MICHIGAN

OFFICE OF THE AUDITOR GENERAL

MANAGEMENT LETTER

STATE OF MICHIGAN
COMPREHENSIVE ANNUAL FINANCIAL REPORT

STATE BUDGET OFFICE
DEPARTMENT OF TECHNOLOGY, MANAGEMENT, AND BUDGET

Fiscal Year 2010-11

E PLURIBUS UNUM
TUEBOR
SI QUÆRIS PENINSULAM AMŒNAM
CIRCUMSPICE

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

071-0010-12

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

Management Letter

State of Michigan Comprehensive Annual Financial Report

State Budget Office

Department of Technology, Management, and Budget

Report Number:
071-0010-12

Released:
May 2012

Generally accepted auditing standards require that significant deficiencies that come to the auditor's attention during the audit be reported. This management letter is the result of such items coming to our attention during the audit of the fiscal year 2010-11 State of Michigan Comprehensive Annual Financial Report (SOMCAFR), *which resulted in an unqualified opinion on the financial statements of the governmental activities, the business-type activities, the aggregate discretely presented component units, each major fund, and the aggregate remaining fund information of the State of Michigan.*

Significant Deficiencies:

Medicaid Accrual

The Department of Community Health (DCH) and the Office of Financial Management (OFM), within the Department of Technology, Management, and Budget (DTMB), did not have sufficient internal control in place to prevent, or detect and correct, misstatements and ensure the accuracy of the Medicaid accrual (Finding 1).

Tax Accruals

OFM, in conjunction with other State departments, did not have sufficient internal control in place to prevent, or detect and correct, misstatements and ensure the accuracy of the tax accruals (Finding 2).

Capital Assets

OFM, in conjunction with other State departments, did not have sufficient internal control in place to ensure that all capital assets were properly accounted for and reported in accordance with generally accepted accounting principles and the State of Michigan Financial Management Guide (FMG) (Finding 3).

Oversight of Accrual Methodologies

OFM, in conjunction with DCH, did not ensure that accrual methodologies submitted to OFM were appropriately revised, approved, and followed (Finding 4).

Agency Response:

Our management letter includes 4 findings and 4 corresponding recommendations.

~ ~ ~ ~ ~ ~ ~ ~ ~ ~

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

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 11, 2012

John E. Nixon, C.P.A., State Budget Director
State Budget Office
Department of Technology, Management, and Budget
George W. Romney Building
Lansing, Michigan

Dear Mr. Nixon:

In planning and performing our audit of the basic financial statements of the State of Michigan principally as of and for the fiscal year ended September 30, 2011, in accordance with auditing standards generally accepted in the United States of America, we considered the Statewide internal control over financial reporting (internal control) as a basis for designing our auditing procedures for the purpose of expressing our opinions on the financial statements, but not for the purpose of expressing an opinion on the effectiveness of the Statewide internal control. Accordingly, we do not express an opinion on the effectiveness of the Statewide internal control.

A deficiency in internal control 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 and correct, misstatements on a timely basis. A material weakness is a deficiency, or a combination of deficiencies, in internal control such that there is a reasonable possibility that a material misstatement of the entity's financial statements will not be prevented, or detected and corrected, on a timely basis.

Our consideration of internal control was for the limited purpose described in the first paragraph and would not necessarily identify all deficiencies in internal control that might be deficiencies, significant deficiencies, or material weaknesses. We did not identify any deficiencies in internal control that we consider to be material weaknesses as defined in the preceding paragraph. However, we identified certain deficiencies in internal control, as described in Findings 1 through 4, that we consider to be significant deficiencies. A significant deficiency is a deficiency, or a combination of deficiencies, in internal control that is less severe than a material weakness, yet important enough to merit attention by those charged with governance.

Certain findings included in this management letter specifically relate to other departments. Although the Office of Financial Management, State Budget Office, Department of Technology, Management, and Budget, may not be directly responsible for these functions, we have addressed these findings to you for corrective action, consistent with your Department's responsibility for financial accounting and reporting under Sections 18.1141 and 18.1421 of the *Michigan Compiled Laws*. The Department's written response to the significant deficiencies identified in our audit has not been subjected to the auditing procedures applied in the audit of the financial statements and, accordingly, we express no opinion on it.

This management letter is intended solely for the information and use of the State's management and the Legislature and is not intended to be and should not be used by anyone other than these specified parties. However, this management letter is a matter of public record and its distribution is not limited.

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

Sincerely,

Thomas H. McTavish

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

TABLE OF CONTENTS

MANAGEMENT LETTER

STATE OF MICHIGAN COMPREHENSIVE ANNUAL FINANCIAL REPORT

STATE BUDGET OFFICE

DEPARTMENT OF TECHNOLOGY, MANAGEMENT, AND BUDGET

Fiscal Year 2010-11
Findings, Recommendations, and
Agency Preliminary Responses

This section contains 4 new and rewritten findings and 4 corresponding recommendations identified in our fiscal year 2010-11 *State of Michigan Comprehensive Annual Financial Report* (*SOMCAFR*) audit.

FINDING

1. Medicaid Accrual

The Department of Community Health (DCH) and the Office of Financial Management (OFM), within the Department of Technology, Management, and Budget (DTMB), did not have sufficient internal control* in place to prevent, or detect and correct, misstatements and ensure the accuracy of the Medicaid accrual.

The internal control did not prevent or detect multiple misstatements, resulting in net overstatements of $7.0 million in assets and $15.0 million in liabilities and net understatements of $8.0 million in fund balance/net assets, $53.6 million in revenues, and $45.6 million in expenditures/expenses in the General Fund financial statements and in the governmental activities of the government-wide financial statements. Subsequent to our review and prior to the issuance of the *SOMCAFR*, DCH, in conjunction with OFM, recorded adjusting entries to correct most of the misstatements. Although OFM made the correcting entries and the financial statements were materially correct, the internal control weaknesses should be corrected to help ensure the accuracy of the Medicaid accrual.

Section 18.1141 of the *Michigan Compiled Laws* (Section 141, Act 431, P.A. 1984, as amended) provides that DTMB shall establish a comprehensive system of internal controls in the management of the State's financial affairs and record transactions in accordance with generally accepted accounting principles* .

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

Section 18.1485 of the *Michigan Compiled Laws* (Section 485, Act 431, P.A. 1984, as amended) provides that the department head of each principal department shall establish and maintain an internal accounting and administrative control system within that principal department using generally accepted accounting principles and in conformance with directives issued pursuant to section 141(d).

Section 1600.106 of the *Codification of Governmental Accounting and Financial Reporting Standards* (Codification), published by the Governmental Accounting Standards Board* (GASB), states that revenues and other governmental fund financial resource increments are recognized in the accounting period in which they become susceptible to accrual. GASB Codification Section 1600.116 states that most expenditures and transfers out are measurable and should be reported when the related liability is incurred.

The Medical Assistance Program (Medicaid) provides medical assistance to individuals and families who meet the Medicaid financial and nonfinancial eligibility factors. The goal of the Medicaid program is to ensure that essential healthcare services are made available to those who would otherwise not have financial resources to purchase them. The Medicaid year-end accruals represent an estimate of the State's liability for those medical services provided to eligible recipients during the fiscal year for which claims have yet to be submitted and/or approved for payment.

We issued a total of 12 audit memorandums related to the Medicaid accrual. Following are four examples of the significant or recurring misstatements and internal control weaknesses noted during our review of the Medicaid accrual:

a. DCH and OFM did not properly estimate the payable and receivable for the full cost school based services component of the Medicaid accrual. As a result, assets were understated by $10.0 million, liabilities were understated by $4.7 million, fund balance/net assets were understated by $5.4 million, revenue was understated by $13.4 million, and expenditures/expenses were understated by $8.0 million.

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

The School Based Services Program reimburses intermediate school districts (ISDs) for Medicaid costs. The State retains 40% of the amount that is federally reimbursed and pays the ISD the remaining 60%. DCH has an approved methodology for accruing the payable and receivable for School Based Services rendered through the fiscal year-end. Using this method, the difference between what DCH expects to pay ISDs for their services and what DCH has already paid is determined. The difference is recorded as the payable and receivable to or from the ISDs. In addition to the federal receivable recorded for the amount due to the ISDs, a federal receivable for the additional 40% that is retained by the State is also recorded.

During our review, we noted that the proper amount paid to the ISDs was not included in the accrual calculation. Payments that occurred during August 2011 were included twice when calculating the total amount already paid. DCH noted the error during its review and recalculated the proper accrual amount; however, an adjusting entry was not posted to the Michigan Administrative Information Network* (MAIN) at that time. Subsequent to our review and prior to the issuance of the *SOMCAFR*, DCH, in conjunction with OFM, recorded adjusting entries to correct the misstatements.

b. DCH and OFM did not properly estimate the payable and receivable for the long term care (LTC) Medicaid Interim Payment (MIP) Program reconciliations component of the Medicaid accrual. During our review, we noted that the spreadsheet used to support the accrual amounts did not properly accumulate the total MIP payable and receivable for the LTC providers because of formula errors. As a result, assets were overstated by $3.5 million, liabilities were overstated by $2.2 million, fund balance/net assets were overstated by $1.3 million, revenue was understated by $2.5 million, and expenditures/expenses were understated by $3.7 million. Subsequent to our review and prior to the issuance of the *SOMCAFR*, DCH, in conjunction with OFM, recorded adjusting entries to correct the misstatements.

c. DCH and OFM did not properly estimate the payable and receivable for the inpatient hospital capital cost component of the Medicaid accrual. During our review, we noted that the methodology used did not include an accrued liability

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

for all inpatient hospital capital costs incurred. As a result, assets were understated by $4.4 million, liabilities were understated by $6.6 million, fund balance/net assets were overstated by $2.2 million, revenue was understated by $4.4 million, and expenditures/expenses were understated by $6.6 million.

Capital costs to Medicaid are the result of sharing in capital type expenses related to buildings, equipment, etc., with inpatient hospitals that serve Medicaid recipients. The initial reimbursement for capital projects is paid by capital interim payments (CIPs). CIPs are made using a semimonthly schedule (24 payments per year). The CIP amount is set using the most recent available cost data, which includes hospital utilization information and an estimated impact of applicable limits on capital costs. The exact amount of capital costs are not known until the provider's cost report is received. This cost report is received five months after the close of the provider's fiscal year. The inpatient hospital capital cost component of the Medicaid accrual estimates the outstanding year-end accrual (receivable or liability) for capital outlay for the portion of the Medicaid population using hospital services on a fee-for-service basis. The capital amount is calculated by subtracting CIPs made to the hospital from the hospital's total capital cost reported amount.

During our review of the accrual, we noted that the latest inpatient hospital year included in the fiscal year 2010-11 accrual ended December 31, 2010. Depending on each inpatient hospital's year-end date, there are 9 to 18 months for which DCH and OFM did not accrue liabilities or receivables related to inpatient hospital capital costs.

We initially identified this issue during the prior audit. At that time, DCH and OFM informed us that they did not believe that there was an alternate estimation method that would be consistently reliable or cost effective.

d. DCH and OFM did not have sufficient procedures in place to ensure that prior accounting estimates were compared with subsequent actual activity to assess the reliability of the established accrual methodologies. For 10 (91%) of 11 components that we reviewed, a comparison was not completed or it did not compare prior year estimates to subsequent actual activity. As a result, DCH and OFM could not ensure the reasonableness of established accrual methodologies that resulted in accrued payables of $1.1 billion and accrued receivables of $295.6 million for fiscal year 2010-11.

In addition, for the provider pipeline component, in which DCH did compare the prior year estimates to subsequent actual activity, there was no documented support for significant variations between the estimate and subsequent actual activity and there was no documented rationale to support why a change in methodology was not warranted.

Effective internal control over the Medicaid accrual should include a comparison of prior accounting estimates with subsequent activity to assess the reliability of the process used to develop the estimates.

We initially identified this issue during the prior audit. At that time, OFM informed us that it would evaluate its processes for reviewing and monitoring accrual methodologies and adjust them as needed to ensure that the methodologies provide reliable estimates.

RECOMMENDATION

We recommend that DCH and OFM improve internal control to prevent, or detect and correct, misstatements and ensure the accuracy of the Medicaid accrual.

AGENCY PRELIMINARY RESPONSE

DCH and OFM agree with the recommendation. OFM informed us that, in those instances where DCH and OFM agreed with the audit memorandum and made corrections, they will strive to improve internal control to prevent the occurrence of similar errors in the future.

However, OFM informed us that DCH and OFM continue to disagree with the suggested change to the estimation methodology regarding the inpatient hospital capital cost component. OFM stated that the existing methodology provides a reliable estimate of the liability and that they are not convinced of the need to change.

In addition, OFM informed us that DCH and OFM disagree with the position that procedures were not in place to compare prior year estimates to actual activity and indicated that most of the methodologies include tracking procedures. DCH and OFM will strive to improve formalized documentation of these validation processes. For those components where methodologies do not include tracking procedures, DCH and OFM will assess and implement changes where appropriate and cost beneficial.

FINDING

2. Tax Accruals

OFM, in conjunction with other State departments, did not have sufficient internal control in place to prevent, or detect and correct, misstatements and ensure the accuracy of the tax accruals.

The lack of internal control resulted in the following misstatements:

	Net Misstatement (in millions)
General Fund:	
Assets	Overstated $36.2
Liabilities	Overstated $19.4
Revenues	Overstated $16.8
Fund Balance	Overstated $16.8
School Aid Fund:	
Assets	Overstated $33.0
Liabilities	Overstated $33.0
Michigan Transportation Fund:	
Assets	Overstated $6.1
Liabilities	Overstated $1.7
Fund Balance	Overstated $4.4
Governmental Activities of the Government-wide Financial Statements:	
Assets	Overstated $75.3
Liabilities	Understated $13.2
Revenues	Overstated $88.5
Net Assets	Overstated $88.5

Subsequent to our review and prior to the issuance of the *SOMCAFR*, the Department of Treasury, in conjunction with OFM, recorded adjusting entries to correct most of the misstatements. Although OFM made the correcting entries and the financial statements were materially correct, the internal control weaknesses should be corrected to help ensure the accuracy of the tax accruals.

Section 18.1141 of the *Michigan Compiled Laws* (Section 141, Act 431, P.A. 1984, as amended) provides that DTMB shall establish a comprehensive system of internal controls in the management of the State's financial affairs and record transactions in accordance with generally accepted accounting principles.

Section 18.1485 of the *Michigan Compiled Laws* (Section 485, Act 431, P.A. 1984, as amended) provides that the department head of each principal department shall establish and maintain an internal accounting and administrative control system within that principal department using generally accepted accounting principles and in conformance with directives issued pursuant to section 141(d).

GASB Codification Section 1600.106 states that revenues and other governmental fund financial resource increments are recognized in the accounting period in which they become susceptible to accrual. GASB Codification Section 1600.116 states that most expenditures and transfers out are measurable and should be reported when the related liability is incurred.

We issued a total of 11 audit memorandums related to tax accruals. Following are three examples of the significant or recurring misstatements and internal control weaknesses noted during our review of the tax accruals:

a. The Department of Treasury and OFM did not properly calculate and record the full accrual tax entries. The Department prepares the GASB 34 Report annually, which contains estimates of the revenues expected to be received in future years and describes the methodology used in developing the estimates. The estimates are then used to support the development of the full accrual financial statements. The Department mistakenly prepared the fiscal year 2010-11 GASB 34 Report using fiscal year 2009-10 instead of fiscal year 2010-11 60-day receivable amounts. Using the GASB 34 Report prepared by the Department, OFM recorded a series of transactions to adjust the tax accrual to the fiscal year 2010-11 ending balance for the government-wide and fund-level financial statements. In addition, when reversing prior year taxes received during fiscal year 2010-11, OFM did not use the same reversal percentages as contained in the final GASB 34 Report. As a result, current assets and deferred revenue were overstated by $34.0 million in the General Fund financial statements and by $33.0 million in the School Aid Fund financial statements. In addition, current assets, revenues, and net assets were overstated by $67.0 million in the governmental activities of the government-wide financial statements. When we brought these errors to their attention, the Department prepared a new fiscal year 2010-11 GASB 34 Report using current year 60-day receivable amounts and OFM processed the necessary correcting entries.

b. The Department of Treasury and OFM did not properly calculate the liability related to unprocessed Michigan Business Tax (MBT) returns claiming a refund. As a result, we estimated that payables were understated and revenues and fund balance/net assets were overstated by $10.7 million with a potential for an additional misstatement of up to $25.8 million in the General Fund and the governmental activities of the government-wide financial statements.

The MBT liability for unprocessed returns was calculated using reports from the automated MBT system. The reports were intended to identify all unprocessed refund returns received by November 30, 2011. In accordance with the current financial resources measurement focus and modified accrual basis of accounting, these unprocessed returns received through November 30 are recognized as a liability and a reduction to tax revenue. In order to validate the reports and the corresponding liability/revenue reduction amounts used, we obtained and analyzed applicable MBT return data from the State's data warehouse. A comparison between our analysis and the reports used in the accrual identified a total difference of $41.5 million.

Examination of this difference identified instances in which the taxpayers filed amended returns. However, the program logic used to create the reports captured the refund amount from the original tax return instead of the refund amount claimed on the amended return. The use of the original return amount could result in two types of miscalculations. The first applies to the situation in which the original return did not claim a refund, but the amended return does. In this situation, the report would not include any of the refund amounts in the calculation of the liability. The second type of miscalculation occurs when the original return claimed a refund amount, but a different refund amount was claimed on the amended return. In this situation, the report would include the incorrect refund amount leading to the liability being either overstated or understated, depending on whether the claimed refund amount decreased or increased.

To substantiate the impact of the miscalculations, we selected the six largest amended returns for taxpayers that were not included in the report used to calculate the accrual but that were included in our analysis. Our review of both the original and amended returns disclosed that, for 4 (67%) of the 6 taxpayers, the original return did not include a refund and the amended return did. As a result, the report used to calculate the accrual was understated by $10.7 million for these 4 taxpayers. The remaining 2 taxpayers, whose refunds totaled $5.0 million, were appropriately excluded from the report. Because of timing differences between when the reports were pulled and when we obtained our data to audit, we were unable to determine the exact amount of the misstatement and estimate that payables were understated and revenues and fund balance/net assets were overstated by $10.7 million with a potential for an additional misstatement of up to $25.8 million. Subsequent to our review and prior to issuance of the *SOMCAFR*, the Department of Treasury, in conjunction with OFM, recorded adjusting entries to correct the $10.7 million misstatement.

c. The Department of Treasury and OFM did not ensure that they consistently applied the methodology related to the use of Single Business Tax (SBT) and MBT historical data to estimate MBT receivables. As a result, assets were overstated by $3.6 million, liabilities were overstated by $0.3 million, and revenues and fund balance were overstated by $3.3 million in the General Fund and assets, revenues, and net assets were overstated by $3.6 million in the governmental activities of the government-wide financial statements.

The Department of Treasury and OFM decided that they would not recognize a full accrual receivable for MBT revenue because historical data was not available to calculate a reasonable estimate. Their position paper on the issue concluded that SBT and MBT have significant differences and independent MBT estimates would not be measurable until fiscal year 2011-12 when additional historical data is available. However, in the calculation of the 60-day accrual, the Department and OFM used historical SBT and MBT collectibility percentages to estimate various components of the MBT receivable. Subsequent to our review and prior to issuance of the *SOMCAFR*, the Department, in conjunction with OFM, recorded adjusting entries to correct the misstatements.

We initially identified this issue during the fiscal year 2008-09 *SOMCAFR* audit. In response to the prior audit management letter, the Department of Treasury and OFM informed us that they would take steps to ensure that the approved methodology is consistently applied.

RECOMMENDATION

We recommend that OFM, in conjunction with other State departments, improve internal control to prevent, or detect and correct, misstatements and ensure the accuracy of the tax accruals.

AGENCY PRELIMINARY RESPONSE

OFM and the other State departments agree with the recommendation. In those instances where OFM and the other State departments agreed with the audit memorandum and made corrections, processing improvements will be implemented to prevent the occurrence of similar errors in the future.

OFM stated that some of the audit memorandums related to tax accruals resulted from differences of opinion regarding accrual methodologies. In those instances, OFM will evaluate the existing accrual methodology and adjust them, if needed.

FINDING

3. Capital Assets

OFM, in conjunction with other State departments, did not have sufficient internal control in place to ensure that all capital assets were properly accounted for and reported in accordance with generally accepted accounting principles and the State of Michigan Financial Management Guide (FMG).

The internal control did not detect or prevent multiple misstatements, resulting in net overstatements of $263.2 million in expenses and net understatements of $263.2 million in assets and net assets in the governmental activities of the government-wide financial statements. Subsequent to our review and prior to the issuance of the *SOMCAFR*, OFM, in conjunction with other State agencies, recorded adjusting entries to correct most of the misstatements. Although OFM made the correcting entries and the financial statements were materially correct, the internal control weaknesses should be corrected to help ensure the accuracy of the capital assets reported.

Section 18.1141 of the *Michigan Compiled Laws* (Section 141, Act 431, P.A. 1984, as amended) provides that DTMB shall establish a comprehensive system of internal controls in the management of the State's financial affairs and record transactions in accordance with generally accepted accounting principles.

Section 18.1485 of the *Michigan Compiled Laws* (Section 485, Act 431, P.A. 1984, as amended) provides that the department head of each principal department shall establish and maintain an internal accounting and administrative control system within that principal department using generally accepted accounting principles and in conformance with directives issued pursuant to section 141(d).

GASB Codification Section 1400 provides accounting guidance for reporting capital assets. The FMG (Part II, Chapter 21) provides State agencies with guidance on the accounting for and reporting of capital assets.

We issued a total of 5 audit memorandums related to capital assets. Following are three examples of the significant misstatements and internal control weaknesses noted during our review of capital assets:

a. The Michigan Department of Transportation (MDOT) and OFM did not properly record expenditures as capital assets. As a result, capital assets and net assets were understated by $255.3 million and expenses were overstated by $255.3 million in the governmental activities of the government-wide financial statements.

   In fiscal year 2009-10, MDOT re-evaluated its assessment of whether the expenditures associated with certain project categories that were not being capitalized should be capitalized. MDOT determined that the expenditures were for road and bridge reconstruction projects that increased the efficiency and/or capacity of the road or bridge and should be capitalized. Expenditures associated with these projects that were incurred in fiscal years 2009-10 and 2010-11 were appropriately capitalized as construction in progress and transferred to the final asset (infrastructure and/or land) as the project was completed. In addition, for projects completed in fiscal years 2009-10 and 2010-11, MDOT identified the expenditures incurred for these projects prior to fiscal year 2009-10 and the costs were included in the total final asset amount.

   However, the expenditures related to these categories of projects completed prior to fiscal year 2009-10 were not identified and capitalized. Also, instead of capitalizing the expenditures incurred prior to fiscal year 2009-10 for ongoing projects as construction in progress, MDOT and OFM determined that they would wait until the projects were complete before identifying the appropriate amount of expenditures that should be capitalized. Subsequent to our review and prior to the issuance of the *SOMCAFR*, MDOT, in conjunction with OFM, recorded adjusting entries to correct the misstatements.

b. The Department of State and OFM did not properly record computer software development expenditures as capital assets. We noted that the Department of State did not include on its year-end capital asset reporting form that was submitted to OFM $2.9 million and $1.9 million of expenditures related to the Business Application Modernization project for fiscal years 2009-10 and

2010-11, respectively. As a result, OFM did not record the necessary entries, resulting in capital assets and net assets being understated and expenses overstated by $4.8 million in the governmental activities of the government-wide financial statements.

c. OFM did not properly record adjustments for impaired capital assets. The Department of Human Services reported a capital asset impairment to OFM on the applicable year-end reporting form; however, OFM did not record the impairment in the accounting records. As a result, assets and net assets were overstated and expenses were understated by $2.0 million in the governmental activities of the government-wide financial statements.

RECOMMENDATION

We recommend that OFM, in conjunction with other State departments, improve internal control to ensure that all capital assets are properly accounted for and reported in accordance with generally accepted accounting principles and the FMG.

AGENCY PRELIMINARY RESPONSE

OFM agrees with the recommendation. OFM informed us that current policies and procedures contain the necessary guidance to address the issues noted in the finding. OFM, in conjunction with other State departments, will strive to improve communication and coordination to facilitate the accurate reporting of capital asset information.

FINDING

4. Oversight of Accrual Methodologies

OFM, in conjunction with DCH, did not ensure that accrual methodologies submitted to OFM were appropriately revised, approved, and followed.

The FMG (Part II, Chapter 11, Section 100 and Part II, Chapter 14 Section 100) provides that new estimation methodologies that are material in nature or represent a significant change from the prior methodology require prior OFM approval.

During our review, we noted that the methodology submitted by DCH and approved by OFM for the new electronic health record incentive payments component of the Medicaid accrual was incomplete and did not include enough information to accurately understand and evaluate the planned methodology. As a result, receivables and liabilities were understated by $4.5 million for the electronic health record incentive payments for hospitals and receivables and liabilities were overstated by $4.1 million for electronic health record incentive payments for professionals. Subsequent to our review and prior to the issuance of the *SOMCAFR*, OFM, in conjunction with DCH, recorded adjusting entries to correct these misstatements.

In addition, we noted that DCH did not submit its revised accrual methodology related to the Michigan AIDS Drug Assistance Program receivable to OFM for approval. Although we determined that the resulting $4.0 million increase in the receivable was reasonable, future unapproved deviations from the established and approved accrual methodology increase the likelihood of a misstatement.

RECOMMENDATION

We recommend that OFM, in conjunction with DCH, ensure that accrual methodologies are appropriately revised, approved, and followed.

AGENCY PRELIMINARY RESPONSE

OFM and DCH agree with the recommendation and will comply.

Fiscal Year 2009-10 Management Letter Follow-Up

In the follow-up of our fiscal year 2009-10 *SOMCAFR* management letter, we noted that OFM and State agencies had complied with 7 of the 13 recommendations. Of the other 6 recommendations, 4 were rewritten in the previous section (Findings 1 and 2), 1 is no longer applicable, and 1 was changed to a verbal comment.

AIDS	acquired immune deficiency syndrome.
CIP	capital interim payment.
Codification	*Codification of Governmental Accounting and Financial Reporting Standards.*
DCH	Department of Community Health.
deficiency in internal control	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 and correct, misstatements on a timely basis.
DTMB	Department of Technology, Management, and Budget.
FMG	Financial Management Guide.
generally accepted accounting principles	A technical accounting term that encompasses the conventions, rules, guidelines, and procedures necessary to define accepted accounting practice at a particular time; also cited as "accounting principles generally accepted in the United States of America."
Governmental Accounting Standards Board (GASB)	An arm of the Financial Accounting Foundation established to promulgate standards of financial accounting and reporting with respect to activities and transactions of state and local government entities.

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.
ISD	intermediate school district.
LTC	long term care.
material misstatement	A misstatement in the financial statements that causes the 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 weakness	A deficiency, or a combination of deficiencies, in internal control such that there is a reasonable possibility that a material misstatement of the financial statements will not be prevented, or detected and corrected, on a timely basis.
MBT	Michigan Business Tax.
MDOT	Michigan Department of Transportation.
Michigan Administrative Information Network	The State's automated administrative management system that supports accounting, purchasing, and other financial management activities.
MIP	Medicaid interim payment.
OFM	Office of Financial Management.
SBT	Single Business Tax.

significant deficiency — A deficiency, or a combination of deficiencies, in internal control that is less severe than a material weakness, yet important enough to merit attention by those charged with governance.

SOMCAFR — *State of Michigan Comprehensive Annual Financial Report.*

This Page Left Intentionally Blank

This Page Left Intentionally Blank

This Page Left Intentionally Blank

STATE OF MICHIGAN

OFFICE of the AUDITOR GENERAL