiencies in internal control over compliance that we consider to be material weaknesses, as defined in the preceding paragraph.

This report is intended solely for the information and use of management, the Secretary of State, others within the Department, 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

June 10, 2009

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

Significant deficiencies* identified that are not considered to be material weaknesses? Yes

Noncompliance or other matters material to the financial schedules? No

Federal Awards

Internal control over major programs:

Material weaknesses* identified? No

Significant deficiencies* 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 or Cluster*</u>
20.232	Commercial Driver License State Programs
20.605, 20.609, and 20.612	Highway Safety Cluster
39.011	Election Reform Payments
90.401	Help America Vote Act Requirements Payments
93.617	Voting Access for Individuals with Disabilities - Grants to States

* See glossary at end of report for definition.

Dollar threshold used to distinguish between type A and type B programs: \$300,000

Auditee qualified as a low-risk auditee*? No

Section II: Findings Related to the Financial Schedules

FINDING (2310901)

1. Revenue Distribution Transactions

The Department of State had not established sufficient controls over the processing of automated revenue distribution transactions. As a result, the Department could not ensure that errors or irregularities would be detected timely to prevent significant errors in its financial schedules and/or those of other State departments.

The State of Michigan Financial Management Guide (Part VII, Chapter 1, Section 900) provides that departments have primary responsibility for establishing, maintaining, and monitoring their internal control over critical information technology applications and the environment in which they operate. Also, departments are responsible for designing monitoring activities to ensure that manual and automated controls within their business processes are operating effectively.

The Department uses various systems to record the collection and distribution of revenue into the proper accounts. The Department's Revenue Interface (RI) System, which resides on the Department's mainframe computer, is used to process revenue distribution transactions to the proper State agency and fund and to classify revenue properly in the Michigan Administrative Information Network* (MAIN). The RI System uses crosswalk tables to calculate revenue distributions in accordance with statutory requirements. The Department performs monthly reconciliations by fee type to reconcile revenue recorded in MAIN with the Department's mainframe to ensure that revenue is recorded accurately.

* See glossary at end of report for definition.

Our review of the Department's controls over the monitoring of the distribution and classification of revenue noted:

- a. The Department did not sufficiently monitor the crosswalk tables in its RI System to ensure that the changes were made in an accurate and timely manner and were made by only authorized users. We noted:
 - (1) The Department did not have procedures to ensure that the changes made to the crosswalk tables were reviewed by someone other than the employee making the changes. We noted that a manager within the Department's revenue collection and monitoring section was responsible for making changes to the crosswalk tables when necessary; however, no one reviewed the changes to ensure that they were accurate and timely.
 - (2) The Department did not have procedures to ensure that the changes to the crosswalk tables were made by only those employees authorized to make changes. We noted that two employees within the Department and six employees within the Michigan Department of Information Technology had access to these crosswalk tables; however, we were not able to determine which users made changes to the crosswalk tables due to the lack of an audit trail. The Department should document all changes to the crosswalk tables made by each user and limit users with access to the crosswalk tables to only those employees authorized to make changes.
- b. The Department did not monitor the monthly fee reconciliations to ensure that they were performed in an accurate and consistent manner. Although the Department had written procedures for performing monthly fee reconciliations, it had not established a monitoring process to ensure that the reconciliations occurred in a timely manner and were accurate and consistent.

We noted that the Department processed 285,331 automated revenue distribution transactions totaling \$1.5 billion during the period October 1, 2006 through September 30, 2008. Because these are automated transactions that are not reviewed and approved, it is important to have sufficient controls over the monitoring of the crosswalk changes and fee code reconciliations.

RECOMMENDATION

We recommend that the Department establish sufficient controls over the processing of automated revenue distribution transactions.

FINDING (2310902)

2. Use of State General Fund/General Purpose Appropriations

The Department did not ensure that State restricted funds were expended before using State General Fund/general purpose appropriations. As a result, the Department used \$1,651,118 in State General Fund/general purpose appropriations that should have been paid for with State restricted funds. Also, as a result, the Department avoided the lapsing of these General Fund appropriations.

Section 18.1395 of the *Michigan Compiled Laws* requires that, in an appropriation financed by multiple sources, any State General Fund/general purpose appropriation shall be used only after the available State restricted funds have been expended.

The Department was appropriated \$24.41 million and \$23.25 million for information technology services and projects in fiscal years 2007-08 and 2006-07, respectively. This appropriation was financed by both State General Fund/general purpose appropriations and multiple State restricted funds. The Department also was appropriated, through boilerplate language, \$4.55 million for its Business Application Modernization (BAM) work project within its appropriation for information technology services and projects in both fiscal years 2007-08 and 2006-07. Although the boilerplate language did not specify how the work project was to be funded, the Department informed us that it designated both State General Fund/general purpose appropriations and State restricted funds to fund this work project.

Our review noted that the Department recorded \$1,539,118 and \$112,000 as State General Fund/general purpose expenditures in fiscal years 2007-08 and 2006-07, respectively, to pay for information technology services and projects when State restricted funds were available.

We noted that \$1.4 million of the expenditures recorded in fiscal year 2007-08 were recorded to reclassify expenditures as State General Fund/general purpose

expenditures that had originally been charged against the Department's Transportation Administration Collection Fund (a State restricted fund). However, the Department had other available revenue in its State restricted funds for driver fees and personal identification fees totaling \$1.8 million.

The Department informed us that it was reserving these State restricted funds for future work project expenditures related to its BAM work project. However, neither the appropriations act nor other statutory provisions permit the Department to first use State General Fund/general purpose appropriations and to reserve State restricted funds for future expenditures related to the work project.

RECOMMENDATION

We recommend that the Department ensure that State restricted funds are expended before using State General Fund/general purpose appropriations.

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 June 10, 2009

PRIOR AUDIT FINDINGS RELATED TO THE FINANCIAL SCHEDULES

There were no findings related to the financial schedules in the prior Single Audit*.

PRIOR AUDIT FINDINGS RELATED TO FEDERAL AWARDS

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

* See glossary at end of report for definition.

DEPARTMENT OF STATE
Corrective Action Plan
As of June 8, 2009

FINDINGS RELATED TO THE FINANCIAL SCHEDULES

Finding Number: 2310901
Finding Title: Revenue Distribution Transactions

Management Views: The Department of State agrees and informed the Office of the Auditor General (OAG) that it is implementing additional monitoring of the crosswalk tables to ensure that the changes were made in an accurate and timely manner and were made by authorized users. However, the Department does not agree with the detailed finding which concludes a control problem currently exists, particularly when considered together with the following compensating controls: (a) A different revenue manager oversees a monthly deduct review and quarterly analytical reviews; and (b) Staff perform monthly reconciliations and monthly bank reconciliations in conjunction with the Department of Treasury. The Department informed the OAG that these compensating controls would identify any errors that might occur when updating the crosswalk tables.

The Department also informed the OAG that it does document all changes to the crosswalk tables and had limited the Department's user access to the tables to two employees. The Department believes that the current limit of two Department employees to make changes to the crosswalk is reasonable. Although the Michigan Department of Information Technology (MDIT) had six employees with access to make changes to the system, the Department informed the OAG that a compensating control is that MDIT requires the Department to submit remedy tickets, which documents the Department's request and

authorization for programming changes. The Department informed the OAG that it has since worked with MDIT to limit this access to two MDIT employees.

Planned Corrective Action: The Department worked with MDIT to restrict access to the crosswalk tables to two MDIT employees. The Department has implemented an immediate review and documentation of the crosswalk tables whenever a change is processed to the crosswalk tables.

The Department is in the process of filling existing vacancies to further monitor the reconciliation process.

In addition, to increase controls over monitoring access, the Department will consider obtaining a cost estimate to enhance the existing system and, based on the return on investment, may seek additional legislative appropriations to finance these internal control improvements for an electronic audit trail.

Anticipated Completion Date: October 2010

Responsible Individual: Duane Berger

Finding Number: 2310902

Finding Title: Use of State General Fund/General Purpose Appropriations

Management Views: The Department does not agree with the finding. The Department informed the OAG that it received an appropriation increase funded by an increase in State General Fund/general purpose, driver fees, and personal identification card fees to finance the Business Application Modernization (BAM) work project. The Department also had boilerplate language designating this work project. In addition, the Office of the State Budget and the State Legislature approved the BAM work project for both appropriation years 2007 and 2008 under

"Appropriations Designated As Work Projects By Law" using \$2.75 million of State General Fund/general purpose, \$1 million of driver fees, and \$.8 million of personal identification fees as the funding sources. The Department informed the OAG that all of these funding sources would lapse to the State General Fund/general purpose fund at the end of the project if the funds were not used.

Planned Corrective Action: The Department agrees to lapse any unused work project funds to the State General Fund/general purpose.

Anticipated Completion Date: October 2010

Responsible Individual: Duane Berger

Auditor's Epilogue The OAG noted that the Department did receive an appropriation increase of approximately \$3.3 million in its line item for information technology services and projects in fiscal year 2003-04, which is when the Department initially obtained boilerplate authorization for its BAM work project. In addition, the OAG noted that there was an increase in funding from State General Fund/general purpose of approximately \$3.1 million and from personal identification card fees of \$800,000. However, the OAG also noted that there was no change in funding from driver fees. While the OAG agrees that there is nothing to prevent the Department from designating both State General Fund/general purpose appropriations and State restricted funds to fund this work project, this does not provide the Department with the authority to expend State General Fund/general purpose appropriations prior to available State restricted funds.

FINDINGS RELATED TO FEDERAL AWARDS

There were no findings related to federal awards for the two-year period ended September 30, 2008.

GLOSSARY

Glossary of Acronyms and Terms

BAM	Business Application Modernization.
CFDA	<i>Catalog of Federal Domestic Assistance.</i>
cluster	A grouping of closely related federal programs that have similar compliance requirements. Although the programs within a cluster are administered as separate programs, a cluster of programs is treated as a single program for the purpose of meeting the audit requirements of OMB Circular A-133.
control deficiency in internal control over federal program compliance	The design or operation of a control that does not allow management or employees, in the normal course of performing their assigned functions, to prevent or detect on a timely basis noncompliance with a type of compliance requirement of a federal program.
control deficiency in internal control over financial reporting	The design or operation of a control that does not allow management or employees, in the normal course of performing their assigned functions, to prevent or detect misstatements on a timely basis.
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 presented fairly in all material respects in conformity with the disclosed basis of accounting.
internal control	A process, effected by those charged with governance, management, and other personnel, designed to provide reasonable assurance about the achievement of the entity's objectives with regard to 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, regulations, contracts, and grants that could have a direct and material effect on major federal programs or on financial schedule and/or financial statement amounts.
material weakness in internal control over federal program compliance	A significant deficiency, or combination of significant deficiencies, that results in more than a remote likelihood that material noncompliance with a type of compliance requirement of a federal program will not be prevented or detected.
material weakness in internal control over financial reporting	A significant deficiency, or combination of significant deficiencies, that results in more than a remote likelihood that a material misstatement of the financial schedules and/or financial statements will not be prevented or detected.
MDIT	Michigan Department of Information Technology.
Michigan Administrative Information Network (MAIN)	The State's fully integrated automated administrative management system that supports the accounting, payroll, purchasing, contracting, budgeting, personnel, and revenue management activities and requirements. MAIN consists of four major components: MAIN Enterprise Information System (EIS); MAIN Financial Administration and Control

System (FACS); MAIN Human Resource System (HRS); and MAIN Management Information Database (MIDB).

OMB

U.S. Office of Management and Budget.

other noncompliance

Violations of contracts or grant agreements that are not material to the financial schedules or financial statements but should be communicated to management in accordance with *Government Auditing Standards*. Other noncompliance also includes violations of laws, regulations, contracts, or grant agreements; fraud; abuse; or other internal control deficiencies that may be communicated to management in accordance with *Government Auditing Standards*.

pass-through entity

A nonfederal entity that provides a federal award to a subrecipient to carry out a federal program.

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.

RI System

Revenue Interface System.

significant deficiency
in internal control over
federal program
compliance

A control deficiency, or combination of control deficiencies, that adversely affects the entity's ability to administer a federal program such that there is more than a remote likelihood that noncompliance with a type of compliance requirement of a federal program that is more than inconsequential will not be prevented or detected.

significant deficiency in internal control over financial reporting	A control deficiency, or combination of control deficiencies, that adversely affects the entity's ability to initiate, authorize, record, process, or report financial data reliably in accordance with generally accepted accounting principles such that there is more than a remote likelihood that a misstatement of the entity's financial schedules and/or financial statements that is more than inconsequential will not be prevented or detected.
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	<p>An auditor's opinion in which the auditor states that:</p> <ul style="list-style-type: none"> 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.

