



# 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**

*Performance Audit*

*Statewide Cost Allocation Plan and  
 Interagency Billing Processes*

*Department of Technology, Management and  
 Budget*

Report Number:  
 071-0131-09

Released:  
 May 2010

*The State of Michigan's Statewide Cost Allocation Plan (SWCAP) is the mechanism by which the State identifies, summarizes, and allocates unbilled indirect costs in a logical and systematic manner. The SWCAP also includes financial and billing rate information for billed central service costs directly charged to agencies or funds. The SWCAP substantiates the State's request for the establishment of an indirect cost rate and a central service cost allocation plan to obtain reimbursement from the federal government for Statewide indirect costs.*

**Audit Objective:**

To assess the effectiveness of the Department of Technology, Management and Budget's (DTMB's) efforts to implement the SWCAP.

**Audit Conclusion:**

We concluded that DTMB's efforts to implement the SWCAP were effective. Our report does not include any reportable conditions related to this audit objective.

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**Audit Objective:**

To assess the effectiveness of DTMB's processes for recovery of selected central service costs.

**Audit Conclusion:**

We concluded that DTMB's processes for recovery of selected central service costs were effective. Our report does not include any reportable conditions related to this audit objective.

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Michigan Office of the Auditor General  
 201 N. Washington Square  
 Lansing, Michigan 48913

**Thomas H. McTavish, C.P.A.**  
 Auditor General

**Scott M. Strong, C.P.A., C.I.A.**  
 Deputy Auditor General





STATE OF MICHIGAN  
OFFICE OF THE AUDITOR GENERAL  
201 N. WASHINGTON SQUARE  
LANSING, MICHIGAN 48913  
(517) 334-8050  
FAX (517) 334-8079

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

May 19, 2010

Mr. Kenneth D. Theis, Director  
Department of Technology, Management and Budget  
Lewis Cass Building  
Lansing, Michigan

Dear Mr. Theis:

This is our report on the performance audit of the Statewide Cost Allocation Plan and Interagency Billing Processes, Department of Technology, Management and Budget.

This report contains our report summary; description of the Statewide Cost Allocation Plan and interagency billing processes; audit objectives, scope, and methodology and prior audit follow-up; comments; and a glossary of acronyms and terms.

We appreciate the courtesy and cooperation extended to us during this audit.

AUDITOR GENERAL



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## Description of the Statewide Cost Allocation Plan and Interagency Billing Processes

The State of Michigan's Statewide Cost Allocation Plan (SWCAP) is the mechanism by which the State identifies, summarizes, and allocates unbilled indirect costs\* in a logical and systematic manner. The SWCAP also includes financial and billing rate information for billed central service costs\* directly charged to agencies or funds through internal service funds\* and trust (retirement) funds and for building occupancy costs through the General Fund. The SWCAP substantiates the State's request for the establishment of an indirect cost rate and a central service cost allocation plan as required by U.S. Office of Management and Budget Circular (OMB) Circular A-87, *Cost Principles for State, Local, and Indian Tribal Governments* (Title 2, Part 225 of the *Code of Federal Regulations*) to obtain reimbursement from the federal government for Statewide indirect costs.

Statewide unbilled indirect costs include the cost of central support services, such as accounting, purchasing, budgeting, payroll, and information systems, provided to operating departments. The Department of Civil Rights; Civil Service Commission; Department of Technology, Management and Budget (DTMB); Department of History, Arts and Libraries (HAL); Department of Treasury; and Office of the Auditor General provide central support services. (DTMB was formerly the Department of Management and Budget, and HAL was abolished by Executive Order No. 2009-36, effective October 1, 2009.)

Billed central service costs include goods or services provided primarily to other State agencies or funds rather than to the general public. Some of these goods and services include motor pool services; printing, reproduction, and mailing services; telecommunication and information technology services; health-related fringe benefits; retirement services; and building occupancy charges.

DTMB's Office of Financial Management is responsible for the State's SWCAP. Since 1987, DTMB has contracted with a private consultant to prepare the SWCAP. DTMB reviews and approves the SWCAP before it is submitted to the U.S. Department of Health and Human Services (HHS).

\* See glossary at end of report for definition.

The State submits a proposed SWCAP based on estimated costs and a final SWCAP based on actual costs to HHS. HHS is the cognizant agency that annually approves the SWCAP and negotiates the Cost Allocation Agreement with DTMB, establishing Statewide indirect costs for the State's operating departments. The Statewide indirect costs are established on a fixed with carry-forward basis\*. The most recent Cost Allocation Agreement approved indirect costs for fiscal year 2008-09 and included estimated costs for the fiscal year 2008-09 SWCAP and carry-forward costs from the fiscal year 2006-07 final SWCAP.

DTMB provides the approved Statewide indirect costs to the State's operating departments for allocation to their federal assistance programs. Statewide indirect costs provided to operating departments and other funds for fiscal year 2008-09 were \$98.8 million.

Operating departments are required by Section 18.1460 of the *Michigan Compiled Laws* (Act 431, P.A. 1984) to establish departmental indirect cost rates and to charge indirect costs to awards, contracts, and grants. The departmental indirect costs may include Statewide indirect costs as determined by each operating department's method of billing indirect costs for different federal assistance programs.

State agencies are billed for goods and services based on rates established to cover actual costs. Billed central service costs charged directly to other State agencies or funds were as follows:

	Fiscal Year	
	2008-09	2007-08
State Sponsored Group Insurance Fund	\$ 719,427,000	\$ 707,737,000
Motor Transport Fund	\$ 55,539,000	\$ 58,359,000
Office Services Revolving Fund	\$ 112,914,000	\$ 111,921,000
Information Technology Fund	\$ 516,877,000	\$ 475,638,000
Building occupancy	\$ 87,683,000	\$ 87,301,000

\* See glossary at end of report for definition.

## Audit Objectives, Scope, and Methodology and Prior Audit Follow-Up

### Audit Objectives

Our performance audit\* of the Statewide Cost Allocation Plan (SWCAP) and Interagency Billing Processes, Department of Technology, Management and Budget (DTMB), had the following objectives:

1. To assess the effectiveness\* of DTMB's efforts to implement the SWCAP.
2. To assess the effectiveness of DTMB's processes for recovery of selected central service costs.

### Audit Scope

Our audit scope was to examine the Statewide Cost Allocation Plans for fiscal years 2006-07 and 2007-08 and to review the billing processes of selected central service costs. We conducted this performance audit in accordance with generally accepted government auditing standards. Those standards require that we plan and perform the audit to obtain sufficient, appropriate evidence to provide a reasonable basis for our conclusions based on our audit objectives. We believe that the evidence obtained provides a reasonable basis for our conclusions based on our audit objectives. Our audit procedures, conducted from May through December 2009, generally covered the period October 1, 2006 through July 31, 2009.

### Audit Methodology

To establish our audit objectives and gain an understanding of the processes used in the development and implementation of the SWCAP, we conducted a preliminary review. This included interviews and discussions with DTMB staff regarding their functions and responsibilities and examination of applicable policies and procedures, laws, and federal regulations. In addition, we met with the consultant who prepares the SWCAP regarding the processes of obtaining data and preparing the SWCAP.

To assess the effectiveness of DTMB's efforts to implement the SWCAP, we reviewed the most recent SWCAP that was based on fiscal year 2007-08 actual costs. Our review included an analysis of balances and recent plan changes. We also reviewed the timeliness of the SWCAP, whether the SWCAP was based on actual account

\* See glossary at end of report for definition.

balances, whether allocation methodologies were reasonable, and whether DTMB properly provided SWCAP information to State departments for inclusion in their departmental indirect cost allocation plans.

To assess the effectiveness of DTMB's processes for recovery of selected central service costs, we reviewed the services provided and the processes used by DTMB for billing State agencies for the costs of central services provided by various internal service funds, trust funds, and the General Fund. We also reviewed the balance sheets required to be submitted by U.S. Office of Management and Budget (OMB) Circular A-87, *Cost Principles for State, Local, and Indian Tribal Governments* (Title 2, Part 225 of the *Code of Federal Regulations*) to ensure that working capital reserves did not exceed more than 60 days of cash expenditures. In addition, we compared billing rates with the actual cost of providing services to determine DTMB's compliance with State requirements.

For mailing services, information technology services, vehicle services, health-related fringe benefits, and building occupancy charges, we documented and tested the controls over billings to help provide assurance that the billing system was designed effectively and that controls were implemented. We reviewed a sample of billings to determine if the billings were based on correct rates and if agencies were properly billed based on the services provided. In addition, we performed analytical procedures to determine whether significant fluctuations were reasonable.

When selecting activities or programs for audit, we use an approach based on assessment of risk and opportunity for improvement. Accordingly, we focus our audit efforts on activities or programs having the greatest probability for needing improvement as identified through a preliminary review. Our limited audit resources are used, by design, to identify where and how improvements can be made. Consequently, we prepare our performance audit reports on an exception basis.

#### Prior Audit Follow-Up

Within the scope of this audit, we followed up all 3 of the prior audit recommendations from our March 2006 performance audit of the Statewide Cost Allocation Plan, Department of Management and Budget (07-131-05). We also followed up 2 of the 3 prior audit recommendations from our May 2005 performance audit of Interdepartmental Billings and Selected Service Delivery Evaluation Efforts, Department of Information Technology (50-505-04). The Departments complied with all of these prior audit recommendations.

# COMMENTS

## EFFECTIVENESS OF EFFORTS TO IMPLEMENT THE SWCAP

### COMMENT

**Audit Objective:** To assess the effectiveness of the Department of Technology, Management and Budget's (DTMB's) efforts to implement the Statewide Cost Allocation Plan (SWCAP).

**Conclusion:** We concluded that DTMB's efforts to implement the SWCAP were effective. Our report does not include any reportable conditions\* related to this audit objective.

## EFFECTIVENESS OF PROCESSES FOR RECOVERY OF SELECTED CENTRAL SERVICE COSTS

### COMMENT

**Audit Objective:** To assess the effectiveness of DTMB's processes for recovery of selected central service costs.

**Conclusion:** We concluded that DTMB's processes for recovery of selected central service costs were effective. Our report does not include any reportable conditions related to this audit objective.

\* See glossary at end of report for definition.

# GLOSSARY

## Glossary of Acronyms and Terms

central service costs	Central services billed to benefiting agencies on an individual fee-for-service basis.
DTMB	Department of Technology, Management and Budget.
effectiveness	Success in achieving mission and goals.
fixed with carry-forward basis	A basis for establishing Statewide indirect costs whereby the costs are estimated in the Cost Allocation Agreement and are adjusted for actual costs in a later year.
HAL	Department of History, Arts and Libraries.
HHS	U.S. Department of Health and Human Services.
indirect costs	Costs incurred for a common or joint purpose that benefit more than one program or function.
internal service fund	A fund established to account for financial transactions for services provided by a State agency to other State agencies.
performance audit	An economy and efficiency audit or a program audit that is designed to provide an independent assessment of the performance of a governmental entity, program, activity, or function to improve program operations, to facilitate decision making by parties responsible for overseeing or initiating corrective action, and to improve public accountability.
reportable condition	A matter that, in the auditor's judgment, falls within any of the following categories: an opportunity for improvement within the context of the audit objectives; a deficiency in internal control that is significant within the context of the objectives of

the audit; all instances of fraud; illegal acts unless they are inconsequential within the context of the audit objectives; significant violations of provisions of contracts or grant agreements; and significant abuse that has occurred or is likely to have occurred.

SWCAP

Statewide Cost Allocation Plan.







