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

Michigan
Office of the Auditor General
REPORT SUMMARY

Performance Audit

Michigan State Disbursement Unit

Office of Child Support

Department of Human Services

Report Number:
431-0142-08

Released:
December 2009

The Department of Human Services (DHS) operates the Michigan State Disbursement Unit (MiSDU) to centrally collect and disburse child support remittances in accordance with federal child support enforcement program requirements. Act 161, P.A. 1999, authorized DHS to establish MiSDU as the State's centralized collection and disbursement unit for all child support remittances and requires an audit of MiSDU.

Audit Objective:

To assess the effectiveness of MiSDU's efforts in monitoring its service provider.

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Audit Conclusion:

We concluded that MiSDU's efforts in monitoring its service provider were effective. However, our assessment disclosed one reportable condition (Finding 1).

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Reportable Condition:

MiSDU should improve the effectiveness of its efforts in monitoring its service provider (Finding 1).

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Agency Response:

Our audit report includes 1 finding and 1 corresponding recommendation. DHS's preliminary response indicated that it agrees with five parts of the finding and partially agrees with four parts of the finding.

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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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December 23, 2009

Mr. Ismael Ahmed, Director
Department of Human Services
Grand Tower
Lansing, Michigan

Dear Mr. Ahmed:

This is our report on the performance audit of the Michigan State Disbursement Unit, Office of Child Support, Department of Human Services.

This report contains our report summary; description; audit objective, scope, and methodology and agency responses and prior audit follow-up; comment, finding, recommendation, and agency preliminary response; and a glossary of acronyms and terms.

The agency preliminary response was taken from the agency's response subsequent to our audit fieldwork. 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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MICHIGAN STATE DISBURSEMENT UNIT

OFFICE OF CHILD SUPPORT

DEPARTMENT OF HUMAN SERVICES

431-0142-08

Description

The Department of Human Services (DHS) operates the Michigan State Disbursement Unit* (MiSDU) to centrally collect and disburse child support remittances in accordance with federal child support enforcement program requirements. Act 161, P.A. 1999, authorized DHS to establish MiSDU as the State's centralized collection and disbursement unit for all child support remittances and requires an audit of MiSDU.

The Personal Responsibility and Work Opportunity Reconciliation Act of 1996 (commonly known as the federal Welfare Reform Act) revised Title IV-D* of the Social Security Act to require that each state operate a state disbursement unit to centrally collect and disburse certain child support remittances. Section 454B of the Social Security Act (Title 42, Section 654b of the *United States Code*) requires state disbursement units to provide one central location for the receipt and disbursement of all Title IV-D child support remittances and for all private payments associated with a child support order* initially issued on or after January 1, 1994 that includes a court order for an employer to withhold income from the check of the noncustodial parent*. Federal law requires that state disbursement units must be able to process all remittances received with complete information within two business days after receipt. Also, state disbursement units are required to use automated data processing to the greatest extent possible. Noncompliance with federal law could result in a substantial loss of federal funds for the State's Child Support Enforcement Program and the Temporary Assistance for Needy Families welfare block grant.

DHS's MiSDU entered into a five-year contract with a service provider to develop and operate MiSDU. The contract period is December 2004 through April 2010. MiSDU receives child support remittances in a variety of methods, including paper payments (personal checks, cashier's checks, certified checks, and money orders) and electronic payments (wire transfers and credit card payments by way of mail, telephone, and Internet). MiSDU's service provider researches unidentified child support remittances* to determine if additional information can be obtained to process the remittance. When MiSDU's service provider cannot obtain sufficient case and remitter information, the remittance is sent to the Michigan Child Support Enforcement System (MiCSES) suspense accounts* using certain suspense hold codes* to be further worked on, returned, or escheated.

* See glossary at end of report for definition.

MiSDU's service provider develops a daily electronic file of child support remittances to be sent to MiCSES. MiCSES determines the appropriate allocation and distribution of the service provider's daily electronic file of remittances based on federal regulations. MiSDU's service provider disburses remittances by generating a support check or direct deposit transaction to the payee or the payee's bank.

MiSDU paid its service provider approximately $34.9 million during the period June 1, 2006 through September 30, 2008. During the audit period, the Office of Child Support Enforcement*, U.S. Department of Health and Human Services, and the State General Fund provided 66% and 34%, respectively, of the funding necessary for MiSDU's operations.

MiSDU collected and processed approximately $3.4 billion of child support remittances received during the period June 1, 2006 through September 30, 2008.

See glossary at end of report for definition.

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Audit Objective

The objective of our performance audit* of the Michigan State Disbursement Unit (MiSDU), Office of Child Support*, Department of Human Services (DHS), was to assess the effectiveness* of MiSDU's efforts in monitoring its service provider.

Audit Scope

Our audit scope was to examine the program and other records of the Michigan State Disbursement Unit administered by the Department of Human Services. 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 finding and conclusion based on our audit objective. We believe that the evidence obtained provides a reasonable basis for our finding and conclusion based on our audit objective. Our audit procedures, conducted from May through October 2008, generally covered the period June 1, 2006 through May 31, 2008.

Audit Methodology

To gain an understanding of MiSDU activities and to establish our audit objective and methodology, we conducted a preliminary review of MiSDU operations. Our preliminary review included interviews with Office of Child Support staff, MiSDU staff, and MiSDU's service provider staff; an on-site observation and examination of processes and procedures of MiSDU staff and MiSDU's service provider staff; a review of applicable federal regulations, State statutes, State policies and procedures, and policies and procedures of the service provider; and a review of the contract with MiSDU's service provider.

To accomplish our audit objective, we examined the contract between MiSDU and its service provider, including the invitation to bid, response to the invitation to bid, and amendments to the contract. We assessed and observed MiSDU's internal control related to receipting and disbursing child support remittances. We examined the SAS 70 report* of the service provider. We assessed MiSDU's review of the service provider's SAS 70 report to determine if key general and application controls were

See glossary at end of report for definition.

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reviewed. We selected a random sample and performed an analytical review of child support remittances with sufficient, identifying information processed at MiSDU. We selected a sample of processing errors identified by the service provider's quality assurance staff. We assessed various processes in identifying processing errors. We selected a random sample of child support remittances with insufficient identifying information that required further research by MiSDU. We assessed various researching methods performed by MiSDU to resolve unidentified child support remittances. Further, we assessed MiSDU's efforts in monitoring its service provider.

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.

Agency Responses and Prior Audit Follow-Up
Our audit report includes 1 finding and 1 corresponding recommendation. DHS's preliminary response indicated that it agrees with five parts of the finding and partially agrees with four parts of the finding.

The agency preliminary response that follows each recommendation in our report was taken from the agency's written comments and oral discussion subsequent to our audit fieldwork. Section 18.1462 of the *Michigan Compiled Laws* and the State of Michigan Financial Management Guide (Part VII, Chapter 4, Section 100) require DHS to develop a formal response to our audit findings and recommendations within 60 days after release of the audit report.

We released our prior performance audit of the Michigan State Disbursement Unit, Office of Child Support, Department of Human Services (431-142-06), in April 2007. Within the scope of this audit, we followed up all 3 prior audit recommendations. DHS complied with 1 of the 3 prior audit recommendations. The other 2 recommendations were rewritten for inclusion in Finding 1 of this report.

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COMMENT, FINDING, RECOMMENDATION, AND AGENCY PRELIMINARY RESPONSE

EFFECTIVENESS IN
MONITORING SERVICE PROVIDER

BACKGROUND

The Michigan State Disbursement Unit (MiSDU) monitors its service provider in a variety of ways, including obtaining and reviewing the annual SAS 70 reports of the service provider, obtaining and reviewing information provided by the service provider, and analyzing bank account information. In its review of the SAS 70 reports, MiSDU reviews the scope and objectives of the audit with its service provider and reviews the report after it is published to determine if there were any items noted which would require further follow-up from the service provider. MiSDU generally looks to ensure that the same issue is not noted in the next annual SAS 70 report. In addition, the service provider prepares and distributes various reports, typically weekly, to MiSDU based on information obtained from the service provider's quality assurance sampling and testing. MiSDU reviews the reports for reasonableness and uses the performance information to determine if the service provider is meeting key benchmarks outlined in the contract, such as the number of sample items tested, the number of errors identified in testing, and the calculated accuracy rate. MiSDU would follow up with the service provider if key benchmarks were not met or if any of the information appears unreasonable. MiSDU tracks certain information provided on the reports to determine activity over a period of time and would follow up with the service provider if the information did not appear to follow its usual trend. In addition, MiSDU monitors customer service calls as reported by its service provider and MiSDU's make whole account* which could identify errors in payments and system processing after the payment has occurred.

COMMENT

Audit Objective: To assess the effectiveness of MiSDU's efforts in monitoring its service provider.

Audit Conclusion: We concluded that MiSDU's efforts in monitoring its service provider were effective. However, our assessment disclosed one reportable condition* related to service provider monitoring (Finding 1).

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

FINDING

1. Service Provider Monitoring

   MiSDU should improve the effectiveness of its efforts in monitoring its service provider. Improvement in MiSDU's monitoring efforts would help to ensure that the service provider's processes and controls over its operating system are sufficient to ensure security and the effective operation of the system. Also, improvement in MiSDU's monitoring efforts would help to ensure that the service provider is meeting certain performance benchmarks and contract compliance criteria.

   Monitoring involves the regular collection, review, and analysis of events for indications of inappropriate or unusual activity and the appropriate investigation and reporting of such activity. MiSDU primarily relies on the service provider's own quality assurance process and associated performance reporting to MiSDU to ensure that the service provider performed in compliance with contract requirements. Because of this, MiSDU should supplement the service provider's quality assurance process with independent monitoring techniques to ensure that the service provider's operating system, including performance reporting, is secure, complete, and reliable.

   Our audit identified several areas where enhancement should be made in the oversight function to reduce the risks of impropriety, inaccurate performance reporting, and breach of security of the operating system. MiSDU could improve the effectiveness of its service provider as described in the following areas:

   a. Work with the service provider to modify the scope of the SAS 70 report to include a review of key general controls of change management or configuration management at the operating system and database levels, the appropriateness of access that certain individuals had to the operating system and applications, and segregation of duties within applications. Without effective general controls, business process application controls can generally be rendered ineffective by circumvention or modification.

   b. Require the service provider to establish segregation of duties of users' access in the Kids 1st* application. The lack of segregation of duties increases the risk of impropriety.

See glossary at end of report for definition.

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c.   Require the service provider to include all daily receipts in its quality assurance process. We noted instances in which more than 50% of daily receipts were not subjected to the quality assurance process. Not subjecting all receipts to the quality assurance process creates a risk that the accuracy and completeness of the performance information provided by the service provider is not reliable. The contract requires the service provider to include all daily receipts in its quality assurance process.

d.   Require the service provider to include all critical errors* in the service provider's weekly performance reports of its accuracy rate. The contract requires the service provider to process child support receipts with a daily accuracy rate of 99.8%.

e.   Monitor payments posted to a child support case from the Michigan Child Support Enforcement System (MiCSES) suspense. Because these payments are an opportunity for fraud, MiSDU should implement a process to monitor the postings or amend the contract to require the service provider to review these postings.

f.   Require the service provider to submit its liability insurance coverage and bond for its employees and couriers to MiSDU annually so MiSDU can ascertain whether the State is fully protected against claims which may arise out of, or result from, the service provider's performance of services.

g.   Require the service provider to change its procedures for identifying related cases of its employees. The contract requires the service provider to monitor any and all employees who are a party to a restricted child support case. The service provider solely relies on disclosure by the employee of related cases. A change to the procedures would help reduce the risk that the service provider's employees could post child support payments intended for other cases to their own cases or to cases in which they had a personal interest.

h.   Conduct a periodic review of changes made to the service provider's software. The service provider's procedures require that only software builds* are put into escrow. However, the contract does not limit what changes are

*See glossary at end of report for definition.

required for escrow and does not require only software builds to be escrowed. A periodic review of the service provider's procedures to escrow software and analysis of the changes that the service provider makes to the software would help to reduce the risk that MiSDU would not have the most recent version of software to continue operations in the case of an emergency or other event.

i.   Monitor the collateral balances of MiSDU to ensure that its service provider complies with the contract to retain sufficient collateral. The contract requires that the service provider have sufficient collateral to cover funds deposited in the MiSDU bank account, to be held in the name of the Michigan Department of Treasury at the Federal Reserve. Monitoring of the collateral balances by MiSDU would help MiSDU to ensure that the risk of the service provider defaulting on contractual obligations is minimized.

RECOMMENDATION

We recommend that MiSDU improve the effectiveness of its efforts in monitoring its service provider.

AGENCY PRELIMINARY RESPONSE

MiSDU agrees with parts a., d., f., h., and i. of the finding and partially agrees with parts b., c., e., and g.

Part a.   MiSDU agrees.

Part b.   MiSDU partially agrees. MiSDU believes that an adequate segregation of duties was in place through the role grid and flex grid. MiSDU agrees that improvement is beneficial and has established an additional process for Kids 1st access. MiSDU informed us that it developed specific forms for application and network access requests which were implemented on December 14, 2008. In addition, MiSDU informed us that it will be performing quarterly reviews of flex and role grids and Kids 1st access beginning November 1, 2009 to further ensure that the appropriate segregation of duties is maintained.

Part c.   MiSDU partially agrees. MiSDU believes that State resources are protected due to the significant oversampling which currently exists (98% confidence rather than the 95% stipulated by the contract in

particular) for receipts exposed to sampling. Moreover, each day 250 - 900 additional payments are sampled from the previous day's processing when quality assurance tests items listed on the pull and derog reports. Derog is a system alert in the Kids 1st processing application that informs the processors of special instructions (non-sufficient funds, stop payment, etc.) in handling specific payments, based on case information such as docket, social security number, member identification, check routing, or account numbers. Additional items are tested on the Recon and Research reports. Staff are held accountable for errors made via a progressive notification and disciplinary process for identifying employees who have committed payment errors as noted during and after quality assurance sampling. However, MiSDU agrees that process improvement is important. MiSDU informed us that it implemented an additional daily quality assurance sample of receipts. This sample will be taken as late as possible during production. MiSDU recognizes that this may not include all receipts, but it will increase the number exposed to sampling while leaving adequate time in the processing day to correct any errors and meet other contractual requirements. The later sample time coupled with other quality assurance activities already in place should ensure that all receipts have a reasonable chance of being included in some part of the quality assurance process.

Part d. MiSDU agrees. MiSDU informed us that it established criteria to be used as a basis for reporting critical errors in quality assurance reviews. Critical errors are defined as:

- Wrong payer or noncustodial parent and wrong amounts.

- Wrong docket or IV-D case; wrong amounts.

- Posting through a posting instruction or non-sufficient fund derog; if a negative effect on payment distribution.

- Posting total check to one noncustodial parent instead of multiple noncustodial parents.

- Posting to wrong member ID.

- Wrong payment source when posting Obligor payment as employer - delays payment.

- Posting replacement/recoupment/return/refund checks - causing negative impact to distribution of funds.

Part e.   MiSDU partially agrees. MiSDU agrees that the implementation of a process to monitor payments posted from MiCSES suspense reduces the risk of fraud. However, MiSDU lacks the real time knowledge to sample payments posted from MiCSES suspense related to cases resolved by the Friend of the Court. Therefore, the ability of MiSDU to mitigate the risk of fraud in this instance is limited to the extent that total payments posted out of MiCSES suspense are performed by employees of the service provider. MiSDU and its vendor implemented a process effective June 1, 2009 to sample payments posted out of MiCSES UNID and UIRE holdcodes, using an Info Trac spreadsheet. These samples are compared to the listing of disclosed cases to ensure that they have not been posted to an employee's disclosed case. The sample size is up to 75 per day, which appears more than adequate given the normal size of the suspense account. In addition, this process has been added as a new control activity to the 2009 SAS 70 audit. Quality assurance will sample only those items posted by the service vendor.

Part f.   MiSDU agrees. MiSDU now requires the vendor to submit verification of its liability insurance on an annual basis.

Part g.   MiSDU partially agrees. MiSDU agrees with the concept of increased monitoring of employees posting payments to related cases. However, in compliance with the contract, MiCSES requirements, and policy, all vendor employees are required to complete the DHS-428, MiCSES Child Support Case Disclosure Form. When completing this form, employees are notified of disciplinary action if this form is not completed accurately. This form is utilized by supervisory personnel in their review of processing activity to identify inappropriate postings by staff who have identified a conflict of interest. MiSDU believes that further investigation of related cases beyond what is disclosed on the DHS-428 is a random search of confidential IV-D information, which is prohibited by policy. The Bureau of

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Child Support, Department of Human Services, is evaluating the feasibility of performing data matches using the data from MiCSES (including the names of workers releasing payments). It is hoped that a means of determining improper releases might be possible. This may also assist with controlling the risk cited in part e. of the finding. Several queries have been attempted so far with little success. The evaluation will continue for a period of time deemed adequate to determine if this can be accomplished with existing resources.

Part h.   MiSDU agrees. MiSDU informed us that it developed a monitoring process that does not depend on the difference between builds and patches as with the old process. Each change will receive an identifying number and be tracked on a log. The service provider and MiSDU staff will jointly determine if the build or patch is significant (in which case it will be escrowed immediately) or minor (in which case it will be escrowed later in combination with other builds or patches). With MiSDU approval noted on the log, MiSDU will be able to better monitor and ensure that past patches not escrowed immediately are picked up in later escrow activities.

Part i.   MiSDU agrees. MiSDU informed us that it implemented a procedure whereby the financial specialist monitors collateral quarterly and provides to the MiSDU director a review of the past quarter and a projection of the upcoming quarter. The MiSDU director will use this information, plus other economic factors as necessary, to determine if further steps need to be taken.

GLOSSARY

child support order	A written court order that provides for the periodic payment of money for the support of a child. Orders may also include other provisions, such as health insurance, childcare, confinement expenses, custody, and parenting time.
critical error	Misapplied payments that directly affect the proper disbursement of dollars to the proper recipient and include delayed payments as well as funds distributed to incorrect custodial parents.
DHS	Department of Human Services.
effectiveness	Program success in achieving mission and goals.
Kids 1st	An application used to process remittances by MiSDU.
make whole account	Monies used to fund reposting of receipts that have been backed out after disbursement has been made to the child support recipient.
Michigan State Disbursement Unit (MiSDU)	The centralized collection, processing, and disbursement unit for child support payments in Michigan.
MiCSES	Michigan Child Support Enforcement System.
noncustodial parent	The parent who does not have primary care, custody, or control of a child and has an obligation to pay child support.
Office of Child Support	The designated Title IV-D child support agency in the State of Michigan.

Office of Child Support Enforcement	The agency within the U.S. Department of Health and Human Services that is responsible for implementing the child support program.
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.
SAS 70 report	Statement on Auditing Standards No. 70. SAS No. 70 provides guidance for independent auditors who issue reports on the processing of transactions by a service organization for use by other auditors. There are two types of SAS 70 reports. A "report on controls placed in operation" contains a description of the service organization's controls that may be relevant to a user of the service organization's internal control. A "report on controls placed in operation and tests of operating effectiveness" states whether controls were suitably designed to achieve specified control objectives, whether they had been placed in operation as of a specific date, and whether the controls that were tested were operating with sufficient effectiveness.
software build	A build that significantly changes the functionality of the software.

suspense accounts	Accounts that hold payments that need additional research before they can be distributed or escheated.
suspense hold codes	Codes in the suspense accounts used to identify the case conditions.
Title IV-D	Refers to Title IV-D of the federal Social Security Act, which requires that each state create a program to locate noncustodial parents, establish paternity, establish and enforce child support obligations, and collect and distribute support payments. All recipients of public assistance (Title IV-A or Temporary Assistance for Needy Families cases) are referred to their respective state's Title IV-D child support program.
unidentified child support remittances	Child support remittances in the MiCSES suspense accounts with missing or incomplete case information and missing or incomplete remitter information. MiSDU researches these payments and determines one of the following outcomes:

- When sufficient case information is obtained, the child support payment is processed.

- When sufficient remitter information is obtained, the remitter is contacted to obtain additional case information for processing or the child support remittance is returned to the remitter.

- When sufficient case and remitter information is not obtained, the payment remains in the MiCSES suspense accounts to be escheated.