



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:
 251-0100-09

Department of History, Arts and Libraries

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 History, Arts and Libraries' (HAL's) financial schedules.

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Internal Control Over Financial Reporting

We identified significant deficiencies in internal control over financial reporting (Findings 1 through 3). We consider Finding 1 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 instances of noncompliance (Findings 4 and 5).

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Federal Awards:

Auditor's Reports Issued on Compliance

We audited 3 programs as major programs and reported known questioned costs of \$6.8 million. HAL expended a total of \$12.0 million in federal awards during the two-year period ended September 30, 2008. We issued 1 qualified opinion and 2 adverse opinions. The opinions issued by program are identified on the back of this summary.

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Internal Control Over Major Programs

We identified significant deficiencies in internal control over federal program compliance (Findings 6 through 8). We consider Findings 6 through 8 to be material weaknesses.

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Required Reporting of Noncompliance

We identified instances of noncompliance that are required to be reported in accordance with U.S. Office of Management and Budget (OMB) Circular A-133 (Findings 6 through 8).

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Systems of Accounting and Internal Control:

We determined that HAL 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>
15.904	Historic Preservation Fund Grants-In-Aid	Qualified
15.929	Save America's Treasures	Adverse
45.310	Grants to States	Adverse

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



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

June 30, 2009

Mr. Mark H. Hoffman, Acting Director
Department of History, Arts and Libraries
702 West Kalamazoo Street
Lansing, Michigan

Dear Mr. Hoffman:

This is our report on the financial audit, including the provisions of the Single Audit Act, of the Department of History, Arts and Libraries (HAL) 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 HAL 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 HAL'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 and Section III 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

Mr. Mark H. Hoffman, Acting Director
Department of History, Arts and Libraries
702 West Kalamazoo Street
Lansing, Michigan

Dear Mr. Hoffman:

We have audited the accompanying financial schedules of the Department of History, Arts and Libraries 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 only the revenues and the sources and disposition of authorizations for the Department of History, Arts and Libraries' 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 the sources and disposition of authorizations of the Department of History, Arts and Libraries for the fiscal years ended September 30, 2008 and September 30, 2007 on the basis of accounting described in Note 1.

In accordance with *Government Auditing Standards*, we have also issued our report dated June 23, 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*, 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

June 23, 2009

DEPARTMENT OF HISTORY, ARTS AND LIBRARIES
Schedule of General Fund Revenues
Fiscal Years Ended September 30

	<u>2008</u>	<u>2007</u>
REVENUES		
From federal agencies:		
Institute of Museum and Library Services	\$ 3,763,455	\$ 4,979,822
U.S. Department of the Interior	792,719	800,533
National Endowment for the Arts	698,845	694,945
Other federal funds	93,562	52,496
Total from federal agencies	<u>\$ 5,348,581</u>	<u>\$ 6,527,796</u>
From services	1,088	107
Miscellaneous revenues (Note 2)	<u>1,808,001</u>	<u>2,668,535</u>
Total revenues	<u><u>\$ 7,157,670</u></u>	<u><u>\$ 9,196,438</u></u>

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

DEPARTMENT OF HISTORY, ARTS AND LIBRARIES
Schedule of Sources and Disposition of General Fund Authorizations
Fiscal Years Ended September 30

	<u>2008</u>	<u>2007</u>
SOURCES OF AUTHORIZATIONS (Note 3)		
General purpose appropriations	\$ 39,298,300	\$ 38,688,600
Budgetary transfers in (out)	(79,172)	
Balances carried forward	1,286,157	1,204,118
Restricted financing sources	9,031,600	10,614,935
Less: Interfund expenditure reimbursements	<u>(1,877,650)</u>	<u>(1,435,149)</u>
Total	<u><u>\$ 47,659,235</u></u>	<u><u>\$ 49,072,504</u></u>
DISPOSITION OF AUTHORIZATIONS (Note 3)		
Gross expenditures and transfers out	\$ 47,831,005	\$ 48,835,420
Less: Interfund expenditure reimbursements	<u>(1,877,650)</u>	<u>(1,435,149)</u>
Net expenditures and transfers out	<u>\$ 45,953,356</u>	<u>\$ 47,400,271</u>
Balances carried forward:		
Encumbrances	\$ 330,862	\$ 23,397
Restricted revenues - authorized	1,208,117	1,231,319
Restricted revenues - not authorized or used	<u>28,948</u>	<u>31,441</u>
Total balances carried forward	<u>\$ 1,567,927</u>	<u>\$ 1,286,157</u>
Balances lapsed	<u>\$ 137,952</u>	<u>\$ 386,076</u>
Total	<u><u>\$ 47,659,235</u></u>	<u><u>\$ 49,072,504</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 History, Arts and Libraries (HAL) for the fiscal years ended September 30, 2008 and September 30, 2007. The financial transactions of HAL 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 notes accompanying these financial schedules relate directly to HAL. The *SOMCAFR* provides more extensive disclosures regarding the State's significant accounting policies; budgeting, budgetary control, and legal compliance; pension benefits; and other postemployment benefits.

The financial schedules do not include the financial activities related to the State Records Management Program's microfilm funds, which are accounted for in the Office Services Revolving Fund, an internal service fund. This Fund is audited separately.

The Mackinac Island State Park Commission (MISPC) is a component unit of the State of Michigan and is reported on in the *SOMCAFR*. MISPC is funded by the Mackinac Island State Park Fund; airport and park operation fees; interagency grants/contracts with the Michigan Department of Transportation, the Department of Natural Resources, and the Department of Environmental Quality; and General Fund support received through HAL. A portion of MISPC's financial transactions are recorded in the State's accounting system within HAL's accounts. These financial transactions are the responsibility of MISPC. HAL receives an annual interfund expenditure reimbursement from MISPC for the portion of expenditures contained in HAL's accounts that are funded by the Mackinac Island State Park Fund and the airport and park operation fees.

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

Note 2 Miscellaneous Revenues

Significant miscellaneous revenues on the schedule of General Fund revenues includes \$586,175 and \$579,732 from museum store operations and \$305,617 and \$344,544 from Heritage Publications magazine subscriptions in fiscal years 2007-08 and 2006-07, respectively.

Note 3 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. Budgetary transfers in (out): Legislatively approved transfers of spending authorization between accounts within a department or between departments. These also include administrative transfers, such as entries to complete the financial closing of the State's fiscal year, that are

approved by the Office of Financial Management, Department of Management and Budget. The budgetary transfers out of \$79,172 in fiscal year 2007-08 related to a legislative transfer from the Michigan Film Office to the Michigan Economic Development Corporation.

- c. 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. Significant balances carried forward by HAL into fiscal year 2007-08 include \$766,330 from the HAL Service Fund and \$348,334 from Heritage Publications magazine subscriptions. Significant balances carried forward by HAL into fiscal year 2006-07 include \$465,445 from the User Fees Fund, \$286,773 from the HAL Service Fund, and \$238,956 from Heritage Publications magazine subscriptions.

- d. Restricted financing sources: Collections of restricted revenues, restricted transfers, and restricted interfund expenditure reimbursements used to finance department 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. HAL's significant restricted financing sources for fiscal years 2007-08 and 2006-07 include the following:

	Fiscal Years	
	2007-08	2006-07
Library Services and Technology Act Federal Grants	\$ 3,763,456	\$ 4,979,822
Mackinac Island State Park Commission Historical Facilities System	\$ 1,240,000	\$ 1,154,457
National Park Service	\$ 792,719	\$ 800,533
National Endowment for the Arts	\$ 698,845	\$ 694,945
Heritage Publications magazine subscriptions	\$ 623,644	\$ 614,813
HAL Service Fund	\$ 561,221	\$ 1,162,058
Museum store operations	\$ 484,928	\$ 529,416

- e. Interfund expenditure reimbursements: Repayments from the funds responsible for particular expenditures or expenses to the funds that initially paid for them. Significant expenditure reimbursements of \$1,240,000 and \$1,154,457 were received from the Mackinac Island State Park Fund for fiscal years 2007-08 and 2006-07, respectively.
- f. 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. Significant encumbrances as of September 30, 2008 include \$200,880 from the Library of Michigan operations appropriations.
- g. 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. Significant restricted revenues - authorized for HAL in fiscal year 2007-08 included \$617,573 from the HAL Service Fund and \$451,126 from Heritage Publications. Significant restricted revenues - authorized for HAL in fiscal year 2006-07 included \$766,330 from the HAL Service Fund and \$348,334 from Heritage Publications.

- h. 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.
- i. 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 4 Compliance With the Management and Budget Act and the State Aid to Public Libraries Act

The Office of the Auditor General concluded that, as of September 30, 2008, HAL was not in compliance with the Management and Budget Act (specifically, Section 18.1460 of the *Michigan Compiled Laws*), which requires that State agencies establish an indirect cost rate and charge indirect costs to all grants, contracts, and awards (Finding 4). The amounts potentially recoverable as indirect cost revenues could not be estimated because HAL had not established an indirect cost rate and also because HAL had not charged all eligible payroll-related expenditures to federal programs.

Also, the Office of the Auditor General questioned whether HAL was in compliance with the State Aid to Public Libraries Act (specifically, Section 397.566(2) of the *Michigan Compiled Laws*) during the audit period (Finding 5). HAL distributed \$7.2 million in State aid to public libraries under this section during fiscal years 2007-08 and 2006-07.

SUPPLEMENTAL
FINANCIAL SCHEDULE

DEPARTMENT OF HISTORY, ARTS AND LIBRARIES
Schedule of Expenditures of Federal Awards (1)
For the Period October 1, 2007 through September 30, 2008

Federal Agency/Program	CFDA (2) Number	Pass-Through Identification Number	For the Fiscal Year Ended September 30, 2007		
			Directly Expended	Distributed to Subrecipients	Total Expended and Distributed
<u>U.S. Department of Housing and Urban Development</u>					
Pass-Through Program:					
Yates Township					
Community Development Block Grants/State's Program and Non-Entitlement Grants in Hawaii	14.228	MSC 206052-EDPA	\$	\$	\$ 0
Total Department of Housing and Urban Development			\$ 0	\$ 0	\$ 0
<u>U.S. Department of the Interior</u>					
Direct Programs:					
Historic Preservation Fund Grants-In-Aid	15.904		\$ 723,559	\$ 77,348	\$ 800,907
Save America's Treasures	15.929		39,721		39,721
Milwaukee Clipper Fire Detection System	15.P6068030039 (3)		4,000		4,000
Total U.S. Department of the Interior			\$ 767,280	\$ 77,348	\$ 844,628
<u>U.S. Department of Transportation</u>					
Pass-Through Program:					
Michigan Department of Transportation Highway Planning and Construction	20.205	ENH200500043 STP 0784(031) STP 0884(048)	\$ 16,471	\$	\$ 16,471
Total U.S. Department of Transportation			\$ 16,471	\$ 0	\$ 16,471
<u>National Endowment for the Arts</u>					
Direct Programs:					
Promotion of the Arts - Grants to Organizations and Individuals	45.024				
Promotion of the Arts - Partnership Agreements	45.025		\$	\$ 694,945	\$ 694,945
Total National Endowment for the Arts			\$ 0	\$ 694,945	\$ 694,945
<u>National Endowment for the Humanities</u>					
Direct Program:					
Promotion of the Humanities - Federal/State Partnership	45.129		\$ 3,308	\$	\$ 3,308
Total Endowment for the Humanities			\$ 3,308	\$ 0	\$ 3,308
<u>Institute of Museum and Library Services</u>					
Direct Program:					
Grants to States	45.310		\$ 4,979,822	\$	\$ 4,979,822
Total Institute of Museum and Library Services			\$ 4,979,822	\$ 0	\$ 4,979,822
<u>National Archives and Records Administration</u>					
Direct Program:					
National Historical Publications and Records Grants	89.003		\$ 8,987	\$	\$ 8,987
Total National Archives and Records Administration			\$ 8,987	\$ 0	\$ 8,987
Total Expenditures of Federal Awards			\$ 5,775,868	\$ 772,293	\$ 6,548,161

(1) Basis of Presentation: This schedule presents the federal grant activity of the Department of History, Arts and Libraries 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 amounts presented in, or used in the preparation of, the financial schedules.

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

(3) CFDA is not available. Number derived from federal agency number and contract number.

For the Fiscal Year Ended September 30, 2008			Total Expended and Distributed for the Two-Year Period
Directly Expended	Distributed to Subrecipients	Total Expended and Distributed	
\$ 30,000	\$	\$ 30,000	\$ 30,000
\$ 30,000	\$ 0	\$ 30,000	\$ 30,000
\$ 708,349	\$ 83,839	\$ 792,188	\$ 1,593,095
70,618		70,618	110,339
		0	4,000
\$ 778,967	\$ 83,839	\$ 862,806	\$ 1,707,434
\$ 36,265	\$	\$ 36,265	\$ 52,736
\$ 36,265	\$ 0	\$ 36,265	\$ 52,736
\$	\$ 5,000	\$ 5,000	\$ 5,000
40,000	658,845	698,845	1,393,790
\$ 40,000	\$ 663,845	\$ 703,845	\$ 1,398,790
\$	\$	\$	\$ 3,308
\$ 0	\$ 0	\$ 0	\$ 3,308
\$ 3,763,456	\$	\$ 3,763,456	\$ 8,743,278
\$ 3,763,456	\$ 0	\$ 3,763,456	\$ 8,743,278
\$	\$ 36,013	\$ 36,013	\$ 45,000
\$ 0	\$ 36,013	\$ 36,013	\$ 45,000
\$ 4,648,688	\$ 783,697	\$ 5,432,385	\$ 11,980,546

INDEPENDENT AUDITOR'S REPORTS ON INTERNAL CONTROL AND COMPLIANCE



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AUDITOR GENERAL

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

Mr. Mark H. Hoffman, Acting Director
Department of History, Arts and Libraries
702 West Kalamazoo Street
Lansing, Michigan

Dear Mr. Hoffman:

We have audited the financial schedules of the Department of History, Arts and Libraries 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 23, 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 certain deficiencies in internal control over financial reporting that we consider to be significant deficiencies.

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 deficiencies described in Findings 1 through 3 in the accompanying schedule of findings and questioned costs to be significant deficiencies 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, of the significant deficiencies described in the third paragraph of this section, we consider Finding 1 to be 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 instances of noncompliance as described in the accompanying schedule of findings and questioned costs as Findings 4 and 5.

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, others within the Department, the Governor, 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 23, 2009



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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

Mr. Mark H. Hoffman, Acting Director
Department of History, Arts and Libraries
702 West Kalamazoo Street
Lansing, Michigan

Dear Mr. Hoffman:

Compliance

We have audited the compliance of the Department of History, Arts and Libraries 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.

As described in Findings 6 through 8 in the accompanying schedule of findings and questioned costs, the Department did not comply with requirements regarding allowable costs/cost principles; matching, level of effort, and earmarking; and reporting that are applicable to its Historic Preservation Fund Grants-In-Aid, Save America's Treasures, and Grants to States Programs. Compliance with such requirements is necessary, in our opinion, for the Department to comply with the requirements applicable to those programs.

In our opinion, because of the effects of the noncompliance described in the preceding paragraph, the Department of History, Arts and Libraries did not comply in all material respects, with the requirements referred to in the first paragraph that are applicable to its Save America's Treasures and Grants to States Programs. Also, in our opinion, except for the noncompliance described in the preceding paragraph, the Department of History, Arts and Libraries complied, in all material respects, with the requirements referred to in the first paragraph that are applicable to its other major federal program for the two-year period ended September 30, 2008. The results of our auditing procedures also disclosed other instances of noncompliance with those requirements, which are required to be reported in accordance with OMB Circular A-133 and which are described in the accompanying schedule of findings and questioned costs as Findings 6 through 8.

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.

Our consideration of internal control over compliance was for the limited purpose described in the preceding paragraph and would not necessarily identify all deficiencies in the Department's internal control that might be significant deficiencies or material weaknesses as defined below. However, as discussed below, we identified certain deficiencies in internal control over compliance that we consider to be significant deficiencies and others that we consider to be material weaknesses.

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. We consider the deficiencies in internal control over compliance described in the accompanying schedule of findings and questioned costs as Findings 6 through 8 to be significant deficiencies.

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. Of the significant deficiencies described in the preceding paragraph, we consider Findings 6 through 8 to be material weaknesses.

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, others within the Department, the Governor, 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 23, 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?	Yes
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?	Yes
Significant deficiencies* identified that are not considered to be material weaknesses?	Yes

Type of auditor's report issued on compliance for major programs:

Qualified*

Historic Preservation Fund Grants-In-Aid

Adverse*

Save America's Treasures

Grants to States

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)?	Yes
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Identification of major programs:

<u>CFDA Number</u>	<u>Name of Federal Program</u>
15.904	Historic Preservation Fund Grants-In-Aid
15.929	Save America's Treasures
45.310	Grants to States

* See glossary at end of report for definition.

Dollar threshold used to distinguish between type A and type B programs: \$359,416

Auditee qualified as a low-risk auditee*? No

Section II: Findings Related to the Financial Schedules

FINDING (2510901)

1. Internal Control Over Financial Reporting

The Department of History, Arts and Libraries' (HAL's) internal control over financial reporting did not ensure that transactions were accurately recorded. As a result, HAL's accounting records did not fully support its financial schedules.

Internal control is 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. Further, Section 18.1485 of the *Michigan Compiled Laws* requires HAL to establish and maintain an internal accounting and administrative control system that includes the following: a system of authorization and recordkeeping procedures to control assets, liabilities, revenues, and expenditures; qualified personnel that maintain a level of competence; and internal control techniques that are effective and efficient. The State of Michigan Financial Management Guide provides guidance to agencies regarding the appropriate methods for accounting for revenues and expenditures.

Our review disclosed:

- a. HAL did not have a consistent method in place to account for pass-through funds received from other State agencies related to the Mackinac Island State Park Commission. As a result, HAL understated miscellaneous revenues by \$78,240 and overstated expenditures by \$1,047 in fiscal year 2007-08. In fiscal year 2006-07, HAL overstated miscellaneous revenues by \$299,056 and overstated expenditures by \$212,183.

* See glossary at end of report for definition.

- b. HAL received \$30,000 in federal pass-through funds from another agency as a subrecipient* in fiscal year 2007-08 and recorded this on its financial schedules as miscellaneous revenue. As a subrecipient, HAL should have recorded federal revenue. As a result, HAL understated federal revenue and overstated miscellaneous revenue by \$30,000 in fiscal year 2007-08.

In our prior two Single Audits*, we reported similar conditions regarding HAL's internal control over financial reporting.

RECOMMENDATION

WE AGAIN RECOMMEND THAT HAL IMPROVE ITS INTERNAL CONTROL OVER FINANCIAL REPORTING TO ENSURE THAT TRANSACTIONS ARE ACCURATELY RECORDED.

FINDING (2510902)

2. Library of Michigan Database* (LMDB)

HAL, in conjunction with the Michigan Department of Information Technology (MDIT), did not implement complete general and application controls over LMDB. General and application controls help ensure that all transactions are properly initiated, processed, and recorded.

Department of Management and Budget (DMB) Administrative Guide procedure 1270.12 states that State agencies are responsible for establishing and maintaining appropriate internal control over information technology (IT) systems. The procedure also states that, in coordination with DMB's Office of Financial Management and MDIT, State agencies will develop, maintain, and monitor appropriate IT related controls. General controls are policies and procedures that help ensure the continued proper operation of IT systems. General controls also support the functioning of application controls. Application controls are programmed procedures in application software and related business procedures. General controls are designed to work in conjunction with application controls to help ensure the completeness and accuracy of information processing.

HAL processed approximately \$50 million of expenditures and \$16 million of revenues using LMDB during the two-year audit period. LMDB is a relational

* See glossary at end of report for definition.

database that allows HAL to enter, approve, and process its financial transactions. LMDB data transfers through an interface to the Michigan Administrative Information Network (MAIN). MAIN is the State's fully integrated automated administrative management system that supports the State's accounting, payroll, purchasing, contracting, budgeting, personnel, and revenue management activities and requirements. HAL processes its financial transactions through LMDB, rather than entering them directly into MAIN.

Executive Order No. 2001-3 transferred the responsibility for all IT services to MDIT. MDIT assists HAL in maintaining LMDB. HAL, as the business owner, retains responsibility for all data processed through LMDB.

We identified the following internal control weaknesses related to HAL's use of LMDB:

a. Program Change Controls

HAL and MDIT did not establish effective program change controls. Without effective program change controls, HAL could not ensure that only authorized modifications were implemented.

Federal Information System Controls Audit Manual* (FISCAM) states that effective change controls are accomplished by the establishment of a formal change management process that institutes policies, procedures, and techniques to help ensure that all program changes are properly authorized, tested, and approved. Our review disclosed:

- (1) HAL and MDIT did not establish documented change control policies and procedures. Change control policies and procedures should define the process for requesting, approving, implementing, logging, and testing program and data changes. The use of policies and procedures helps ensure that management's intent is clearly communicated to all individuals responsible for program change controls.
- (2) HAL and MDIT did not use a standardized change request form. HAL and MDIT informed us that change requests are initiated verbally or by e-mail. The use of a standardized form helps ensure that all requests are clearly communicated and that approvals are documented.

* See glossary at end of report for definition.

- (3) HAL and MDIT did not maintain a log or formally document program changes. A log or a record of these changes would help ensure that program changes are authorized and approved by management.

b. Access Controls

HAL and MDIT did not establish effective access controls over LMDB. Without effective access controls, HAL could not ensure the security and integrity of LMDB data.

FISCAM states that access controls help to protect computerized data from unauthorized modification, loss, and disclosure. Our review of access controls over LMDB disclosed the following weaknesses:

- (1) HAL and MDIT did not encrypt LMDB passwords. As a result, three LMDB users had access to all LMDB users' passwords.

FISCAM states that encrypting the password file reduces the risk of password disclosure.

- (2) HAL and MDIT did not ensure appropriate segregation of duties over LMDB. One MDIT employee had access to LMDB production data through the database as well as the ability to edit and move program code. As a result, this person could access and change LMDB data without HAL's authorization or knowledge.

FISCAM states that proper segregation of duties helps to reduce the risk of inadvertent or intentional processing of erroneous transactions and the alteration or destruction of data. Segregation of duties also helps to reduce the risk of implementing improper program or data changes.

- (3) HAL and MDIT did not establish strong password parameters in LMDB. As a result, HAL and MDIT did not require LMDB users to use alphanumeric characters or a minimum of six characters in their passwords.

FISCAM recommends that passwords should be a minimum of six characters and contain a combination of alpha and numeric characters.

- (4) HAL used an access request form to request access to LMDB; however, HAL did not have documented policies and procedures for assigning, modifying, or removing user access to LMDB data. As a result, HAL could not ensure that all user access was appropriate.

FISCAM states that in order to adequately control user accounts, an entity should institute policies and procedures for authorizing access and should document such authorizations.

c. Backup and Disaster Recovery

HAL and MDIT did not establish a comprehensive disaster recovery plan for LMDB. As a result, HAL and MDIT could not fully ensure the integrity and availability of LMDB data, applications, and systems software in the event of a business disruption.

FISCAM states that entities should implement policies and procedures to prevent or minimize potential damage and interruption to critical systems and develop a comprehensive disaster recovery plan.

RECOMMENDATION

We recommend that HAL, in conjunction with MDIT, implement complete general and application controls over LMDB.

FINDING (2510903)

3. Museum Store Operations

HAL did not establish effective internal control over its museum stores. As a result, HAL did not appropriately safeguard museum store assets and provide sufficient oversight over museum store operations.

Internal control is 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. Further, Section 18.1485 of the *Michigan Compiled Laws* requires HAL to establish and maintain an internal accounting and administrative control system that includes the following: a system of authorization

and recordkeeping procedures to control assets, liabilities, revenues, and expenditures; qualified personnel that maintain a level of competence; and internal control techniques that are effective and efficient.

HAL operates museum stores at the six following locations: Michigan Library and Historical Center in Lansing, Tawas Point Lighthouse in East Tawas, Michigan Iron Industry Museum in Negaunee, Thunder Bay National Marine Sanctuary in Alpena, Fayette Historic Townsite in Garden, and P.J. Hoffmaster State Park in Muskegon. HAL recorded museum store revenues of \$1.0 million and expenditures of \$.9 million during the audit period.

Our review of HAL's museum store operations disclosed the following internal control weaknesses:

a. Policies and Procedures

HAL did not have comprehensive written policies and procedures in place. As a result, HAL did not set standards for such things as museum store monitoring, inventory counts, inventory tracking, cash handling, and employee expectations and responsibilities.

Establishing comprehensive written policies and procedures would help HAL ensure consistent and appropriate oversight and administration of the museum stores and help minimize the risk associated with the specific control deficiencies reported in this finding (see parts b. through e.).

b. Inventory

HAL did not establish effective controls over museum store inventories, thus increasing the risk of inventory loss due to theft or misplacement. HAL estimated that the retail value of inventory was \$368,596 and \$364,895 at the end of fiscal years 2007-08 and 2006-07, respectively.

Our review disclosed:

- (1) HAL did not establish a proper segregation of duties within the inventory process. One person performed the ordering, receiving, and recording of the inventory. In addition, some of the same individuals who worked in the museum stores performed the inventory counts. A proper

segregation of duties is critical to effective internal control as it reduces the risk of both erroneous and inappropriate actions.

- (2) HAL did not reconcile differences found between inventory records and physical inventory counts for 2 (33%) of 6 stores during fiscal year 2007-08. HAL indicated that transfers between the two stores caused these differences. However, because HAL did not follow up and determine the actual cause of these differences, it could not ensure the accuracy of the inventory records at either location.
- (3) HAL informed us that it did reconcile the differences between inventory records and physical inventory counts at 4 of the 6 museum stores during fiscal year 2007-08, but it did not maintain documentation of 2 of the reconciliations. Proper documentation is a critical component of effective internal control to ensure that all differences are properly followed up and explained, especially if these differences are the result of misappropriation by employees.

In addition, HAL informed us that it did not update the inventory records for 1 (17%) of 6 stores based on the inventory counts performed in fiscal year 2007-08.

c. Storage of Sensitive Data

HAL did not secure sensitive customer credit card information.

Documentation that included full credit card numbers and expiration dates was not stored in a secure location. As a result, the credit card information was at an increased risk of being stolen and used by people other than the cardholders to make purchases.

The Payment Card Industry Security Standards Council's Data Security Standards require that a business that accepts credit card transactions physically secure all paper and electronic media that contain cardholder data.

d. Cash Handling

HAL did not establish proper accountability for museum store cash.

The sales clerks at the museum stores shared cash drawers, which resulted in reduced accountability. HAL's museum stores receipted \$344,092 and \$353,655 in cash during fiscal years 2007-08 and 2006-07, respectively.

Establishing accountability for museum store cash would help to reduce the risk of both erroneous and inappropriate actions.

e. Backup and Recovery

HAL did not have a backup recovery system for the museum stores' point-of-sale system. As a result, HAL could not ensure the preservation of sales and inventory records.

Secure Michigan Initiative, a report issued by MDIT, recommends the establishment of documented and tested backup and disaster recovery plans to ensure that a department can recover and continue its operations in the event of a disaster.

RECOMMENDATION

We recommend that HAL establish effective internal control over its museum stores.

FINDING (2510904)

4. Use of State General Fund/General Purpose Appropriations

HAL did not maximize its use of federal sources of financing by billing for indirect costs and by expending federal funds before using State General Fund/general purpose appropriations. As a result, HAL used State General Fund/general purpose appropriations to pay for indirect and administrative program costs that could have been paid for with federal funds.

HAL is responsible under the Management and Budget Act (specifically, Sections 18.1460 and 18.1395 of the *Michigan Compiled Laws*) to ensure that it maximizes the use of federal and other restricted funds by recovering indirect costs when

applicable and by expending all available federal funds and other restricted funds before using State General Fund/general purpose appropriations.

Our review of HAL's use of federal funding sources disclosed:

- a. HAL did not establish an indirect cost rate and did not charge indirect costs to grants, contracts, and awards, including those received from the federal government.

Section 18.1460 of the *Michigan Compiled Laws* requires each State agency to establish an indirect cost rate and to charge indirect costs to grants, contracts, and awards. OMB Circular A-87, *Cost Principles for State, Local, and Indian Tribal Governments* (Title 2, Part 225 of the *Code of Federal Regulations [CFR]*), allows grant recipients to recover indirect costs from the federal grant funds received.

Indirect costs are generally recovered for departmental overhead; Statewide expenditures under the Statewide Cost Allocation Plan; agency direct billed costs, such as retirement and vehicle charges; and agency central support costs, such as accounting, payroll, and information systems.

During our audit period, HAL expended \$12.0 million from 10 separate federal programs, including payroll-related expenditures of \$1.8 million for 6 federal programs.

Our prior two Single Audits recommended that HAL establish an indirect cost rate. In its corrective action plan sent to the DMB Office of the State Budget, HAL stated that it would establish and apply an indirect cost rate if federal funds were available and if it did not cost more to revise and maintain an indirect cost rate than would be recovered from applying such a rate. Subsequent to the prior audit, HAL obtained a quote from a vendor to develop an indirect cost rate but did not pursue the matter any further.

- b. HAL used State General Fund/general purpose appropriations when federal funds were available.

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 federal funds have been expended.

Our review disclosed that HAL charged \$62,203 in eligible Grants to States (CFDA 45.310) direct program costs as administrative costs. As a result, HAL had reached its 4% cap on administrative costs and was unable to charge any more administrative (including indirect) costs to the grant. If HAL had charged the \$62,203 as direct program costs and reduced its administrative costs, HAL could have reduced General Fund/general purpose expenditures by \$62,203.

We noted this same condition in our prior Single Audit report.

RECOMMENDATIONS

WE AGAIN RECOMMEND THAT HAL ESTABLISH AN INDIRECT COST RATE AND CHARGE INDIRECT COSTS TO GRANTS, CONTRACTS, AND AWARDS AS REQUIRED BY STATE LAW.

WE ALSO AGAIN RECOMMEND THAT HAL EXPEND FEDERAL FUNDS BEFORE USING STATE GENERAL FUND/GENERAL PURPOSE APPROPRIATIONS AS REQUIRED BY STATE LAW.

FINDING (2510905)

5. State Aid to Libraries

HAL should obtain a formal Attorney General opinion to determine whether State aid payments to public libraries under Section 397.566(2) of the *Michigan Compiled Laws* were distributed in accordance with State law. HAL distributed \$7.2 million to public libraries under this section during fiscal years 2007-08 and 2006-07.

During our audit period, HAL distributed State aid payments under the following sections of the State Aid to Public Libraries Act (Sections 397.551 - 397.576 of the *Michigan Compiled Laws*):

- Cooperative library - 50 cents per capita payments (Section 397.563 of the *Michigan Compiled Laws*).

- Public library belonging to a cooperative library - 50 cents per capita payments (Section 397.566(4) of the *Michigan Compiled Laws*).
- Cooperative library - density payments (Section 397.566(4) of the *Michigan Compiled Laws*).
- County library - reimbursable salary payments (Section 397.566(5) of the *Michigan Compiled Laws*).
- Public library - 50 cents per capita payments (Section 397.566(2) of the *Michigan Compiled Laws*).

However, our review disclosed that Section 397.566(2) provided that a public library was to receive the 50 cents per capita payment only during fiscal year 1978-79:

A public library shall receive 50 cents per capita from state aid *during the fiscal year 1978-79* [emphasis added] if in the prior year the public library received local support equal to that required by this act, the library has not reduced its local support by an amount equal to or larger than the state aid from the previous year without the approval of the department, and the library meets the minimum standards established by the department and this act.

Even though this section specifically states that it applies to only fiscal year 1978-79, HAL continued to make payments under this section. In fiscal years 2007-08 and 2006-07, HAL paid \$7.2 million to libraries under this section.

Because HAL made State aid payments under Section 397.566(2) of the *Michigan Compiled Laws*, HAL prorated its State aid payments to libraries in both fiscal years 2007-08 and 2006-07 based on the amount of funding that was available.

HAL's distribution of State aid, by funding component, was as follows:

Funding Component	Section of the <i>Michigan Compiled Laws</i>	Fiscal Years 2007-08 and 2006-07		
		Amount of State Aid Paid	Amount of State Aid That Would Have Been Paid Excluding Section 397.566(2) Payments	Difference
Cooperative library - 50 cents per capita	397.563	\$ 7,211,354	\$ 9,813,951	\$ (2,602,597)
Public library belonging to a cooperative library - 50 cents per capita	397.566(4)	7,156,370	9,735,178	(2,578,808)
Cooperative library - Density	397.566(4)	530,845	723,178	(192,333)
County library - Reimbursable salaries	397.566(5)	82,137	113,129	(30,992)
Public library - 50 cents per capita (fiscal year 1978-79)	397.566(2)	7,162,294		7,162,294
Total		\$22,143,000	\$20,385,436	\$ 1,757,564

We noted this same condition in our prior Single Audit report.

HAL informed us that it believed the payments made under Section 397.566(2) of the *Michigan Compiled Laws* since fiscal year 1978-79 were consistent with its interpretation of the intent of the Legislature and in accordance with its *State Aid Guidelines for Michigan Public Libraries* and that HAL obtained an advisory memorandum from the Department of Attorney General that supports the State aid distribution used by HAL. The advisory memorandum was an informal communication within the Department of Attorney General and represents informal advice at the division level and was not the formal opinion of the Attorney General.

RECOMMENDATION

WE AGAIN RECOMMEND THAT HAL OBTAIN A FORMAL ATTORNEY GENERAL OPINION TO DETERMINE WHETHER STATE AID PAYMENTS TO PUBLIC LIBRARIES UNDER SECTION 397.566(2) OF THE *MICHIGAN COMPILED LAWS* WERE DISTRIBUTED IN ACCORDANCE WITH STATE LAW.

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

FINDING (2510906)

6. Historic Preservation Fund Grants-In-Aid (HPF), CFDA 15.904

U.S. Department of the Interior	CFDA 15.904: Historic Preservation Fund Grants-In-Aid
Award Number: 26-06-21525 26-07-21626 26-08-21727	Award Period: 10/01/2005 - 09/30/2007 10/01/2006 - 09/30/2008 10/01/2007 - 09/30/2009
	Known Questioned Costs: \$78,140

HAL's internal control over the HPF Program did not ensure compliance with federal laws and regulations regarding activities allowed or unallowed; allowable costs/cost principles; and matching, level of effort, and earmarking. Our review disclosed material weaknesses in internal control and material noncompliance with federal laws and regulations regarding allowable costs/cost principles. As a result, we issued a qualified opinion on compliance with federal laws and regulations for the HPF Program.

Internal control that does not ensure compliance with federal laws and regulations could result in sanctions, disallowances, and/or future reductions of HPF Program awards.

Federal expenditures for the HPF Program totaled \$1.6 million for the two-year period ended September 30, 2008. We identified known questioned costs of \$78,140.

* See glossary at end of report for definition.

Our exceptions, by compliance area, are as follows:

a. Activities Allowed or Unallowed

HAL did not ensure that HPF Program expenditures were for allowable activities as required by federal regulations.

Section 300(b) of OMB Circular A-133 requires HAL to maintain internal control over federal programs that provides reasonable assurance that HAL is managing federal awards in compliance with laws, regulations, and the provisions of contracts or grant agreements that could have a material effect on its programs. To provide reasonable assurance that HPF Program payroll expenditures are allowable activities, HAL's internal control process requires supervisory approval of time sheets. However, as discussed in the Allowable Costs/Cost Principles section of this finding (part b.(1)(a)), HAL did not ensure that it properly approved all payroll costs charged to the HPF Program, as required by federal regulation.

b. Allowable Costs/Cost Principles

HAL did not ensure that HPF Program expenditures met the allowable cost principles of OMB Circular A-87 (federal regulation 2 *CFR* 225). Our review disclosed:

(1) HAL did not ensure supervisory approval of expenditures charged to the HPF Program, including expenditures that were State funded and used to match the HPF grant awards. We reviewed a sample of 36 payroll and 9 nonpayroll expenditures:

(a) HAL did not document supervisory approval for 3 (8%) of 36 sampled payroll expenditures. Further review disclosed that HAL did not document supervisory approval of time sheets for 11 of the 15 employees charged to the HPF Program or State funded and used as match for the HPF grant awards for the pay period ended July 12, 2008. We further noted that HAL did not document supervisory approval for 11 additional time sheets for 1 employee and 5 time sheets for another employee. We questioned costs of \$50,075 related to these unapproved time sheets.

Appendix B, section 8(h) of OMB Circular A-87 (federal regulation 2 *CFR* 225) requires that a responsible HAL official approve payroll charged to federal awards or used in meeting matching requirements of federal awards.

- (b) HAL did not document supervisory approval for one travel expenditure that was State funded and used to match federal grant awards.

Appendix A, section C(1) of OMB Circular A-87 (federal regulation 2 *CFR* 225) requires that expenditures be consistent with policies, regulations, and procedures that apply uniformly to both federal awards and other activities of the governmental unit.

DMB Administrative Guide procedure 0420.02 requires the approval of each travel voucher by the traveler and the head of the agency or authorized agent.

- (2) HAL did not ensure that it adjusted budgeted payroll costs to actual costs in accordance with Appendix B, section 8(h) of OMB Circular A-87 (federal regulation 2 *CFR* 225). These included expenditures charged to the HPF Program and State-funded expenditures that were used to match the HPF grant awards. Our review noted that 1 (3%) of 36 sampled payroll expenditures was recorded based on a budgeted amount and was not adjusted to actual until the end of the fiscal year. Further review of payroll for the sampled individual noted that, from October 1, 2006 through February 24, 2007, budgeted payroll was not adjusted to actual and that, from February 25, 2007 through May 19, 2007, budgeted payroll exceeded actual payroll by 38.7% and was not adjusted to actual until the end of the fiscal year. We questioned costs of \$28,065 related to these pay periods.

Appendix B, section 8(h) of OMB Circular A-87 (federal regulation 2 *CFR* 225) requires HAL to adjust costs charged to federal awards or used in meeting matching requirements of federal awards to reflect actual activity performed at least quarterly unless the difference between actual and budgeted costs is less than 10%.

c. Matching, Level of Effort, and Earmarking

HAL's internal control did not ensure that HPF Program expenditures met federal requirements for matching, level of effort, and earmarking. A portion of the payroll expenditures for the HPF Program are funded by the federal grant awards and the remaining expenditures are State funded and used to match the federal grant awards. Our review disclosed:

- (1) As discussed in the Allowable Costs/Cost Principles section (part b.(1)) of this finding, HAL did not ensure supervisory approval of expenditures that were State funded and used to match the HPF grant awards. We determined that \$14,802 of payroll expenditures and \$143 of nonpayroll expenditures that we reviewed in part b.(1) of this finding were State funded and used as matching expenditures for the HPF Program.

Appendix B, section 8(h)(7) of OMB Circular A-87 (federal regulation 2 *CFR* 225) requires payroll costs used in meeting matching requirements of federal awards to be supported in the same manner as those claimed as allowable costs under federal awards.

The Historic Preservation Fund Grants Manual requires that OMB Circular A-87 (federal regulation 2 *CFR* 225) applies irrespective of whether a particular item of cost is treated as the federal share or matching share of HPF grant assistance.

- (2) As discussed in the Allowable Costs/Cost Principles section (part b.(2)) of this finding, HAL did not ensure that it adjusted budgeted payroll costs that were used in meeting matching requirements of the grant awards to actual costs in accordance with OMB Circular A-87 (federal regulation 2 *CFR* 225). We determined that \$17,515 of the payroll expenditures we reviewed in part b.(2) of this finding were State funded and used as matching expenditures for the HPF Program.

Appendix B, section 8(h)(7) of OMB Circular A-87 (federal regulation 2 *CFR* 225) requires payroll costs used in meeting matching requirements of federal awards to be supported in the same manner as those claimed as allowable costs under federal awards.

RECOMMENDATIONS

WE AGAIN RECOMMEND THAT HAL ESTABLISH INTERNAL CONTROL OVER THE HPF PROGRAM TO ENSURE COMPLIANCE WITH FEDERAL LAWS AND REGULATIONS REGARDING ALLOWABLE COSTS/COST PRINCIPLES AND MATCHING, LEVEL OF EFFORT, AND EARMARKING.

We also recommend that HAL establish internal control over the HPF Program to ensure compliance with federal laws and regulations regarding activities allowed or unallowed.

FINDING (2510907)

7. Save America's Treasures (SAT), CFDA 15.929

U.S. Department of the Interior	CFDA 15.929: Save America's Treasures
Award Number: 26-06-PA-2019 26-07-PA-3018	Award Period: 05/01/2006 - 05/31/2009 07/01/2007 - 06/30/2009
	Known Questioned Costs: \$27,392

HAL's internal control over the SAT Program did not ensure compliance with federal laws and regulations regarding allowable costs/cost principles and matching, level of effort, and earmarking. Our review disclosed material weaknesses in internal control and material noncompliance with federal laws and regulations regarding allowable costs/cost principles and matching, level of effort, and earmarking. As a result, we issued an adverse opinion on compliance with federal laws and regulations for the SAT Program.

Internal control that does not ensure compliance with federal laws and regulations could result in sanctions, disallowances, and/or future reductions of SAT Program awards.

Federal expenditures for the SAT Program totaled \$110,339 for the two-year period ended September 30, 2008. We identified known questioned costs of \$27,392.

Our exceptions, by compliance area, are as follows:

a. Allowable Costs/Cost Principles

HAL did not ensure that expenditures used to match SAT Program expenditures met the allowable cost principles of OMB Circular A-87 (federal regulation 2 *CFR* 225). Our review disclosed:

- (1) HAL did not complete any semiannual certifications for the three interns who worked 100% on the SAT Program. HAL used these payroll expenditures to match the SAT grant awards. We identified known questioned costs of \$21,528.

Appendix B, section 8(h) of OMB Circular A-87 (federal regulation 2 *CFR* 225) requires certifications, at least semiannually, for employees who work solely on a single federal award.

- (2) HAL did not ensure that 2 (12%) of 17 sampled personnel-payroll costs used to match the SAT grant awards were supported by personnel activity reports that met the requirements of OMB Circular A-87 (federal regulation 2 *CFR* 225). The personnel activity reports included the date and hours that the employee worked on the federal program, but the employee did not sign them. Also, the personnel activity reports did not account for the total activity for which HAL compensated the employee. We identified known questioned costs of \$5,864.

Appendix B, section 8(h) of OMB Circular A-87 (federal regulation 2 *CFR* 225) requires payroll used in meeting matching requirements of federal awards to be supported by personnel activity reports that account for the total activity for which an employee was compensated and that are signed by the employee.

- (3) HAL did not approve 1 (6%) of 17 sampled personnel-payroll costs used to match the SAT grant awards. We questioned costs of \$423 in part a.(2) of this finding.

Appendix B, section 8(h) of OMB Circular A-87 (federal regulation 2 *CFR* 225) requires payroll charged to federal awards or used in meeting

matching requirements of federal awards to be approved by a responsible official of the governmental unit.

b. Matching, Level of Effort, and Earmarking

HAL's internal control did not ensure that expenditures used to match SAT Program expenditures met federal allowable cost requirements. Our review disclosed:

- (1) As discussed in the Allowable Costs/Cost Principles section (part a.(1)) of this finding, HAL did not complete any semiannual certifications for the three interns who worked 100% on the SAT Program and whose payroll costs were used to match the SAT grant awards.
- (2) As discussed in the Allowable Costs/Cost Principles section (part a.(2)) of this finding, HAL did not ensure that personnel-payroll costs used to match the SAT grant awards were supported by personnel activity reports that met the requirements of OMB Circular A-87 (federal regulation 2 *CFR* 225).
- (3) As discussed in the Allowable Costs/Cost Principles section (part a.(3)) of this finding, HAL did not approve 1 (6%) of 17 sampled personnel-payroll costs used to match the SAT grant awards.

Appendix B, section 8(h) of OMB Circular A-87 (federal regulation 2 *CFR* 225) requires that HAL support payroll costs used in meeting matching requirements of federal awards in the same manner as those claimed as allowable costs under federal awards.

RECOMMENDATION

We recommend that HAL establish internal control over the SAT Program to ensure compliance with federal laws and regulations regarding allowable costs/cost principles and matching, level of effort, and earmarking.

FINDING (2510908)

8. Grants to States, CFDA 45.310

Institute of Museum and Library Services	CFDA 45.310: Grants to States
Award Number: LS-00-06-0023-06 LS-00-07-0023-07 LS-00-08-0023-08	Award Period: 10/01/2005 - 09/30/2007 10/01/2006 - 09/30/2008 10/01/2007 - 09/30/2009
	Known Questioned Costs: \$6,721,331

HAL's internal control over the Grants to States Program did not ensure compliance with federal laws and regulations regarding allowable costs/cost principles; matching, level of effort, and earmarking; and reporting. Our review disclosed material weaknesses in internal control and material noncompliance relating to allowable costs/cost principles; matching, level of effort, and earmarking; and reporting requirements. As a result, we issued an adverse opinion on compliance with federal laws and regulations for the Grants to States Program.

Internal control that does not ensure compliance with federal laws and regulations could result in sanctions, disallowances, and/or future reductions of Grants to States awards.

Federal expenditures for the Grants to States Program totaled \$8.7 million for the two-year period ended September 30, 2008. We identified known questioned costs of \$6,721,331.

Our exceptions, by compliance area, are as follows:

a. Allowable Costs/Cost Principles

HAL's internal control did not ensure that Grants to States Program expenditures met the allowable cost principles of OMB Circular A-87 (federal regulation 2 *CFR* 225). Our review disclosed:

- (1) As discussed in the Matching, Level of Effort, and Earmarking section (part b.(1)) of this finding, HAL could not document that State-funded aid payments to public libraries met federal allowable costs/cost principle requirements. We questioned costs in part b.(1) of this finding.

Appendix A, section C of OMB Circular A-87 federal regulation 2 *CFR* 225 requires costs to be adequately documented. Federal regulation 45, *CFR* 1183.20 requires that fiscal control and accounting procedures of the State must be sufficient to permit the tracing of funds to a level of expenditures adequate to establish that such funds have not been used in violation of the restrictions and prohibitions of application statutes.

- (2) HAL did not complete 32 (70%) of 46 required semiannual certifications for 19 employees who worked 100% of their time on the Grants to States Program. HAL either charged these payroll expenditures to the Program or they were State funded and used to match the federal grant awards for the Program. As a result, we identified known questioned costs of \$96,484 related to the expenditures that were charged to the federal program.

Appendix B, section 8(h) of OMB Circular A-87 federal regulation 2 *CFR* 225 requires certifications, at least semiannually, for employees who work solely on a single federal award.

b. Matching, Level of Effort, and Earmarking

Our review disclosed:

(1) Matching

HAL did not comply with federal matching requirements. As noted in parts b.(1)(a) and b.(1)(b), our review identified expenditures reported by HAL as meeting matching requirements that did not qualify in accordance with federal regulations. As a result, HAL was \$2,113,745 and \$1,299,055 short of meeting the matching requirements for the 2006 and 2007 grant awards, respectively. We questioned the associated federal expenditures that did not have the required match and identified known questioned costs of \$6,624,847. Our review disclosed:

- (a) Federal matching regulations require that HAL provide a 34% match for the Grants to States Program. HAL utilizes State-funded aid payments to public libraries to meet these federal matching requirements.

HAL distributed \$23,153,000 in State-funded aid payments to public libraries during the two-year period ended September 30, 2008. Federal program guidance issued by the Institute of Museum and Library Services provides HAL must spend matching funds on activities that relate directly to the State's five-year plan for the program. However, because HAL did not review the expenditures made by the public libraries with these payments, HAL cannot ensure that public libraries used State-funded aid payments in accordance with federal regulations. Consequently, HAL could not document that State-funded aid payments to public libraries met federal matching requirements for the Grants to States Program.

- (b) As discussed in the Allowable Costs/Cost Principles section (part a.) of this finding, HAL did not complete 32 (70%) of 46 required semiannual certifications for 19 employees who worked 100% of their time on the Grants to States Program. The personnel costs related to 17 of these individuals were State funded and used to match the federal grant awards for the Program. We determined that \$675,409 of payroll expenditures that we reviewed in part a. of this finding were State funded and used to match the federal grant awards for the Program.

Appendix B, section 8(h) of OMB Circular A-87 (federal regulation 2 CFR 225) requires that HAL support payroll costs used in meeting matching requirements of federal awards in the same manner as those claimed as allowable costs under federal awards.

(2) Level of Effort

Federal level of effort regulations require that HAL maintain a specified level of State expenditures each year in order to receive its full Grants to States Program federal allotment.

Title 20, Section 9133(c) of the *United States Code* requires that the amount of Grants to States funds payable to a state for a fiscal year shall be reduced if the level of state expenditures for the previous fiscal year is less than the average of the total of such expenditures for the three fiscal years preceding that previous fiscal year.

Based on the expenditures reported by HAL as meeting federal level of effort requirements for the prior three fiscal years, we calculated that HAL met the 2006 grant award level of effort requirement and was \$2,511,510 short of meeting the level of effort requirements for the 2007 grant award. These calculations include the State-funded aid payments that we reported on in part b.(1)(a) of this finding. However, HAL did not ensure that public libraries used State-funded aid payments in accordance with federal regulations. In addition, HAL did not consistently use the same methodology to determine the required level of effort. For the 2006 grant award, HAL used \$500,000 for one of the years in the three-year average used to calculate the required level of effort. If HAL had used actual level of effort expenditures for that year, HAL would have been \$806,845 short of meeting the required level of effort.

c. Reporting

HAL's internal control did not ensure that its federal reports were supported by its financial records or were in accordance with program requirements. Our review disclosed:

- (1) As discussed in the Matching, Level of Effort, and Earmarking section (part b.(1)) of this finding, HAL could not document that State-funded aid payments to public libraries met federal requirements. As a result, these State-funded payments should not have been reported as matching and maintenance of effort on the 2006 and 2007 financial status reports. We questioned costs in part b.(1) of this finding.
- (2) HAL understated matching and level of effort expenditures reported for the Services to the Blind and Physically Handicapped by \$94,169 and \$136,254 for fiscal years 2007-08 and 2006-07, respectively. HAL informed us that it used budgeted expenditures for permanent staff and did not include eligible student payroll costs in fiscal year 2006-07. A clerical error caused the fiscal year 2007-08 understatement.
- (3) HAL incorrectly reported individual administrative salary expenditures in both fiscal years 2007-08 and 2006-07. The misstatements ranged from an overstatement of \$10,510 to an understatement of \$12,557. Overall, HAL understated administrative personnel expenditures in fiscal year 2007-08 by \$1,126.

RECOMMENDATION

We recommend that HAL improve its internal control over the Grants to States Program to ensure compliance with federal laws and regulations regarding allowable costs/cost principles; matching, level of effort, and earmarking; and reporting.

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

OTHER SCHEDULES

DEPARTMENT OF HISTORY, ARTS AND LIBRARIES
Summary Schedule of Prior Audit Findings
As of June 23, 2009

PRIOR AUDIT FINDINGS RELATED TO THE FINANCIAL SCHEDULES

Audit Findings Not Corrected or Partially Corrected:

Audit Period: October 1, 2002 through September 30, 2004
Finding Number: 250501
Finding Title: Internal Control Over Financial Reporting

Finding: The Department of History, Arts and Libraries' (HAL's) internal control over financial reporting did not ensure that transactions were accurately recorded and that identified errors were corrected.

Agency Comments: HAL reviewed the year-end closing guide in the Department of Management and Budget (DMB) Financial Users Manual for direction and clarification when establishing work project accounts to strengthen internal control over financial reporting as of the year-end closing for fiscal year 2004-05.

Audit Period: October 1, 2004 through September 30, 2006
Finding Number: 2510701
Finding Title: Internal Control Over Financial Reporting

Finding: HAL's internal control over financial reporting did not ensure that transactions were accurately recorded.

Agency Comments: HAL reviewed the year-end closing guide in the DMB Financial Users Manual for direction and clarification when recording federal revenues to strengthen internal control over financial reporting as of the year-end closing for fiscal year 2006-07.

Audit Period: October 1, 2002 through September 30, 2004
Finding Number: 250502
Finding Title: Indirect Costs

Finding: HAL did not establish an indirect cost rate and charge indirect costs to awards, contracts, and grants, including those received from the federal government.

Agency Comments: HAL began the process of establishing an indirect cost rate through discussions with the State's designated contractor. Discussions were suspended because of the likelihood that the State would develop a Statewide indirect cost rate as part of the accounting consolidation.

Audit Period: October 1, 2004 through September 30, 2006
Finding Number: 2510702
Finding Title: Use of State General Fund/General Purpose Appropriations

Finding: HAL did not maximize its use of federal sources of financing by billing for indirect costs and by expending federal funds before using State General Fund/general purpose appropriations.

Agency Comments: HAL has revised its process as of October 1, 2007 to ensure the use of all available grant funds before use of State General Fund/general purpose funds. HAL began the process of establishing an indirect cost rate through discussions with the State's designated contractor. Discussions were suspended because of the likelihood that the State would develop a Statewide indirect cost rate as part of the accounting consolidation.

Audit Period: October 1, 2004 through September 30, 2006
Finding Number: 2510703
Finding Title: State Aid to Libraries

Finding: HAL should obtain a formal Attorney General opinion to determine whether State aid payments to public libraries under Section 397.566(2) of the *Michigan Compiled Laws* were distributed in accordance with State law.

Agency Comments: HAL obtained an advisory memorandum from the Department of Attorney General on whether State aid payments to public libraries were distributed in accordance with State law. The memorandum supports the distribution methodology that HAL used. The advisory memorandum was not the formal opinion of the Attorney General.

PRIOR AUDIT FINDINGS RELATED TO FEDERAL AWARDS

Audit Findings Not Corrected or Partially Corrected:

Audit Period: October 1, 2004 through September 30, 2006
Finding Number: 2510704
Finding Title: Historic Preservation Fund Grants-in-Aid, *CFDA* 15.904

Finding: HAL had not established internal control over the Historic Preservation Fund Grants-in-Aid Program to ensure compliance with federal laws and regulations regarding allowable costs/cost principles; matching, level of effort, and earmarking; and reporting.

Agency Comments: The State Historic Preservation Office instituted additional procedures as of June 2007 to address compliance issues with the reporting requirements of U.S. Office of Management and Budget (OMB) Circular A-87.

HAL has instituted procedures to support the requirement to meet the 25% limit on administrative costs for federal earmarking requirements under the Historic Preservation Fund Grants-In-Aid Program.

HAL has changed its procedures to submit final project reports to the National Park Service immediately upon closing out the project, ensuring that the reports are submitted to the National Park Service within the specified time period.

DEPARTMENT OF HISTORY, ARTS AND LIBRARIES

Corrective Action Plan

As of June 16, 2009

FINDINGS RELATED TO THE FINANCIAL SCHEDULES

Finding Number: 2510901

Finding Title: Internal Control Over Financial Reporting

Management Views: The Department of History, Arts and Libraries (HAL) agrees with the finding.

The error of recognizing the revenue as miscellaneous revenue instead of deferred revenue was an oversight and not intentional. The Office of Financial Management (OFM) year-end closing guide procedures are used on a regular basis.

The designation of HAL as a subrecipient or vendor has not been clearly stated in the formal memorandums of understanding (MOUs) between HAL and other departments. In addition, the project fund source has not been included in the MOU. HAL has requested that both designations be added to every MOU by the department initiating the MOU.

Planned Corrective Action: HAL will continue to use the OFM year-end closing guide as a basis for year-end closing procedures. The occurrence of errors has been minimal. Revenues were not lost, only reported incorrectly.

HAL has created a checklist that has been circulated to employees who have the opportunity to review MOUs prior to signatures and employees who have the authority to sign an MOU. The checklist identifies data that should be included in the body of the MOU.

Anticipated Completion Date: September 30, 2009

Responsible Individual: Mark Hoffman, Acting Department Director

Finding Number: 2510902

Finding Title: Library of Michigan Database (LMDB)

Management Views: HAL agrees with the content of the findings; however, the corrective actions are out of the control of HAL and must be accomplished in association with the Michigan Department of Information Technology (MDIT) because MDIT is the owner and manager of all information technology systems and equipment.

- a. HAL communicated LMDB programming changes through e-mail and at meetings with the programmer contracted by MDIT. HAL was not informed of established policies, procedures, or formal processes for requesting programming changes. HAL staff provided examples and discussed with the contractor updates that were needed, prioritized the list, and tested the changes on a development server as they were made, prior to requesting transfer to the live server.

MDIT informed HAL that MDIT has implemented, as of January 2009, change controls on new versions of LMDB through the change process and the local change board approval process. This process requires approval and tracking of all versions of LMDB.

- b.(1) During the audit period, the passwords were not encrypted. Passwords have been encrypted

and are not visible since it was brought to HAL's attention during the audit.

- b.(2) One MDIT employee has access to LMDB code and production data. Due to limited MDIT staffing, lack of LMDB programming knowledge and experience, and reduced resources, a second MDIT employee has not been assigned to maintain the system and ensure segregation of duties. Someone at MDIT, however limited, has to be available to address system needs if a problem occurs in the day-to-day operation of LMDB.
- b.(3) Initial passwords are system generated to first-time LMDB users. Users are required to update passwords the first time they log on and prompted to change passwords every 90 days.
- b.(4) Access to LMDB is limited to only HAL staff who have a need to use the system. The employee's supervisor must request access to specific components of LMDB as required by the job. An access request form must be completed by the supervisor and submitted to the HAL Business Office.
- c. LMDB is housed on servers owned and operated by MDIT and are located in restricted areas, limited to only MDIT staff. The control and operation of the servers, including a disaster recovery plan, must be initiated, implemented, and amended only by MDIT staff in conjunction with HAL.

Planned Corrective Action:

- a. MDIT Agency Services is in the process of implementing the System Engineering

Methodology (SEM) Maintenance model that will track formal change control requests between HAL and MDIT. This will include the use of standardized forms and procedures that will provide an acceptable level of control and standardization. This will be fully implemented in October 2009. HAL will work with MDIT to implement MDIT's new process.

- b.(1) Password encryption was corrected while the auditors were conducting the audit. All LMDB passwords are now encrypted.
- b.(2) This correction is out of HAL's control. HAL does not manage MDIT staff and does not assign resources. MDIT has informed HAL that MDIT will examine ways in which risk can be remedied by incorporating a combination of change management, server access controls, and segregation of duties for development staff.
- b.(3) Updated passwords are system required every 90 days. HAL has requested programming changes that will require passwords to be a minimum length and combination of six alpha and numeric characters.
- b.(4) HAL has a required access form that must be completed and signed by the employee's supervisor. HAL will document the procedure to complete the form.
- c. MDIT, in conjunction with HAL, will begin a full analysis of backup and disaster recovery needs for LMDB. The application and the server are currently being backed up daily to the enterprise-wide Veritas backup system. The

analysis will determine if current needs justify a full disaster recovery plan with its associated costs and requirements. This will be completed by January 2010. If HAL were to experience an interruption, other State systems, such as the Michigan Administrative Information Network (MAIN), would be available to process payments and receipts as performed in LMDB.

Anticipated Completion Date: September 30, 2009, except part c., which will be completed by January 29, 2010.

Responsible Individual: Mark Hoffman, Acting Department Director

Finding Number: 2510903

Finding Title: Museum Store Operations

Management Views: HAL agrees with some of the individual findings and that internal control should be improved in some areas and procedures documented in all areas. However, HAL believes that many of the existing controls are effective and appropriate to the size and operations of the museum store system. The point-of-sale (POS) cash register system provides a monitoring base that is reinforced by State purchasing and disbursement systems.

- a. HAL agrees that it has not completed a formal document detailing museum store procedures; however, HAL does not agree that the result is a lack of internal control of monitoring, inventory, cash handling, or employee expectations and responsibilities. Individual training and coaching reinforce the Museum Store Manual, which outlines employee expectations and responsibilities. Internal control is maintained

through the reports generated by the POS cash register system. All purchasing and disbursement follow the policies and procedures established by HAL and the Department of Management and Budget purchasing.

One Lansing store employee reviews the electronic journals of every store daily. The other compares the deposits to the POS reports. A variance of \$5 or more at any one location triggers a detailed review. Both are particularly vigilant about an increase in returns or voided sales, either of which could be a sign of a problem. In fiscal year 2007-08, the total variance between deposits and the POS system was \$253.99 of \$530,085.37 (.048%).

The HAL Business Office prepares Lansing deposits and records all other deposits, adding another check on the system.

- b. HAL agrees with the finding.
 - (1) HAL notes that the two stores in question hold 10% to 12% of the total inventory value. Store management changed the procedures after fiscal year 2006-07 to ensure that this would not be a problem in the future.
 - (2) HAL notes that it retains documentation of the inventories conducted during the audit period for most sites. Reconciliation notes for major questionable discrepancies that are beyond acceptable shrinkage are noted on the inventories.

Because HAL maintains a perpetual inventory control system, inventories are performed at different times depending on business needs. For example, books are inventoried before submitting any large order and seasonal stores are inventoried at the end of the season.

Most inventory records are maintained in the single POS system, and the counts in that system are updated after every transaction. Physical inventories are conducted at each seasonal site at the close of the season and all weather sensitive items are returned to Lansing. Inventories are updated with transfer reports and shipment receiving recaps throughout the operating season.

During the audit period, the following storewide inventories were conducted and the POS system updated:

Store	Inventory Date	POS Update
Lansing	January 2008	January 2008
Fayette	October 2007	January 2008
Tawas	December 2007	December 2007
Hoffmaster	April 2007	April 2007
Iron Industry	October 2007	January 2008
Alpena	October 2007	

(3) Because inventory work is a business process as well as a control process, store employees are involved in the periodic inventories that occur throughout the year. Nonstore employees performed the Lansing store biannual count in January 2008. During the audit period, the store manager participated in the initial inventory counts for

the Lansing and Hoffmaster stores by providing the forms, organizing the work, answering questions, and counting some backroom items that were later verified by other staff. She initiated or performed follow-up counts where there were significant discrepancies.

c. HAL agrees with the finding.

The materials stored were POS credit card reports that had credit card numbers and expiration dates (used in reconciling the cash register record for the day and the deposit counted at the end of the day). There were no names, social security numbers, or addresses associated with the numbers, making the use of the numbers to make purchases highly unlikely. The reports were kept in an office that was locked at night.

Individual credit card slips, which do not contain full numbers, are stapled in envelopes and stored in a locked and secure area. This procedure is in compliance with the Michigan Identity Theft Protection Act policy.

d. HAL does not agree with the finding.

Cashiers log in individually when utilizing the registers at the field sites, with the exception of the Lansing store. While the drawers are shared at the field sites, transactions are separated by cashier. Overlap of cashiers in the Lansing store is minimal, with each staff person having dedicated days for cashiering. On anticipated heavy traffic days at the Lansing store (the only

store with two registers), separate drawers and separate registers are used. All sales are monitored daily.

- e. HAL agrees with the finding.

The effort to replace the backup system was delayed because replacement requires an upgrade of the entire POS system.

Planned Corrective Action:

- a. Policies and procedures: HAL will complete the Museum Store Manual policies and procedures by September 30, 2009.
- b. Inventory: HAL will create clearer policies and documentation of inventory control by September 30, 2009. The museum director and a HAL Business Office employee will formally review the inventory, reconciliation, and adjustments.
- c. Storage of sensitive data: In order to avoid any future concerns, HAL has instituted a policy of printing out the POS credit card report only when there is an end-of-day cash variance of \$5 or more. The report will be stored in a locked cabinet and, once the research on the variance is complete, the POS credit card report is shredded.
- d. Cash handling: HAL believes that current procedures are adequate. To avoid future concerns, HAL will document them in the Museum Store Manual.
- e. Backup and recovery: The POS system, including the backup system, will be replaced by September 30, 2009.

Anticipated Completion Date: September 30, 2009

Responsible Individual: Sandra Clark, Michigan Historical Director

Finding Number: 2510904

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

Management Views: HAL agrees with the finding.

In response to the prior audit, HAL agreed to establish and apply an indirect cost rate if federal funds were available and if it did not cost more to revise and maintain an indirect cost rate than would be recovered from applying such a rate. HAL began the process of establishing an indirect cost rate through discussions with the State's designated contractor. Discussions were suspended because of the likelihood that the State would develop a Statewide indirect cost rate as part of the accounting consolidation.

Planned Corrective Action: HAL will use all available grant funds before using State General Fund/general purpose funds.

Anticipated Completion Date: September 30, 2009

Responsible Individual: Mark Hoffman, Acting Department Director

Finding Number: 2510905

Finding Title: State Aid to Libraries

Management Views: HAL does not agree with the finding.

During the previous audit, HAL obtained an advisory memorandum from the Department of Attorney

General on whether State aid payments to public libraries were distributed in accordance with State law. The memorandum states:

HAL's authority to distribute State aid to public libraries is derived from each year's appropriations act, and subsection 16(2) does not limit how HAL may distribute the State aid to public libraries.

The Auditor General's reading of subsection 16(2) does not take into account the dual nature of the subsection as both a substantive act and an appropriations act. Appropriations are only valid for the current and next ensuing fiscal year. After that time, the appropriation is not invalid, but only expresses an intent to appropriate. When the Legislature enacted subsection 16(2), it limited the appropriation contained in that subsection to fiscal year 1978-79. But the Legislature did not and could not limit future Legislatures from appropriating the same amount of State aid to public libraries under the same standards set forth in subsection 16(2). One Legislature cannot bind the power of its successor.

The Legislature appropriates funds to HAL under an appropriations act and not under the State Aid to Public Libraries Act. HAL uses the State Aid Guidelines for Michigan Public Libraries to determine how to distribute the State aid to public libraries. The guidelines use the funding levels established in sections 13 and 16 of the Act when it establishes standards for staffing and local funding for libraries to meet to qualify for the State aid. But the fact

that the guidelines refer to eligibility for State aid under subsection 16(2) and that subsection 16(2) allocates funds during the fiscal year 1978-79 does not mean that HAL lacks authority to distribute State aid under the same standards set forth in subsection 16(2).

The appropriations acts for fiscal years 2004-05 and 2005-06 provide line-item state aid to public libraries, and the acts do not restrict how HAL may distribute the State aid to public libraries.

Planned Corrective Action: None

Anticipated Completion Date: None

Responsible Individual: Mark Hoffman, Acting Department Director

FINDINGS RELATED TO FEDERAL AWARDS

Finding Number: 2510906

Finding Title: Historic Preservation Fund Grants-In-Aid (HPF),
CFDA 15.904

Management Views: HAL agrees with the finding but notes that it has no control over the recording system used for the technical documentation of the reported time. While HAL concurs that timeliness in approval is important, timeliness is not the basis for this citation.

There are design limitations within the Data Collection and Distribution System (DCDS) timekeeping system that HAL is obligated to use. DCDS removes unapproved time and attendance records from the

supervisor's mailbox after three pay periods, with no notification to the supervisor, timekeeper, or management. DCDS does not provide a method to approve the time and attendance record after it is removed from the supervisor's mailbox, making approval impossible after this period of time. DCDS allows time and attendance to be posted even if the supervisor has not approved the record. Two of the individuals identified as not having time approvals in DCDS were new hires and had not yet been coded by the Department of Civil Service to appear on the supervisor's screen for approval, making DCDS approval impossible for the supervisor.

Planned Corrective Action:

To avoid any future questions, HAL will institute corrective actions as follows:

- (1) HAL will institute a procedure to ensure that employee time and attendance records are approved within DCDS time limitations. HAL will also institute a procedure to ensure that an authorized manager approves the State Historic Preservation Officer's travel reimbursement requests.
- (2) Part b.(2) was a finding in the fiscal year 2005-06 HAL audit and brought to the attention of HAL in February 2007. Upon notification by the auditors, HAL immediately instituted a policy to track actual payroll expenditures charged to the HPF Program and HPF matching expenditures using paper time sheets. Beginning May 20, 2007 to present, actual payroll expenditures charged to the HPF Program and actual time charged to State-funded matching expenditures are entered directly into DCDS each pay period.

Anticipated Completion Date: September 30, 2009

Responsible Individual: Brian Conway, State Historic Preservation Officer

Finding Number: 2510907

Finding Title: Save America's Treasures (SAT), *CFDA* 15.929

Management Views: HAL agrees with parts a.(3) and b.(3) and does not agree with parts a.(1), a.(2), b.(1), and b.(2) of the finding:

a.(1) HAL met the requirement of certifications for the interns.

Section 3-19 of the U.S. Office of Management and Budget (OMB) Circular A-87 Implementation Guide says that if an employee works on only one federal award, the certification requirement can be met through certain payroll coding and time and attendance certifications pursuant to payroll authorizations if (a) the employee works in a dedicated function; (b) the potential assignment to multiple programs/activities is not within the authority, function, or purview of the supervisor responsible for certifying payroll time and attendance; (c) the employee is coded to a dedicated function not benefiting multiple functions or programs, then the certification shall be accepted in lieu of the semiannual certification of time and effort.

(a) The interns were hired to work 100% of their time on grant activities related to one grant award. Their position descriptions specifically state the activities to be carried

out, all related to one grant. Requirement (a) was met.

(b) The supervisor approving the time and attendance in DCDS did not have the authority to assign the interns to other activities other than those to complete the grant work that they were hired to perform. Therefore, requirement (b) was met.

(c) The interns' payroll expense was coded to a single index code dedicated to the project. Requirement (c) was met.

Therefore, the certification requirement was met through DCDS time and attendance certifications pursuant to payroll authorizations.

a.(2) HAL met the requirements of personnel activity reports. The employees tracked project match time worked on their personal work calendars. The project time was reported on a paper time sheet and/or through an e-mail record. The total activity of the employee was recorded in DCDS. This method of recording match time has been used by the Michigan Historical Center for the past 20 years.

a.(3) The supervisor did not approve one employee's time and attendance during one pay period. This is a system design limitation with DCDS timekeeping which HAL is obligated to use and has no control over. DCDS removes unapproved time and attendance records from the supervisor's mailbox after three pay periods, with no notification to the supervisor, timekeeper, or management. DCDS does not

provide a method to approve the time and attendance record after it is removed from the supervisor's mailbox, making approval impossible after this period of time. DCDS allows time and attendance to be posted even if the supervisor has not approved the record. While HAL concurs that timeliness in approval is important, timeliness is not the basis for this citation.

Planned Corrective Action: To avoid any future questions, HAL will ensure that it obtains semiannual certifications from employees who work 100% of their time on a federal grant.

HAL will change its policy on personnel activity reports to meet the auditors' interpretation of the requirements of Title 2, Part 255 of the *Code of Federal Regulations*.

To avoid any future questions, HAL will also institute a procedure to ensure that employee time and attendance records are approved within DCDS time limitations.

Anticipated Completion Date: September 30, 2009

Responsible Individual: Brian Conway, State Historic Preservation Officer

Finding Number: 2510908
Finding Title: Grants to States, *CFDA* 45.310

Management Views: HAL does not agree with parts a.(1), b.(1)(a), b.(2), and c.(1) and agrees with parts a.(2), b.(1)(b), c.(2), and c.(3).

HAL uses State aid to public libraries as part of the match and maintenance of effort required by the federal program. Matching funds must be used to support the priorities of the State Five-Year Plan. Maintenance of effort funds must be used to support the four purposes of the Library Services and Technology Act (LSTA). HAL receives and reviews an annual State aid report from each public library. Libraries report their operating income and expenditures separately from capital income and expenditures. State aid is included in operating income. The reports document that public libraries spend State aid on operating expenditures, which are activities directly related to the State Five-Year Plan, Goal I, and the purposes of LSTA. The State aid report documentation confirms that State aid is wholly appropriate for use as match and maintenance of effort.

In addition, the Institute of Museum and Library Services program officer for Michigan reviewed the State aid reports as part of a site visit in July 2007 and did not issue a finding.

HAL agrees that certifications were not completed for student workers the first year they were hired. Certifications were completed for full-time staff. Certifications for student workers started as soon as program staff were made aware of the issue during the audit period.

HAL understood in the audit of fiscal years 2002-03 and 2003-04 that the previous methodology in determining maintenance of effort was incorrect according to LSTA. At that time, HAL changed the methodology to come into compliance. The inconsistency listed resulted from the corrections HAL

made in response to the prior audit. Since that time, the methodology has been standard and in compliance.

Planned Corrective Action: HAL will require semiannual certification for all staff who work 100% of their time on the Grants to States Program. HAL will require certifications for all staff used as match for the Grants to States Program.

To mitigate reporting errors in the future, program staff will request the required financial information from the accounting office and both offices will review the final report prior to submitting it to the federal agency.

Anticipated Completion Date: September 30, 2009

Responsible Individual: Nancy Robertson, State Librarian

GLOSSARY

Glossary of Acronyms and Terms

adverse opinion	An auditor's opinion in which the auditor states that the audited agency did not comply, in all material respects, with the cited requirements that are applicable to each major federal program.
<i>CFDA</i>	<i>Catalog of Federal Domestic Assistance.</i>
<i>CFR</i>	<i>Code of Federal Regulations.</i>
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.
DCDS	Data Collection and Distribution System.
DMB	Department of Management and Budget.
Federal Information System Controls Audit Manual (FISCAM)	Guidance to auditors in evaluating internal control over the integrity, confidentiality, and availability of data maintained in information systems.
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.
HAL	Department of History, Arts and Libraries.

HPF	Historic Preservation Fund Grants-In-Aid.
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.
IT	information technology.
Library of Michigan Database (LMDB)	HAL's relational database that allows HAL to enter, approve, and process its financial transactions through an interface to the State's automated administrative management system, the Michigan Administrative Information Network (MAIN).
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.
LSTA	Library Services and Technology Act.
MAIN	Michigan Administrative Information Network.
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.
MISPC	Mackinac Island State Park Commission.
MOU	memorandum of understanding.
OFM	Office of Financial Management.
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 <i>Government Auditing Standards</i> . 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 <i>Government Auditing Standards</i> .
pass-through entity	A nonfederal entity that provides a federal award to a subrecipient to carry out a federal program.
POS	point-of-sale.
qualified opinion	An auditor's opinion in which the auditor: <ul style="list-style-type: none"> a. Identifies a scope limitation or one or more instances of misstatements that impact the fair presentation of the

financial schedules and/or financial statements presenting the basic financial information of the audited agency in conformity with the disclosed basis of accounting or the financial schedules and/or financial statements presenting supplemental financial information 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

- b. Expresses reservations about the audited agency's compliance, in all material respects, with the cited requirements that are applicable to each major 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.

SAT

Save America's Treasures.

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 <i>Government Auditing Standards</i> 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.
<i>SOMCAFR</i>	<i>State of Michigan Comprehensive Annual Financial Report.</i>
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: <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.

