



# 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*

*Bureau of Commercial Services (BCS)*

*(Renamed Corporations, Securities, and Commercial Licensing Bureau)*

*Department of Licensing and Regulatory Affairs*

Report Number:  
641-0431-12

Released:  
February 2013

*BCS includes three primary divisions. The Licensing Division is responsible for licensing, registration, and certification for certain professions and occupations. The Enforcement Division is responsible for the regulation, investigation, and prosecution related to complaints filed against individuals or businesses licensed or regulated by BCS and for the performance of required inspections. The Corporation Division is responsible for facilitating the formation and development of business entities and maintains a record of documents filed by these business entities. BCS also includes the Regulatory Compliance Division and the Executive Office.*

**Audit Objective:**

To assess the effectiveness of BCS's efforts to perform statutorily required inspections.

**Audit Conclusion:**

We concluded that BCS's efforts to perform statutorily required inspections for barber colleges, schools of cosmetology, ski lifts, and carnival-amusement rides were effective. However, BCS's efforts to perform statutorily required inspections for barbershops and cosmetology shops were not effective. We noted one material condition (Finding 1).

**Material Condition:**

BCS did not perform all required inspections for barbershops and cosmetology shops (Finding 1).

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**Audit Objective:**

To assess the effectiveness of BCS's efforts to respond to complaints filed against licensees.

**Audit Conclusion:**

We concluded that BCS's efforts to respond to complaints filed against licensees regarding statutory notification and reporting requirements were effective. However, BCS's efforts to process complaints filed against licensees in a timely manner were moderately effective. We noted two reportable conditions (Findings 2 and 3).

**Reportable Conditions:**

BCS did not process complaints filed against licensees in a timely manner (Finding 2).

BCS did not fully report its regulatory activity performance in its MiScorecard (Finding 3).

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**Audit Objective:**

To assess the effectiveness of BCS's efforts to ensure that selected licenses are issued in compliance with the *Michigan Compiled Laws* and the *Michigan Administrative Code*.

**Audit Conclusion:**

We concluded that BCS's efforts to ensure that selected licenses are issued in compliance with the *Michigan Compiled Laws* and the *Michigan Administrative Code* were effective. Our audit report does not include any reportable conditions related to this audit objective.

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**Audit Objective:**

To assess the effectiveness of BCS's efforts to safeguard cash receipts.

**Audit Conclusion:**

We concluded that BCS's efforts to safeguard cash receipts were effective. However, we noted one reportable condition (Finding 4).

**Reportable Condition:**

BCS did not always have sufficient internal control over its cash receipting process (Finding 4).

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**Audit Objective:**

To assess the effectiveness of BCS's efforts to account for fees assessed by the Corporation Division.

**Audit Conclusion:**

We concluded that BCS's efforts to account for fees assessed by the Corporation Division were effective. Our audit report does not include any reportable conditions related to this audit objective.

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**Audit Objective:**

To assess the effectiveness of BCS's efforts to monitor licensees' compliance with final orders issued as a result of complaint investigations.

**Audit Conclusion:**

We concluded that BCS's efforts to monitor licensees' compliance with final orders issued as a result of complaint investigations were effective. Our audit report does not include any reportable conditions related to this audit objective.

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**Observation:**

Our analysis of BCS records and operations resulted in an observation related to the time line and status of information technology system upgrades (Observation 1).

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**Agency Response:**

Our audit report contains 4 findings and 4 corresponding recommendations. BCS's preliminary response indicates that it agrees with 2 recommendations and partially agrees with 2 recommendations.

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

February 22, 2013

Mr. Steve Arwood, Director  
Department of Licensing and Regulatory Affairs  
Ottawa Building  
Lansing, Michigan

Dear Mr. Arwood:

This is our report on the performance audit of the Bureau of Commercial Services (renamed Corporations, Securities, and Commercial Licensing Bureau), Department of Licensing and Regulatory Affairs.

This report contains our report summary; description of agency; audit objectives, scope, and methodology and agency responses and prior audit follow-up; comments, findings, recommendations, and agency preliminary responses; an observation; various exhibits, presented as supplemental information; and a glossary of acronyms and terms.

Our comments, findings, and recommendations are organized by audit objective. The agency preliminary responses were 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 plan to comply with the audit recommendations and submit it within 60 days after release of the audit report to the Office of Internal Audit Services, State Budget Office. Within 30 days of receipt, the Office of Internal Audit Services is required to review the plan and either accept the plan as final or contact the agency to take additional steps to finalize the plan.

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

Sincerely,

A handwritten signature in black ink that reads "Thomas H. McTavish". The signature is written in a cursive style with a horizontal line above the name.

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



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(RENAMED CORPORATIONS, SECURITIES, AND  
COMMERCIAL LICENSING BUREAU)  
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## Description of Agency

The mission\* of the Bureau of Commercial Services (BCS), Department of Licensing and Regulatory Affairs (LARA), is to support business growth while safeguarding Michigan's citizens through a simple, fair, efficient, and transparent regulatory structure. BCS includes three primary divisions: the Licensing Division, the Enforcement Division, and the Corporation Division. BCS also includes the Regulatory Compliance Division and the Executive Office.

The Licensing Division is responsible for the licensing, registration, and certification of individuals who engage in the practice of certain professions and occupations. The Licensing Division primarily administers the Occupational Code (Act 299, P.A. 1980, as amended) and the following acts:

- Carnival-Amusement Safety Act of 1966 (Act 225, P.A. 1966, as amended).
- Cemetery Regulation Act (Act 251, P.A. 1968, as amended).
- Forensic Polygraph Examiners Act (Act 295, P.A. 1972, as amended).
- Michigan Immigration Clerical Assistant Act (Act 161, P.A. 2004).
- Prepaid Funeral and Cemetery Sales Act (Act 255, P.A. 1986, as amended).
- Private Security Business and Security Alarm Act (Act 330, P.A. 1968, as amended).
- Professional Investigator Licensure Act (Act 285, P.A. 1965, as amended).
- Ski Area Safety Act of 1962 (Act 199, P.A. 1962, as amended).
- Michigan Unarmed Combat Regulatory Act (Act 403, P.A. 2004).
- Vehicle Protection Product Act (Act 263, P.A. 2005).

The Licensing Division had 297,179 active licensees as of May 1, 2012. A schedule of licensees by profession as of May 1, 2012 is presented as supplemental information (Exhibit 1). The Licensing Division had 40 staff as of June 30, 2012.

\* See glossary at end of report for definition.

The Enforcement Division is responsible for the regulation, investigation, and prosecution related to consumer complaints filed against individuals or businesses licensed or regulated by BCS. Also, the Enforcement Division is responsible for periodic inspections of barbershops and barber colleges, cosmetology shops and schools of cosmetology, proprietary schools, and funeral establishments and for safety inspections of ski areas and amusement parks and rides. Further, the Enforcement Division is responsible for the oversight of unarmed events (professional mixed martial arts and professional boxing) in the State.

During fiscal year 2010-11, the Enforcement Division investigated 2,562 complaints filed against individuals and businesses. It issued 415 final orders\* as a result of previously investigated complaints and assessed fines totaling \$774,501. A schedule of final orders by license type issued during fiscal year 2010-11 is presented as supplemental information (Exhibit 2). The Enforcement Division had 32 staff as of June 30, 2012.

The Corporation Division is responsible for facilitating the formation and development of business entities in Michigan. The Corporation Division maintains a record of the documents filed by these business entities and makes this information available to the public. Also, the Corporation Division is responsible for administering the following:

- Business Corporation Act (Act 284, P.A. 1972, as amended).
- Michigan Limited Liability Company Act (Act 23, P.A. 1993, as amended).
- Michigan Revised Uniform Limited Partnership Act (Act 213, P.A. 1982, as amended).
- Nonprofit Corporation Act (Act 162, P.A. 1982, as amended).
- Professional Service Corporation Act (Act 192, P.A. 1962, as amended).
- Registration of Names and Insignia Act (Act 281, P.A. 1927, as amended).
- Trademarks and Service Marks Act (Act 242, P.A. 1969, as amended).
- Individual sections of numerous other acts.

\* See glossary at end of report for definition.

The Corporation Division registered 71,669 new businesses during fiscal year 2010-11. As of August 1, 2012, the Corporation Division had 675,198 active business entities and 977,737 inactive business entities on record. A schedule of the status of Michigan business entities is presented as supplemental information (Exhibit 3). The Corporation Division had 39 staff as of June 30, 2012.

The Regulatory Compliance Division is responsible for Freedom of Information Act requests, ensures that proper representation is provided on enforcement matters for complaints, and schedules compliance conferences. The Regulatory Compliance Division director is also the Cemetery Commissioner. The Division had 13 staff as of June 30, 2012.

BCS's Executive Office houses testing and education services; licensee audits; and centralized bureau functions, such as information technology, budget, finance, and imaging. The Office had 19 staff as of June 30, 2012.

As of June 30, 2012, BCS had 143 staff. In fiscal year 2010-11, the State collected revenues totaling \$36.4 million through license fees, regulatory fees and fines, and corporation fees. BCS received \$20.0 million of the collected fees and incurred expenditures of \$16.3 million. Schedules of revenues and expenditures by fund and by license type are presented as supplemental information (Exhibits 4 and 5).

Effective November 5, 2012, Executive Order No. 2012-13 transferred all authority, powers, duties, and functions of the Securities Division within the Office of Financial and Insurance Regulation to LARA. Effective February 1, 2013, LARA renamed the Bureau of Commercial Services as the Corporations, Securities, and Commercial Licensing Bureau.

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

### Audit Objectives

Our performance audit\* of the Bureau of Commercial Services (BCS) (renamed Corporations, Securities, and Commercial Licensing Bureau), Department of Licensing and Regulatory Affairs (LARA), had the following objectives:

1. To assess the effectiveness\* of BCS's efforts to perform statutorily required inspections.
2. To assess the effectiveness of BCS's efforts to respond to complaints filed against licensees.
3. To assess the effectiveness of BCS's efforts to ensure that selected licenses are issued in compliance with the *Michigan Compiled Laws* and the *Michigan Administrative Code*.
4. To assess the effectiveness of BCS's efforts to safeguard cash receipts.
5. To assess the effectiveness of BCS's efforts to account for fees assessed by the Corporation Division.
6. To assess the effectiveness of BCS's efforts to monitor licensees' compliance with final orders issued as a result of complaint investigations.

### Audit Scope

Our audit scope was to examine the program and other records of the Bureau of Commercial 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 findings and conclusions based on our audit objectives. We believe that the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objectives. Our audit procedures, performed primarily

\* See glossary at end of report for definition.

from May through August 2012, included an examination of BCS's records and activities generally for the period October 2009 through June 2012 and a review of the information technology upgrade projects in BCS from February 2001 through August 2012.

BCS licenses and regulates certified public accountants. As of September 21, 2012, the Office of the Auditor General employed 59 certified public accountants.

As part of our audit report, we included supplemental information that relates to our audit objectives and findings (Exhibits 1 through 7). Our audit was not directed toward expressing an opinion on this information and, accordingly, we express no opinion on it.

#### Audit Methodology

We conducted a preliminary review of BCS's operations to formulate a basis for defining the audit objectives and scope. Our preliminary review included interviewing BCS staff, reviewing applicable statutes and regulations, analyzing available data and statistics, and reviewing BCS policies and procedures to obtain an understanding of BCS's operational activities.

To accomplish our first objective, we identified four areas that have statutorily required inspections upon initial issuance of a license and yearly thereafter, including barbershops and barber colleges; cosmetology shops and schools of cosmetology; ski lifts, and carnival-amusement rides. We reviewed the procedures and processes for assigning, completing, and monitoring inspections for the four identified areas. In addition, we performed selected testing of inspections completed for the four identified areas and compared the number of inspections required to be completed with the number of inspections completed.

To accomplish our second objective, we reviewed the procedures for responding to consumer complaints about licensees, including preliminary review, investigation, prosecution, sanction, and compliance. Also, we analyzed the timeliness of BCS's processing of all outstanding complaints as of June 28, 2012 and the processing of all complaints closed from October 1, 2009 through April 30, 2012.

To accomplish our third objective, we performed analytical audit procedures related to all 29 professions regulated by BCS. These procedures included review of the number

of licenses issued, prior audit findings, and the process to issue each type of license. Based on the analytical procedures performed, we judgmentally selected the following 10 professions to accomplish our audit objective: accountancy, architect, barber, carnival-amusement, cosmetology, professional engineer, real estate, real estate appraiser, residential builder, and unarmed combat commission. We then tested selected license applications for each profession and tested for compliance with statutory requirements for verification of education, experience, examination, and good moral character for the selected professions. Also, we reviewed testing services provided on behalf of BCS by contractors and evaluated BCS's oversight and monitoring of examination contractors, including the bid process. In addition, we determined whether BCS conducted the proper testing to ensure that promoters carried the proper insurance coverage required for certain professions.

To accomplish our fourth objective, we reviewed BCS's cash handling and mail opening procedures for compliance with the Department of Technology, Management, and Budget Administrative Guide. In addition, we observed BCS's cash handling process throughout our audit fieldwork.

To accomplish our fifth objective, we reviewed BCS's accounts receivable and collection processes for fees related to the Corporation Division.

To accomplish our sixth objective, we selected a random sample of final orders issued during the period October 1, 2009 through April 30, 2012, reviewed the procedures for monitoring the disposition of final orders, and determined if BCS appropriately sanctioned licensees who failed to comply with final orders within 60 days.

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 contains 4 findings and 4 corresponding recommendations. BCS's preliminary response indicates that it agrees with 2 recommendations and partially agrees with 2 recommendations.

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 LARA to develop a plan to comply with the audit recommendations and submit it within 60 days after release of the audit report to the Office of Internal Audit Services, State Budget Office. Within 30 days of receipt, the Office of Internal Audit Services is required to review the plan and either accept the plan as final or contact the agency to take additional steps to finalize the plan.

We released our prior performance audit of the Bureau of Commercial Services, Department of Consumer and Industry Services (63-431-02), in April 2003. Within the scope of this audit, we followed up 9 of the 10 prior audit recommendations. BCS complied with 6 of the prior audit recommendations. The other 3 prior audit recommendations were rewritten for inclusion in Findings 1 and 2.

COMMENTS, FINDINGS, RECOMMENDATIONS,  
AND AGENCY PRELIMINARY RESPONSES

## **EFFECTIVENESS OF EFFORTS TO PERFORM STATUTORILY REQUIRED INSPECTIONS**

### **COMMENT**

**Audit Objective:** To assess the effectiveness of the Bureau of Commercial Services' (BCS's) efforts to perform statutorily required inspections.

**Audit Conclusion:** We concluded that BCS's efforts to perform statutorily required inspections for barber colleges, schools of cosmetology, ski lifts, and carnival-amusement rides were effective. However, BCS's efforts to perform statutorily required inspections for barbershops and cosmetology shops were not effective. Our assessment disclosed one material condition\*. BCS did not perform all required inspections for barbershops and cosmetology shops (Finding 1).

### **FINDING**

#### **1. Barbershop and Cosmetology Shop Inspections**

BCS did not perform all required inspections for barbershops and cosmetology shops. As a result, BCS issued licenses to new barbershops and cosmetology shops prior to the shops satisfactorily passing an inspection. Also, BCS could not ensure that existing barbershops and cosmetology shops were continually in compliance with the Occupational Code and applicable administrative rules, including whether the personnel performing the services were properly licensed and whether the barbershops and cosmetology shops met sanitation standards.

The *Michigan Compiled Laws* requires inspections for barbershops and cosmetology shops prior to issuing the license and then annually thereafter. We tested 28 new licenses issued during our audit period within the barber and cosmetology professions to determine that the licensees fulfilled the minimum requirements for the issuance of a license. Our selection included 20 new individual, 5 new barbershop, and 3 new cosmetology shop licenses. We also performed a review of annual inspections conducted for barbershops and

\* See glossary at end of report for definition.

cosmetology shops from October 1, 2009 through June 22, 2012. Our reviews disclosed:

- a. BCS staff did not perform inspections of any of the 8 (100%) new barbershops and cosmetology shops prior to the issuance of licenses to determine if the shops were satisfactory to open and met minimum sanitation standards and facility requirements. Sections 339.1111 and 339.1204(1)(c) of the *Michigan Compiled Laws* include requirements for a new shop to satisfactorily pass an inspection prior to the issuance of the license. We determined that BCS allowed the applicants to submit a self-inspection checklist form, which was not allowed for in the *Michigan Compiled Laws*, with their completed applications to BCS. Therefore, we deemed the self-inspection checklist as not an acceptable alternative for ensuring compliance with the *Michigan Compiled Laws*.

BCS issued licenses to the 5 new barbershops and 2 of the 3 new cosmetology shops prior to conducting an initial inspection. The barbershops' licenses were issued from 178 to 466 days prior to conducting an initial inspection, and the cosmetology shops' licenses were issued from 154 to 156 days prior to conducting an initial inspection. Also, BCS issued the third cosmetology shop a license for 81 days without an inspection being completed as of July 24, 2012.

- b. BCS did not conduct 5,821 (97%) of 5,994 required inspections for 2,120 barbershops. Section 339.1113 of the *Michigan Compiled Laws* requires that BCS inspect each barbershop at least annually. Also, BCS did not conduct 31,057 (96%) of 32,281 required inspections for 11,763 cosmetology shops. Section 339.1218 of the *Michigan Compiled Laws* requires that BCS inspect each cosmetology shop at least annually.

BCS staff informed us that they have not performed all required inspections because of inadequate staffing resources. BCS staff also informed us that they have tried to prioritize available staffing resources to complete the required inspections. Our analysis of revenues and expenditures specifically related to the barber and cosmetology professions noted that BCS collected \$2.7 million of revenues in excess of expenditures from October 1, 2009 through September 30, 2011.

We noted a similar situation in our two prior audits of BCS (63-431-02 and 63-431-94). BCS indicated that it agreed with the recommendations; however, it did not initiate corrective action as it did not feel that it was appropriate for BCS to request amendatory legislation.

### **RECOMMENDATION**

We recommend that BCS perform all required inspections for barbershops and cosmetology shops or request amendatory legislation.

### **AGENCY PRELIMINARY RESPONSE**

BCS agrees that it did not perform all required inspections for barbershops and cosmetology shops. BCS provided the following additional information regarding its inspections of barbershops and cosmetology shops:

- Prior to 1990, BCS had a dedicated inspection unit that consisted of approximately 18 full-time staff. This work unit performed all mandated inspections of barbershops and cosmetology shops, barber colleges, and schools of cosmetology. Because of budgetary issues in the early 1990s, the inspection unit was abolished. Since that time, BCS has been unable to conduct the majority of the mandated inspections. Currently, BCS employs 10 regulation agents who investigate consumer complaints for the 32 occupations and conduct inspections as their complaint investigative workload permits. It is BCS's goal that an inspection program, currently in development, will bring BCS more in line with the statutory mandate. Also, BCS is considering the issuance of a temporary license until the inspection is completed. If the inspection is satisfactory, BCS would then issue a permanent license.
- Statewide, there are in excess of 12,000 barber and cosmetology establishments. This would require 18 full-time equated staff positions to conduct 3 inspections per day in order to comply with statutory requirements. Also, it would require an estimated minimum of \$2.5 million to operate such a program. Of the 32 occupations regulated by BCS, the revenue generated by 26 occupations is not sufficient to cover the cost of regulating the occupations. Therefore, the 6 occupations with revenue greater than expenditures support the regulation of the remaining 26 occupations.

## **EFFECTIVENESS OF EFFORTS TO RESPOND TO COMPLAINTS FILED AGAINST LICENSEES**

### **COMMENT**

**Audit Objective:** To assess the effectiveness of BCS's efforts to respond to complaints filed against licensees.

**Audit Conclusion:** We concluded that BCS's efforts to respond to complaints filed against licensees regarding statutory notification and reporting requirements were effective. However, BCS's efforts to process complaints filed against licensees in a timely manner were moderately effective. Our assessment disclosed two reportable conditions\* related to complaints and the MiScorecard\* Performance Summary (Findings 2 and 3).

### **FINDING**

#### **2. Complaints**

BCS did not process complaints filed against licensees in a timely manner. As a result, BCS did not timely address issues brought to its attention and determine if corrective action should have been taken to protect the public.

Sections 339.502 and 339.504 of the *Michigan Compiled Laws* describe the BCS complaint process, including the actions that the enforcement staff and the regulatory staff should take to resolve or close complaints.

BCS's complaint process includes receipt of the complaint, determination of jurisdiction, notification of receipt of the complaint, investigation of the complaint, and the issuance of either a no violation decision or the appropriate final action if a violation is noted. Also, the complaint process allows for hearings to resolve complaints. While not required by the *Michigan Compiled Laws* or the *Michigan Administrative Code*, BCS had set a performance measure to process 90% of its complaints through the investigative stage within 180 days of receipt.

We determined that there were 1,074 open complaints in BCS's licensing system as of June 28, 2012. Also, we determined that 243 of the 1,074 open complaints were in the investigative stage as of June 28, 2012. Our analysis of the

\* See glossary at end of report for definition.

243 complaints disclosed that 55 (23%) were open for longer than 180 days, ranging from 10 days to 2,783 days (over 7 years) for an average of 188 days. As BCS was 13% below its performance measure of processing 90% of complaints through the investigative stage within 180 days of receipt, we concluded that BCS did not timely process complaints.

Also, BCS had not set a performance measurement goal for processing complaints from intake to final decision. We analyzed 6,161 complaints processed by BCS from October 1, 2009 through April 30, 2012. We determined that the 6,161 processed complaints remained open from 0 days to 3,983 days (over 10 years) for an average of 306 days. Because BCS had not established a performance measure for fully completed claims, we could not effectively assess the reasonableness of a 306-day average time frame for complaint processing.

We noted a similar situation in our prior audit of BCS (63-431-02). BCS indicated that it agreed with the recommendation and that it would more closely monitor outstanding complaints.

## **RECOMMENDATION**

We recommend that BCS process complaints filed against licensees in a timely manner.

## **AGENCY PRELIMINARY RESPONSE**

BCS partially agrees. BCS agrees that it has complied with the statutory requirements regarding complaint processing. BCS also agrees that complaints need to be processed timely and informed us that it is reviewing complaint files open for an unreasonable length of time to ensure that the delay issues are addressed to eliminate such delays in the future.

BCS informed us that the Department of Licensing and Regulatory Affairs' (LARA's) Executive Office directed BCS to create three to five scorecard metrics for LARA's MiScorecard as part of the Governor's Dashboard. BCS stated that it complied with the directive, which required that the metrics be set at a level difficult to reach. BCS informed us that it set the complaint metric as it was aware that this was an area for improvement. According to BCS, since the September 30, 2011 inception of the metric, BCS has improved by approximately 30%. BCS stated that

it has improved from approximately 50% of complaints through the investigative stage in 180 days to approximately 80% of complaints through the investigative stage in 180 days.

However, BCS stated that it purposely did not set a metric from input to final decision because BCS does not have control over certain portions of the complaint process from input to final decision. For example, BCS informed us that it relinquishes control of a complaint file when it is submitted to the Michigan Administrative Hearing System for an administrative hearing.

## **FINDING**

### **3. MiScorecard Performance Summary**

BCS did not fully report its regulatory activity performance in its MiScorecard. As a result, BCS's MiScorecard did not provide users with a full understanding of its performance in meeting established goals and statutory requirements.

The Governor announced the MiScorecard initiative in the 2011 State of the State Address in which he directed the heads of the executive branch agencies to develop a scorecard to assess the State's performance in key areas. LARA's MiScorecard is intended to demonstrate its support of business growth and job creation while safeguarding Michigan's citizens through an efficient and transparent regulatory structure. BCS established performance measures for complaints and inspections that are part of the MiScorecard and reported to the Governor monthly.

Our review of BCS's MiScorecard Performance Summary and subsequent reporting of its regulatory activity disclosed:

- a. BCS did not fully define its metric for processing complaints. As a result, BCS's MiScorecard did not allow users to assess BCS's performance in achieving its established performance measure. BCS's MiScorecard metric definition was "Percent of Complaints Processed Within 180 days." However, this metric did not measure the full complaint process, including intake, investigation, and adjudication. Rather, BCS informed us that this metric measured only those complaints that moved in that quarter from the intake and investigative process to the adjudicative process within 180 days.

- b. BCS had not established a meaningful performance measure for the BCS MiScorecard related to conducting inspections. As a result, BCS's MiScorecard reporting did not provide users with a full understanding of BCS's performance in fulfilling its statutory requirements regarding inspections.

BCS's goal was to complete 90% of inspections within a 75-day performance measure. BCS's performance measure was for a BCS staff person to complete an inspection within 75 days of being assigned the inspection. BCS reported that it had completed 145 (52.7%) of 275 inspections within 75 days of assignment to a BCS staff person for the month ended June 30, 2012. However, reporting the number of days that a BCS staff person takes to complete an inspection after assignment does not correlate to the requirement for timely completion of inspections required by the *Michigan Compiled Laws*.

As reported in Finding 1, BCS did not conduct 97% of the required annual barbershop inspections and 96% of the required annual cosmetology shop inspections. In addition, BCS did not include data related to statutorily required inspections of ski lifts and carnival-amusement rides.

### **RECOMMENDATION**

We recommend that BCS fully report its regulatory activity performance in its MiScorecard.

### **AGENCY PRELIMINARY RESPONSE**

BCS partially agrees. BCS informed us that it should have been more careful in defining the metric referred to in part a. of this finding. BCS also informed us that, since the audit, it has clearly defined this metric. However, BCS stated that it purposely did not define a metric to measure the "full complaint process" because BCS does not control the "full complaint process." According to BCS, it relinquishes control during the hearing stage, which the Michigan Administrative Hearing System controls.

Regarding part b. of this finding, BCS informed us that it did not design metrics to measure the fulfillment of its statutory requirements related to inspections because BCS did not have the resources to conduct such inspections (Finding 1).

BCS also informed us that its metrics were developed to address areas within which BCS needed improvement. BCS stated that there has been improvement, but greater improvement is anticipated and expected.

**EFFECTIVENESS OF EFFORTS TO ENSURE  
SELECTED LICENSES ARE ISSUED IN COMPLIANCE WITH  
THE *MICHIGAN COMPILED LAWS* AND  
THE *MICHIGAN ADMINISTRATIVE CODE***

**COMMENT**

**Audit Objective:** To assess the effectiveness of BCS's efforts to ensure that selected licenses are issued in compliance with the *Michigan Compiled Laws* and the *Michigan Administrative Code*.

**Audit Conclusion:** We concluded that BCS's efforts to ensure that selected licenses are issued in compliance with the *Michigan Compiled Laws* and the *Michigan Administrative Code* were effective. Our audit report does not include any reportable conditions related to this audit objective.

**EFFECTIVENESS OF EFFORTS TO  
SAFEGUARD CASH RECEIPTS**

**COMMENT**

**Audit Objective:** To assess the effectiveness of BCS's efforts to safeguard cash receipts.

**Audit Conclusion:** We concluded that BCS's efforts to safeguard cash receipts were effective. However, our assessment disclosed one reportable condition related to cash receipts (Finding 4).

## **FINDING**

### **4. Cash Receipts**

BCS did not always have sufficient internal control\* over its cash receipting process. As a result, BCS could neither detect nor address errors or irregularities within its cash handling processes in a timely manner.

The State of Michigan Financial Management Guide (Part II, Chapter 9, Section 100) requires each department to establish internal control to safeguard cash receipts, including the assurance that the handling of cash and or cash records from receipt to verification of deposits is not entrusted to only one employee. These controls include opening mail in the presence of two employees, restrictively endorsing checks immediately upon receipt, and initialing the cash log by the cash openers. Treasury Bulletin BT-11003 includes the preferred method for preparing deposits for pick up by a courier.

During our audit period, BCS receipted \$3.1 million at its cashiering window. These receipts included cash, checks, and credit card payments for services performed by the Licensing Division, Enforcement Division, and Corporation Division.

Our review of BCS's cash receipts disclosed:

- a. BCS did not have appropriate procedures for handling cash receipts at the cashiering window. For example:
  - (1) BCS did not ensure that cash receipts received via the mail were opened in the presence of two employees.
  - (2) BCS did not restrictively endorse checks upon receipt.
  - (3) BCS did not ensure that employees' individual cash receipt logs were verified by a second employee.

Implementation of such controls is important to reduce the risk of errors or irregularities in the cash receipts process.

\* See glossary at end of report for definition.

- b. BCS did not have appropriate controls to ensure that cash receipts prepared for deposit were maintained in a secured environment until courier pick-up. Although BCS maintained cash receipts in a locked bag in a safe overnight, the locked bag was moved to an unsecure mail bin until courier pick-up. Ensuring that the deposit is maintained in a secure location would reduce the risk of a potential loss.

We subsequently determined that, once these weaknesses were brought to BCS's attention, BCS implemented corrective action to improve internal control over BCS's cash receipting process.

### **RECOMMENDATION**

We recommend that BCS improve the internal control over its cash receipting process.

### **AGENCY PRELIMINARY RESPONSE**

BCS agrees and informed us that it has issued directives to address parts a. and b. of this finding.

## **EFFECTIVENESS OF EFFORTS TO ACCOUNT FOR FEES ASSESSED BY THE CORPORATION DIVISION**

### **COMMENT**

**Audit Objective:** To assess the effectiveness of BCS's efforts to account for fees assessed by the Corporation Division.

**Audit Conclusion:** **We concluded that BCS's efforts to account for fees assessed by the Corporation Division were effective.** Our audit report does not include any reportable conditions related to this audit objective.

## **EFFECTIVENESS OF EFFORTS TO MONITOR COMPLIANCE WITH FINAL ORDERS**

### **COMMENT**

**Audit Objective:** To assess the effectiveness of BCS's efforts to monitor licensees' compliance with final orders issued as a result of complaint investigations.

**Audit Conclusion:** We concluded that BCS's efforts to monitor licensees' compliance with final orders issued as a result of complaint investigations were effective. Our audit report does not include any reportable conditions related to this audit objective.

# OBSERVATION

The observation\* presented in this report relates to the Bureau of Commercial Services' (BCS's) efforts to upgrade its information technology systems for both the corporation database and the licensing system. The observation, which may be of interest to users of this report, highlights the length of time as well as the economic and staffing resources that have been expended for the upgrades. Observations differ from audit findings in that they may not include attributes (condition, effect, criteria, cause, and recommendation) that are presented in audit findings.

1. Time Line and Status of Information Technology System Upgrades

In 2001, BCS began an initiative to upgrade its information technology systems to more efficiently and effectively track its regulatory functions related to licensure, complaints, inspections, and corporations. This 11-year initiative, which evolved over time and continued during our audit fieldwork, has resulted in significant effort by BCS; the Department of Technology, Management, and Budget; and contract vendors. BCS had expended \$13.8 million as of September 2011 (see Exhibit 6). However, as of the end of our audit fieldwork, the goal of rewriting the corporation database and upgrading the licensing system had not yet come to fruition. We documented the time line for the status of this initiative in Exhibit 7.

\* See glossary at end of report for definition.

# SUPPLEMENTAL INFORMATION

**BUREAU OF COMMERCIAL SERVICES**  
Department of Licensing and Regulatory Affairs  
Schedule of Licensees by Profession  
As of May 1, 2012

Profession	Total Active Licensees
Accountancy	18,517
Architect	6,902
Auctioneer	86
Barber	7,321
Carnival/amusement	2,343
Cemetery regulation	307
Collection practices	1,276
Community planner	74
Cosmetology	107,106
Forester	217
Hearing aid dealer	480
Immigration clerical assistant	7
Landscape architect	610
Mortuary science	2,882
Ocularist	14
Personnel agency	69
Polygraph examiner	114
Prepaid funeral provider	578
Professional engineer	20,978
Professional investigator	1,142
Professional surveyor	1,042
Real estate	56,822
Real estate appraiser	3,484
Residential builder	63,109
Security alarm	405
Security guard	366
Ski areas	362
Unarmed combat commission	538
Vehicle protection warrantor	28
Total licensed professionals	297,179

Source: The Office of the Auditor General prepared this schedule based on information obtained from the Bureau of Commercial Services.

BUREAU OF COMMERCIAL SERVICES  
Department of Licensing and Regulatory Affairs  
Schedule of Final Orders by License Type  
Fiscal Year 2010-11

License Type	Number of Final Orders Issued	Amount of Fines Assessed
Accountancy	14	\$ 50,000
Appraiser	31	60,750
Architect	2	3,100
Barber	18	14,800
Builder	189	381,850
Cemetery	2	600
Collection	13	10,500
Cosmetology	90	78,900
Mortuary science	8	16,000
Prepaid funeral	3	25,000
Surveyor	2	3,000
Real estate	31	127,400
Unarmed combat commission	12	2,601
 Total all professions	 415	 \$ 774,501

Source: The Office of the Auditor General prepared this schedule based on information obtained from the Enforcement Division, Bureau of Commercial Services.

BUREAU OF COMMERCIAL SERVICES  
Department of Licensing and Regulatory Affairs  
Schedule of the Status of Michigan Business Entities  
As of August 1, 2012

Type of Business Entity	New Entities Formed Fiscal Year		Total Active Entities as of August 1, 2012
	2009-10	2010-11	
Domestic profit corporations	12,201	11,662	193,992
Domestic nonprofit corporations	4,349	4,143	73,067
Foreign corporations (profit and nonprofit)	2,156	2,127	22,239
Domestic limited liability companies	49,511	51,596	352,705
Foreign limited liability companies	1,683	1,947	13,122
Domestic limited partnerships	112	131	17,507
Foreign limited partnerships	62	63	2,566
 Total all business entities	 <u>70,074</u>	 <u>71,669</u>	 <u>675,198</u>

Source: The Office of the Auditor General prepared this schedule based on information obtained from the Corporation Division, Bureau of Commercial Services.

**BUREAU OF COMMERCIAL SERVICES**  
 Department of Licensing and Regulatory Affairs  
 Schedule of Revenues and Expenditures by Fund  
October 1, 2009 Through September 30, 2011

Fund	Fiscal Year 2009-10		
	Net Revenues (1)	Expenditures (2)	Excess (Deficit) Revenue
Homeowner Construction Lien Recovery Fund	\$ 388,486	\$ 943,165	\$ (554,679)
Real Estate Education Fund	595,090	272,100	322,990
Real Estate Appraiser Education Fund	34,583	20,142	14,441
Builder Enforcement Fund	53,209	90,770	(37,561)
Licensing and Regulation Fees	12,024,030	12,222,395	(198,365)
Corporation Fees	21,194,083	19,057,373	2,136,710
Real Estate Enforcement Fund	338,003	175,810	162,193
Security Business Fund	92,104	221,129	(129,025)
Unarmed Combat Fund	99,371	126,988	(27,617)
Accountancy Enforcement Fund	954,584	119,081	835,503
Land Sales Fees	5,203	5,203	0
<b>Total all funds</b>	<b>\$ 35,778,746</b>	<b>\$ 33,254,156</b>	<b>\$ 2,524,590</b>

(1) Net revenues represent the total amount of revenue collected less revenue deducts processed for central support services.

(2) Expenditures represent the total amount expended by the Bureau of Commercial Services, other areas within the Department of Licensing and Regulatory Affairs, and other State agencies that provide services to the Bureau of Commercial Services.

Source: The Office of the Auditor General prepared this schedule based on information obtained from Finance and Administrative Services, Department of Licensing and Regulatory Affairs.

UNAUDITED  
Exhibit 4

Fiscal Year 2010-11

Net Revenues (1)	Expenditures (2)	Excess (Deficit) Revenue
\$ 91,122	\$ 48,308	\$ 42,814
43,947	153,785	(109,838)
52,171	43,062	9,109
947,316	270,959	676,357
13,902,734	11,897,021	2,005,713
21,273,543	19,495,699	1,777,844
(323,433)	162,660	(486,093)
95,991	300,568	(204,577)
121,638	74,648	46,990
151,517	136,385	15,132
\$ 36,356,546	\$ 32,583,095	\$ 3,773,451

BUREAU OF COMMERCIAL SERVICES  
 Department of Licensing and Regulatory Affairs  
 Schedule of Revenues and Expenditures by License Type  
October 1, 2009 Through April 30, 2012

License Type (2)	Fiscal Year 2009-10		
	Revenues	Expenditures	Excess (Deficit) Revenue
Accountancy (b)	\$ 2,050,640	\$ 782,159	\$ 1,268,481
Architect (b)	250,622	259,223	(8,601)
Auctioneer (b)	12,990	167,837	(154,847)
Barber (b)	135,634	505,577	(369,943)
Carnival-amusement (a)	58,375	549,624	(491,249)
Cemetery regulation (a)	22,308	629,870	(607,562)
Collection practices (a)	151,880	599,800	(447,920)
Community planner (b)	5,260	125,438	(120,178)
Cosmetology (c)	3,010,645	1,485,538	1,525,107
Engineer (b)	1,028,015	347,050	680,965
Forester (b)	16,810	129,199	(112,389)
Hearing aid (b)	57,330	230,777	(173,447)
Immigration clerical assistance (d)		126,508	(126,508)
Interior design (e)	60		60
Landscape architect (b)	74,265	143,022	(68,757)
Mortuary science (b)	148,745	303,198	(154,453)
Occularist (a)	540	125,210	(124,670)
Polygraph examiner (a)	5,349	125,667	(120,318)
Prepaid funeral (d)	8,830	382,646	(373,816)
Private detective (d)	196,451	181,776	14,675
Private employment (a)	6,315	128,722	(122,407)
Professional surveyor (b)	65,775	221,687	(155,912)
Real estate (c)	2,710,943	1,264,938	1,446,005
Real estate appraiser (b)	506,805	616,844	(110,039)
Residential builder (b)	489,083	2,614,239	(2,125,156)
Security alarm contractor and security guard (b)	92,104	147,449	(55,345)
Ski safety (a)	13,401	450,002	(436,601)
Unarmed combat (mixed martial arts) (a)	99,370	186,932	(87,562)
Vehicle protection (a)	7,040	125,211	(118,171)
<b>Total all license types</b>	<b>\$ 11,225,585</b>	<b>\$ 12,956,143</b>	<b>\$ (1,730,558)</b>

- (1) Fiscal year 2011-12 expenditures do not include the allocated amounts for overhead charges.
- (2) Each license type has a prescribed renewal cycle, which affects revenue flow. The following are the renewal cycles for each license type:
- (a) Annual renewal
  - (b) Biennial renewal
  - (c) Biennial renewal with approximately half renewed each year
  - (d) Triennial renewal
  - (e) No renewal required

Source: The Office of the Auditor General prepared this schedule based on information obtained from Finance and Administrative Services, Department of Licensing and Regulatory Affairs.

Fiscal Year 2010-11			Fiscal Year 2011-12 (1) (Through April 30, 2012)		
Revenues	Expenditures	Excess (Deficit) Revenue	Revenues	Expenditures	Excess (Deficit) Revenue
\$ 102,980	\$ 671,929	\$ (568,949)	\$ 2,320,202	\$ 288,136	\$ 2,032,066
204,062	247,971	(43,909)	106,210	37,195	69,015
15,610	154,546	(138,936)	7,490	13,472	(5,982)
426,995	407,928	19,067	96,645	59,489	37,156
53,998	538,279	(484,281)	20,040	208,312	(188,272)
9,550	861,186	(851,636)	2,780	200,628	(197,848)
148,080	386,521	(238,441)	19,750	63,899	(44,149)
4,015	131,161	(127,146)	3,540		3,540
3,044,840	1,518,046	1,526,794	412,410	183,871	228,539
877,342	349,549	527,793	394,073	89,413	304,660
1,050	130,326	(129,276)	9,370	6,942	2,428
23,455	257,074	(233,619)	46,025	58,327	(12,302)
	129,225	(129,225)	500		500
20	134,052	(134,032)	40	865	(825)
8,385	148,168	(139,783)	3,570	9,944	(6,374)
149,986	344,652	(194,666)	118,845	52,662	66,183
675	129,345	(128,670)	280	3,596	(3,316)
4,974	131,037	(126,063)	4,904	88	4,816
11,095	279,307	(268,212)	4,980	49,544	(44,564)
99,839	264,755	(164,916)	97,959	8,494	89,465
5,400	131,869	(126,469)	4,900	145	4,755
52,565	200,285	(147,720)	28,310	31,012	(2,702)
378,400	754,767	(376,367)	163,089	335,475	(172,386)
473,545	752,785	(279,240)	26,760	147,264	(120,504)
8,344,590	3,116,890	5,227,700	415,855	340,774	75,081
99,023	577,856	(478,833)		135,447	(135,447)
11,853	446,797	(434,944)	9,698	168,531	(158,833)
122,116	242,326	(120,210)		44,778	(44,778)
6,250	131,385	(125,135)	1,250	11,098	(9,848)
<u>\$ 14,680,693</u>	<u>\$ 13,570,017</u>	<u>\$ 1,110,676</u>	<u>\$ 4,319,475</u>	<u>\$ 2,549,401</u>	<u>\$ 1,770,074</u>



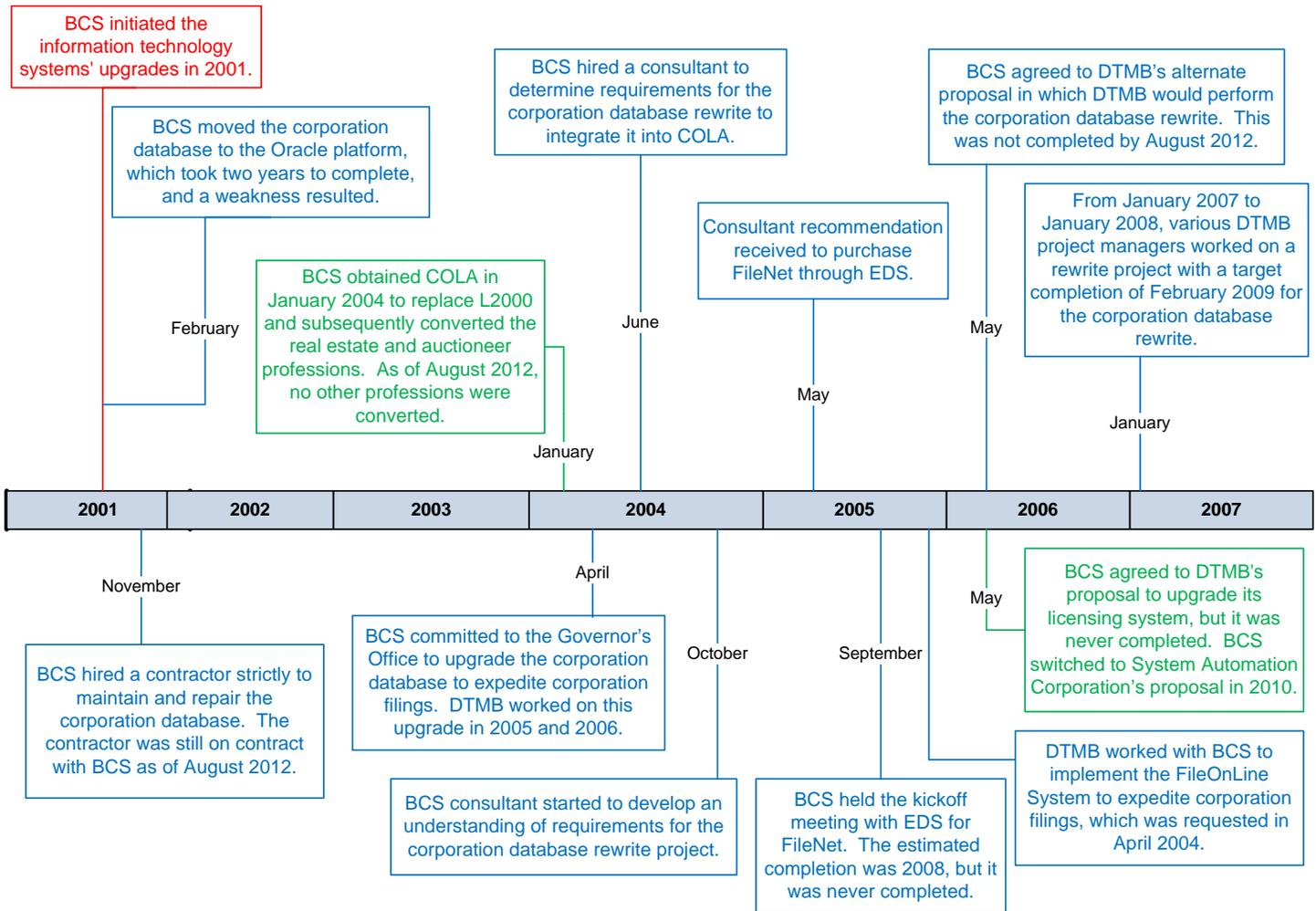
BUREAU OF COMMERCIAL SERVICES (BCS)  
Department of Licensing and Regulatory Affairs  
Estimate of Expenditures Incurred for Information Technology System Upgrades  
Contract Vendors and Department of Technology, Management, and Budget  
January 2006 through September 2011

Estimated Expenditures*	Work Performed	
	Contract Vendors:	
\$ 440,960	Technology Resource	L2000 support and corporation database rewrite
288,080	Technology Resource	L2000 support
160,160	Compuware Corporation	Daily project management for corporation database rewrite
312,000	Mejenta Systems	Java Developer, corporation database
104,000	Iknowvate Technologies, Inc.	Java Developer, corporation database
99,200	Iknowvate Technologies, Inc.	Java Developer, corporation database
112,288	WebZion	Restart corporation database rewrite
218,240	EDS	Daily project management for corporation database rewrite
305,536	Grafius Consulting	Corporation database maintenance and support
68,135	IBM	Corporation database rewrite
168,640	Compuware Corporation	Assist in configuration of Enterprise Licensing System
168,640	Compuware Corporation	Assist in configuration of Enterprise Licensing System
168,640	Mejenta Systems	Java Developer, corporation database
4,571,636	System Automation Corporation	Enterprise Licensing System
\$ 7,186,154	Total contract vendors	
<u>6,584,963</u>	Department of Technology, Management, and Budget	Information technology services provided to BCS
<u>\$ 13,771,117</u>	Total estimated expenditures for information technology system upgrades	

\* These estimated expenditures do not include the payroll costs incurred by BCS staff for their efforts in upgrading the information technology systems.

Source: The Office of the Auditor General prepared this estimate of expenditures based on information obtained from BCS.

**BUREAU OF COMMERCIAL SERVICES**  
 Department of Licensing and Regulatory Affairs  
 Time Line of Information Technology System Upgrade Projects  
 February 2001 through August 2012



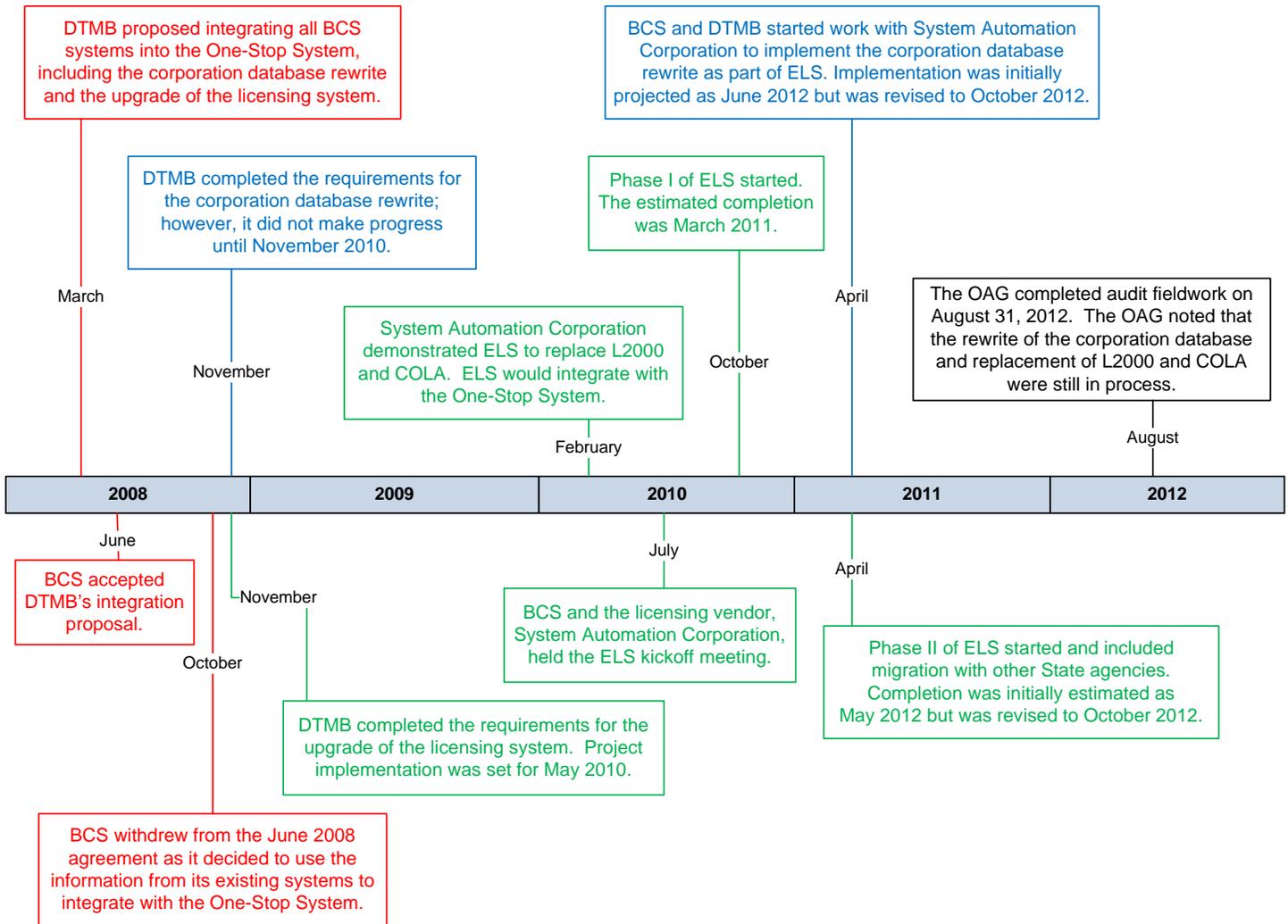
**Acronyms Key:**

BCS - Bureau of Commercial Services, Department of Licensing and Regulatory Affairs.  
 COLA - Comprehensive Occupational Licensing Application.  
 L2000 - License 2000®/MyLicense® System.  
 DTMB - Department of Technology, Management, and Budget.  
 EDS - Electronic Data Systems.  
 ELS - Enterprise Licensing System.  
 OAG - Office of the Auditor General

**Color Key:**

Blue text and boxes - Events related to the corporation database rewrite.  
 Green text and boxes - Events related to the licensing system replacement.  
 Red text and boxes - Events related to both information technology system upgrades.

Source: The OAG prepared this time line based on information and project documentation provided by BCS.



# GLOSSARY

## Glossary of Acronyms and Terms

BCS	Bureau of Commercial Services.
COLA	Comprehensive Occupational Licensing Application.
DTMB	Department of Technology, Management, and Budget.
EDS	Electronic Data Systems.
effectiveness	Success in achieving mission and goals.
ELS	Enterprise Licensing System.
final order	An order issued by the department or board detailing the sanctions levied upon a respondent and is the final determination of a complaint investigation.
internal control	The plan, policies, methods, and procedures adopted by management to meet its mission, goals, and objectives. Internal control includes the processes for planning, organizing, directing, and controlling program operations. It includes the systems for measuring, reporting, and monitoring program performance. Internal control serves as a defense in safeguarding assets and in preventing and detecting errors; fraud; violations of laws, regulations, and provisions of contracts and grant agreements; or abuse.
LARA	Department of Licensing and Regulatory Affairs.
License 2000®/MyLicense® System (L2000)	A Windows-based application that provides comprehensive licensing, continuing education monitoring, disciplinary tracking, rehabilitation, and administrative support for licensing agencies. It accommodates the needs of multi-profession agencies that perform certification and licensing functions.

material condition	A reportable condition that could impair the ability of management to operate a program in an effective and efficient manner and/or could adversely affect the judgment of an interested person concerning the effectiveness and efficiency of the program.
MiScorecard	Part of the State of Michigan's goal to increase accountability and transparency. The monthly MiScorecard reports current performance levels for certain areas within the various departments and serves as an internal management tool for decision-makers.
mission	The main purpose of a program or an entity or the reason that the program or the entity was established.
OAG	Office of the Auditor General.
observation	A commentary that highlights certain details or events that may be of interest to users of the report. An observation differs from an audit finding in that it may not include the attributes (condition, effect, criteria, cause, and recommendation) that are presented in an audit finding.
One-Stop System	A Statewide Web-based system to assist businesses in working with the State of Michigan.
performance audit	An audit that provides findings or conclusions based on an evaluation of sufficient, appropriate evidence against criteria. Performance audits provide objective analysis to assist management and those charged with governance and oversight in using the information to improve program performance and operations, reduce costs, facilitate decision making by parties with responsibility to oversee or initiate corrective action, and contribute to public accountability.

reportable condition

A matter that, in the auditor's judgment, is less severe than a material condition and 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 audit objectives; 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.





