Office of the Auditor General
Report on Internal Control, Compliance, and Other Matters

State of Michigan
Comprehensive Annual Financial Report
State Budget Office

Fiscal Year Ended September 30, 2018

State of Michigan Auditor General
Doug A. Ringler, CPA, CIA

071-0010-19

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.

The auditor general may make investigations pertinent to the conduct of audits.

Article IV, Section 53 of the Michigan Constitution

Office of the Auditor General

Report Summary

Report on Internal Control, Compliance, and Other Matters
State of Michigan Comprehensive Annual Financial Report (SOMCAFR)
State Budget Office
Fiscal Year Ended September 30, 2018

Report Number:
071-0010-19

Released:
June 2019

Generally accepted government auditing standards require an auditor to report on internal control over financial reporting; compliance with provisions of laws, regulations, contracts, or grant agreements that have a material effect on the financial statements; and other matters coming to the attention of the auditor during the completion of a financial audit. We are issuing this report in conjunction with our independent auditor's report on the *SOMCAFR* dated April 30, 2019.

Findings Related to Internal Control, Compliance, and Other Matters	Material Weakness	Significant Deficiency	Agency Preliminary Response
The State should enhance its oversight of third party service organizations. The security review obtained for the State's bank did not provide sufficient assurance of the existence of controls over the State's bank account (Finding #1).	X		Agree
The Department of Treasury (Treasury) did not establish detailed procedures for all State agencies regarding cash deposits, resulting in inconsistent recording and incomplete audit trails (Finding #2).		X	Agree
Treasury and the Michigan Department of Health and Human Services (MDHHS) did not sufficiently limit access to confidential information to appropriate users of the information in the Statewide Integrated Governmental Management Applications (SIGMA). This may put the State at risk for sanctions and penalties for noncompliance (Finding #3).		X	Agree
State agencies and the Office of Financial Management (OFM) did not have sufficient internal control in place to help ensure the accuracy and completeness of the accounting for capital assets, which led to significant correcting transactions (Finding #4).		X	Agree

Findings Related to Internal Control, Compliance, and Other Matters *(Continued)*	Material Weakness	Significant Deficiency	Agency Preliminary Response
State agencies and OFM should improve internal control in a variety of areas to help ensure the completeness and accuracy of the *SOMCAFR* (Finding #5).		X	Agree
Treasury and OFM should continue to enhance internal control to prevent, or detect and correct, misstatements and help ensure the accuracy of tax accruals (Finding #6).		X	Agree
MDHHS did not have sufficient procedures and enhanced communications among department staff to help ensure the accuracy of accounts receivable and accounts payable transactions (Finding #7).		X	Agree
Various State agencies did not have sufficient internal control to help ensure the accuracy of the accounting information recorded in the *SOMCAFR* (Finding #8).		X	Agree
The Michigan Department of Transportation (MDOT) did not have sufficient internal control in place to evaluate the dates of service when processing payments and liquidating prior year accounts payable estimates (Finding #9).		X	Agree
Treasury and MDOT did not have sufficient internal control to help ensure compliance with various sections of the *Michigan Compiled Laws* related to the allocation of revenues, resulting in misallocations of tax revenue (Finding #10).		X	Agree
Treasury should further establish a process to help ensure the accuracy of statutory sales tax revenue allocations among State funds (Finding #11).		X	Agree

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June 28, 2019

Mr. Chris Kolb, State Budget Director
State Budget Office
George W. Romney Building
Lansing, Michigan

Dear Mr. Kolb:

This report on internal control, compliance, and other matters is being issued in conjunction with our financial audit of the *State of Michigan Comprehensive Annual Financial Report* for the fiscal year ended September 30, 2018.

Certain findings included in this report specifically relate to other State agencies. Although the Office of Financial Management, State Budget Office, may not be directly responsible for these functions, we have addressed these findings to you for corrective action, consistent with your responsibility for financial accounting and reporting under Sections 18.1141 and 18.1421 of the *Michigan Compiled Laws*.

The Office of Financial Management provided preliminary responses to the recommendations at the end of our fieldwork. The *Michigan Compiled Laws* and administrative procedures require an audited agency to develop a plan to comply with the recommendations and to submit it to the State Budget Director upon completion of an audit. Within 30 days of receipt, the Office of Internal Audit Services, State Budget Office, 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,

Doug Ringler

Doug Ringler
Auditor General

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INDEPENDENT AUDITOR'S REPORT ON INTERNAL CONTROL AND COMPLIANCE

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

Mr. Chris Kolb, State Budget Director
State Budget Office
George W. Romney Building
Lansing, Michigan

Dear Mr. Kolb:

We have audited, in accordance with the auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards* issued by the Comptroller General of the United States, 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 principally as of and for the fiscal year ended September 30, 2018 and the related notes to the financial statements, which collectively comprise the State's basic financial statements, and have issued our report thereon dated April 30, 2019. Our report includes a reference to other auditors who audited the financial statements of the:

- State Lottery Fund (a major fund)
- Michigan Unemployment Compensation Funds (a major fund)
- Michigan Employment Security Act - Administration Fund
- Unemployment Obligation Trust Fund
- State Building Authority - Debt Service Fund
- State Building Authority - Capital Projects Fund
- Attorney Discipline System
- State Sponsored Group Insurance Fund
- Michigan Education Savings Program
- Michigan Achieving a Better Life Experience Program
- Michigan Finance Authority
- Michigan State Housing Development Authority
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- Mackinac Bridge Authority
- Mackinac Island State Park Commission
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- Michigan Education Trust
- State Bar of Michigan
- Venture Michigan Fund
- Central Michigan University
- Western Michigan University
- Eastern Michigan University
- Ferris State University
- Grand Valley State University
- Lake Superior State University
- Michigan Technological University
- Northern Michigan University
- Oakland University
- Saginaw Valley State University

This report does not include the results of the other auditors' testing of internal control over financial reporting or compliance and other matters that are reported on separately by those auditors.

Internal Control Over Financial Reporting
In planning and performing our audit of the basic financial statements, we considered the State's internal control over financial reporting (internal control) to determine the audit procedures that are appropriate in the circumstances for the purpose of expressing our opinions on the basic financial statements, but not for the purpose of expressing an opinion on the effectiveness of the State's internal control. Accordingly, we do not express an opinion on the effectiveness of the State's internal control.

Our consideration of internal control was for the limited purpose described in the preceding paragraph and was not designed to identify all deficiencies in internal control that might be material weaknesses or significant deficiencies and, therefore, material weaknesses or significant deficiencies may exist that have not been identified. However, as described in the body of our report, we identified a deficiency in internal control that we consider to be a material weakness and other deficiencies that we consider to be significant deficiencies.

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 basic financial statements will not be prevented, or detected and corrected, on a timely basis. We consider the deficiency described in Finding #1 to be a material weakness.

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. We consider the deficiencies described in Findings #2 through #11 to be significant deficiencies.

Compliance and Other Matters

As part of obtaining reasonable assurance about whether the State's basic financial statements are free from material misstatement, we performed tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements, noncompliance with which could have a direct and material effect on the determination of financial statement amounts. However, providing an opinion on compliance with those provisions was not an objective of our audit, and accordingly, we do not express such an opinion. The results of our tests disclosed no instances of noncompliance or other matters that are required to be reported under *Government Auditing Standards.*

Office of Financial Management's Response to Findings

Certain findings included in this report specifically relate to other State agencies. Although the Office of Financial Management, State Budget Office, may not be directly responsible for these functions, we have addressed these findings to you for corrective action, consistent with your responsibility for financial accounting and reporting under Sections 18.1141 and 18.1421 of the *Michigan Compiled Laws*.

The Office of Financial Management's preliminary responses to the findings identified in our audit are included in the body of our report. The responses were not subjected to the auditing procedures applied in the audit of the basic financial statements and, accordingly, we express no opinion on them.

Purpose of This Report

The purpose of this report is solely to describe the scope of our testing of internal control and compliance and the results of that testing, and not to provide an opinion on the effectiveness of the entity's internal control or on compliance. This report is an integral part of an audit performed in accordance with *Government Auditing Standards* in considering the entity's internal control and compliance. Accordingly, this communication is not suitable for any other purpose.

Sincerely,

Doug Ringler

Doug Ringler
Auditor General
April 30, 2019

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FISCAL YEAR 2018

FINDINGS, RECOMMENDATIONS,

AND AGENCY PRELIMINARY RESPONSES

FINDING #1

Improved guidance and oversight needed for third party service organization monitoring.

The State should enhance its oversight of third party service organizations. The State Budget Office (SBO), through its Office of Internal Audit Services (OIAS), issued guidance to the State departments to assess and manage risks associated with the departments' service organizations, including when and how to accomplish this. However, in many instances, the departments have not effectively applied this guidance. Because of the risk associated with the use of third party service providers and the lack of sufficient oversight, we consider this to be a material internal control* weakness.

The State of Michigan Financial Management Guide (FMG) (Part VII, Chapter 1, Section 1000) requires each department to establish and maintain a sound internal control system over activities and transactions, including those managed by service organizations. Departments can utilize reports issued in accordance with the American Institute of Certified Public Accountants' (AICPA's) System and Organization Controls* (SOC) reporting framework or customized AICPA examination reports to gain assurances that service organization controls are present and functioning as intended. The FMG also provides templates that the State agencies can use to help in their determination of whether SOC or other third party review reports are necessary and assist with the review of any reports obtained. Further, OIAS provides specific guidance to departments on request.

We reviewed monitoring controls for judgmentally selected third party service organizations and noted:

a. The Michigan Department of Treasury (Treasury) did not ensure that the security review obtained for the State's bank provided sufficient assurance of the existence of controls over the State's bank account. Treasury did not obtain a SOC 1 report for the State's bank applicable to fiscal year 2018.

   Treasury did obtain an AT-C 205 report covering security related controls for the State's bank. However, this report did not provide a sufficient level of assurance that controls were adequately designed and operating effectively. Specifically:

   (1) The report obtained for fiscal year 2018 covered only the last 3 months of the fiscal year and did not include the testing of financial processing controls. Treasury last obtained a SOC 1 report in 2016 that covered controls over mail receipt processing, tax return processing, and deposit preparation controls.

   (2) Management's assertion of the control environment was not included in the 2018 report, which is a required section in a SOC report. The 2018 report

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

obtained was not a SOC report, and without management's assertion of the control environment, it does not provide the same level of assurance as a SOC report.

(3) The 2018 report did not address complementary user entity controls, which have been addressed in prior SOC reports.

b. SBO did not sufficiently assess the level of coverage obtained in the SOC report for the Statewide Integrated Governmental Management Applications* (SIGMA). Our IT performance audit of SIGMA - Selected Application Controls and Service Level Requirements, issued in March 2019, and located at audgen.michigan.gov/wp-content/uploads/2019/03/r071059518-2222.pdf, identified concerns in Finding #6, parts a., b., and c., which noted that the SOC 2 report for fiscal year 2017 did not include coverage of the confidentiality, privacy, and processing integrity trust principles and did not include an assessment of the database administration controls. We reviewed the SIGMA SOC reports for fiscal year 2018 and determined that the same concerns still exist.

c. State agencies did not:

(1) Ensure that SOC reports provided coverage during the audit period. We noted that 2 (7%) of the 29 SOC reports reviewed did not provided any coverage during fiscal year 2018.

(2) Obtain bridge letters for 6 (33%) of the 18 SOC reports that did not cover the entire fiscal year. Also, 4 (33%) of the 12 bridge letters obtained covered a period greater than 3 months. A bridge letter is an assertion from the service provider that controls have not changed significantly since the SOC report was issued. The OIAS guidance states that if the report covers a period of less than 6 months, it provides minimal assurance that the controls are in place and that if the gap period is greater than 90 days, the State agency should evaluate if a bridge letter is sufficient or if additional procedures are needed.

(3) Document their review of 14 (52%) of the 27 fiscal year 2018 SOC reports. Also, 5 (38%) of the 13 reviews that were documented were not done in a timely manner. In one case, an entire year passed before the State agency reviewed the SOC reports. One State agency informed us that some of the SOC reports were not requested until the year-end closing

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

process was already underway and the SOC reports obtained often covered the prior fiscal year.

(4) Consider the need to obtain SOC reports for the vendor's subservice providers for 8 (50%) of the 16 SOC reports reviewed that referenced subservice providers, 3 (38%) of which referenced two subservice organizations.

(5) Document the State agencies' review of complementary user-entity controls for 22 (92%) of the 24 SOC reports that included these controls. SOC reports usually state that the user can rely on the controls tested in the SOC report only if the user entity (State) has implemented the complementary user-entity controls.

State agencies informed us that they did not have sufficient guidance to know how to review the SOC reports, the types of assertions or concerns to look for, and the time line that should be used to complete their reviews. OIAS provided some guidance during fiscal year 2018, but the process for receiving and reviewing the SOC reports was already underway. Some State agencies also informed us that in order to ensure that the SOC reports covered sufficient time within the fiscal year being tested, contract changes would likely be necessary, which could take a few years to implement. Third party service organization oversight will require improvements in the guidance provided, training in the use of the information obtained, and possible contract modifications.

RECOMMENDATION

We recommend that the State enhance its oversight of third party service organizations.

AGENCY PRELIMINARY RESPONSE

The Office of Financial Management (OFM) provided us with the following response:

*State agencies, OIAS, and OFM agree that oversight of third-party service organizations should be enhanced. OIAS will continue to enhance the FMG (Part VII, Chapter 1, Section 1000), which addresses Service Organizations. Additional guidance, such as addressing bridge letters and service organization risk assessments will also be enhanced. In addition, the "*SOC Report Review Template*" will be improved to better enable the agency user to review the SOC report for relevant information, including reporting periods, user complementary controls, and relevant control objectives and testing. In addition, OIAS will facilitate discussions between key stakeholders including the Michigan cyber security, agency business process/procurement personnel, and the Department of Technology, Management, and Budget (DTMB) central procurement personnel to identify opportunities for improved guidance and oversight that will improve practices to obtain proper assurances from third-party service organizations.*

Regarding part b, as noted in the Office of the Auditor General (OAG) report on its IT performance audit of SIGMA, SBO agrees with the need to continually assess the level of coverage obtained in the annual security review service level requirement, but does not agree with the assertion that the level of coverage obtained was not sufficiently assessed.

AUDITOR'S COMMENTS TO AGENCY PRELIMINARY RESPONSE*

Regarding part b., in the SIGMA audit report we addressed the disagreement raised by SBO. For this audit, we again considered SBO's position and believe that the finding is accurate as written.

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

FINDING #2

Detailed procedures needed for cash deposits.

As of December 6, 2018, Treasury had approximately $5 million in unreconciled banking activity for fiscal year 2018.

Treasury did not establish detailed procedures for all State agencies regarding cash deposits, resulting in inconsistent recording and incomplete audit trails. As of December 6, 2018, Treasury had approximately $5 million in unreconciled banking activity for the fiscal year ended September 30, 2018.

The Management and Budget Act (Section 18.1485 of the *Michigan Compiled Laws*) states that each department's internal control system shall be designed with techniques that are effective and efficient. The FMG (Part II, Chapter 9, Section 100) states that Treasury establishes policies and procedures for depositing receipts by State agencies.

Treasury performs monthly cash reconciliations using software to identify and match deposits between the State's bank accounts and the State's accounting system. SIGMA allows for the recording of deposit ticket numbers and deposit dates within specified fields for deposit transactions; however, these SIGMA data fields were not consistently used by State agencies when recording their cash deposits. Because Treasury did not update FMG guidance to require the capture of necessary data elements, State agencies did not consistently record cash deposits, resulting in inefficiencies in the cash reconciliation process.

The development of standard cash deposit procedures, which require certain data elements to be recorded in SIGMA, would establish a consistent audit trail and would reduce the effort required to reconcile cash deposits.

RECOMMENDATION

We recommend that Treasury establish detailed procedures for all State agencies regarding cash deposits.

AGENCY PRELIMINARY RESPONSE

OFM provided us with the following response:

Treasury and OFM agree that standardizing the completion of the deposit ticket and deposit date fields would make the cash reconciliation process more efficient. Currently both of these fields are required in SIGMA, but there are not edits for content of the deposit ticket field. Treasury is in the process of updating the FMG to include more detailed instructions for agencies and has submitted a request to the SIGMA Operations and Support (SOS) to determine if there are additional system configurations that can be modified to enhance the edits on the deposit ticket field.

Treasury and OFM would like to note that the existing procedures enabled Treasury to reconcile cash activity to the bank statement in an accurate and timely manner. The corrective action contemplated by Treasury is intended to improve the efficiency of the process, while maintaining the accuracy and timeliness of the existing process.

FINDING #3

Improvements needed to limit access to confidential information in SIGMA.

Treasury and the Michigan Department of Health and Human Services (MDHHS) did not sufficiently limit access to confidential information to appropriate users of the information in SIGMA. As a result, the State may be at risk for sanctions and penalties for noncompliance with data protection requirements.

Section 445.84 of the *Michigan Compiled Laws* requires DTMB, in conjunction with State agencies, to create a privacy policy that safeguards social security numbers to ensure, to the extent practicable, the confidentiality of social security numbers and limits who has access to information or documents that contain social security numbers. Also, State of Michigan Administrative Guide to State Government policy 1340 states that security controls must be implemented to protect State of Michigan information from unauthorized access, use, disclosure, modification, destruction, or denial and to ensure the confidentiality, integrity, and availability of State of Michigan information.

The SIGMA Project did communicate to departments the restrictions on the inclusion of legally protected data in SIGMA "…unless the agency has demonstrated a compelling need and has a written agreement in place with SIGMA."

We noted:

a. The ability to view confidential information interfaced from State agency systems to SIGMA was not limited to SIGMA users with a business need to view the information:

   (1) Treasury interfaced transactions from the Garnishment and Levies (GAL) system to SIGMA that displayed certain identifying information within the check description field in SIGMA. We identified 946 SIGMA users with access to view GAL transactions in SIGMA. Title 5, section 552a of the *United States Code* states that each agency shall establish appropriate administrative, technical, and physical safeguards to insure the security and confidentiality of records. Treasury informed us that the interface design included the identifying information and would require a change to SIGMA.

   (2) MDHHS interfaced transactions from the Michigan Statewide Automated Child Welfare Information System (MiSACWIS) and the Bridges Integrated Automated Eligibility Determination System (Bridges) to SIGMA that displayed certain identifying information within the check description field in SIGMA. We identified 1,253 Statewide SIGMA users with access to view MDHHS transactions in SIGMA. Federal and State regulations protect the confidentiality of

The State may be at risk for sanctions and penalties for noncompliance with data protection requirements.

information the State retains. For example, Title 45, Part 205, section 50 of the *Code of Federal Regulations** (*CFR)* states that the release or use of information concerning individuals applying for or receiving financial assistance is restricted to persons or agency representatives that require it for a specific purpose, including the administration of the program, employment verifications or audit activity. The federal grantor agency could issue sanctions or disallowances related to noncompliance with the program's State plan. MDHHS informed us that the check description field is viewed by vendors and providers to identify which participant or child the payment relates to.

b. MDHHS did not provide sufficient guidance to staff to ensure that confidential documentation was not included in SIGMA as transaction support. As a result, MDHHS included certain confidential information for foster care and non-emergency medical transportation payment transactions in SIGMA. As noted in part a.(2) of this finding, federal and State regulations require recipient information to be restricted to persons or agencies for specific purposes. For example, the Health Insurance Portability and Accountability Act (HIPAA) Privacy Rule, federal regulation 45 *CFR* 164.502, states that when using or disclosing protected health information, an entity must make reasonable efforts to limit protected health information to the minimum necessary to accomplish the intended purpose of the use, disclosure, or request. The Secretary of Health and Human Services could impose a civil money penalty if the Secretary determines that the entity violated an administrative simplification provision.

   MDHHS informed us that it has discussed disclosing certain information with the MDHHS legal team and concluded that foster care information did not have HIPAA restrictions, making it acceptable to disclose in SIGMA; however, there are also specific program requirements that prohibit disclosing confidential information. When informed that the accounting service centers were attaching potentially confidential information in SIGMA related to non-emergency medical transaction payments, MDHHS directed the accounting service centers to maintain supporting documentation on file rather than attach the information in SIGMA. As noted in part a.(2) of this finding, 1,253 Statewide SIGMA users have access to view MDHHS transactions.

RECOMMENDATION

We recommend that Treasury and MDHHS limit access to confidential information to appropriate users of the information.

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

AGENCY PRELIMINARY RESPONSE

OFM provided us with the following response:

MDHHS, Treasury and OFM agree that access to confidential information should be limited to appropriate users of the information.

With respect to each component of the finding:

a.(1) Treasury is in the process of modifying the GAL interface to exclude confidential information.

a.(2) MDHHS is actively working with DTMB to identify potential interface design changes to eliminate sending confidential information to fields in SIGMA that have widespread access and evaluating the cost and impacts on MDHHS business process needs.

b. MDHHS stopped disclosing transaction support with confidential information in fiscal year 2018.

FINDING #4

Significant improvement needed for financial accounting practices related to capital assets.

State agencies and OFM, within SBO, did not have sufficient internal control in place to help ensure the accuracy and completeness of the accounting for capital assets, which led to significant correcting transactions. We noted:

a. The Michigan Department of Transportation (MDOT) could not provide project level support when reclassifying balances within the statement of net position. Historically:

- Prior to fiscal year 2018, the construction in progress (CIP) balance was a cumulative, summary level balance in the State's financial accounting system. Each fiscal year, MDOT would make a summary level entry to account for the costs for projects that were still in process. As projects were completed, the associated project costs would be removed from the CIP balance. Project level records were stored in several MDOT systems rather than the State's financial accounting system. MDOT used queries from its systems to calculate the total dollar amount to be removed from the CIP balance each fiscal year for individual projects completed before the end of the fiscal year.

- In fiscal year 2018, SIGMA incorporated the project and accounting coding and the related program costs (formerly project) into individual CIP assets, which were used to create the *State of Michigan Comprehensive Annual Financial Report (SOMCAFR)*.

- Upon SIGMA conversion, MDOT determined that the beginning CIP balance of $2.3 billion was overstated by $420 million because the program detail and associated CIP asset values totaled only $1.9 billion. MDOT reclassified approximately $420 million from CIP to the applicable infrastructure and land and other non-depreciable asset balances.

- The OAG requested MDOT's supporting documentation for the $420 million to validate MDOT's reclassification. MDOT stated that it could not provide supporting documentation because it did not track the costs at the individual project level.

Based on cumulative project level documentation used since the implementation of Governmental Accounting Standards Board* (GASB) Statement No. 34, we identified individual project costs of $179.4 million associated with incomplete, canceled, or local projects that were not State-owned assets that should not have been reclassified. MDOT corrected this issue prior to the *SOMCAFR's* issuance.

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

b. MDOT did not report all accrued expenditures related to CIP assets as of September 30. Although MDOT reported $32.7 million of accrued expenditures prior to the fiscal year 2018 closing deadline, MDOT identified an additional $3.2 million affecting CIP assets that was processed in April 2019. MDOT corrected this issue prior to the *SOMCAFR's* issuance.

c. OFM did not have a process in place to ensure that the recognition of depreciation was correctly matched with the recognition of the associated depreciable capital asset. OFM corrected these issues prior to the *SOMCAFR's* issuance. Specifically:

   (1) Depreciation expense of $4.3 million was not recorded in fiscal year 2018 for 231 depreciable fixed assets that did not properly convert into SIGMA.

   (2) Depreciation expense in fiscal year 2018 was overstated by $1.4 million for 13 capital assets that should not have been recognized or depreciated until fiscal year 2019.

d. OFM did not reverse the prior year lease interest payable of $3.7 million after establishing the lease interest payable for fiscal year 2018. Also, OFM did not ensure that the fiscal year 2018 $5.0 million lease interest payable was part of the correct line item in the financial statements. OFM corrected the prior year lease interest payable issue prior to the *SOMCAFR's* issuance.

RECOMMENDATION

We recommend that State agencies and OFM establish sufficient internal control to help ensure the accuracy and completeness of the accounting for capital assets.

AGENCY PRELIMINARY RESPONSE

OFM provided us with the following response:

OFM and the State agencies agree that internal controls related to the accuracy and completeness of the accounting for capital assets should be enhanced and will work to implement needed improvements.

FINDING #5

Various improvements needed to internal control.

State agencies and OFM, within SBO, should improve internal control to help ensure the completeness and accuracy of the *SOMCAFR*. We noted:

a. State agencies did not ensure that ending account balances from the Michigan Administrative Information Network* (MAIN) that were converted to beginning account balances in SIGMA included sufficient detail for State agencies to evaluate the accuracy of account balances.

   Section 18.1485 of the *Michigan Compiled Laws* states that each department shall establish and maintain an internal accounting and administrative control system using generally accepted accounting principles* (GAAP). These controls should include a system of authorization and recordkeeping procedures to control assets, liabilities, revenues, and expenditures and internal control techniques that are effective and efficient.

   Specifically:

   (1) The State converted balances into SIGMA at the fund level; however, some of the State agencies recorded liquidations and write-offs using more detailed coding than SIGMA used to convert the balances. As a result, some account balances at the detail level will not reflect the correct balance. For example:

Accounts Payable Example

	Beginning Balance	Fiscal Year 2017 Liquidation	Fiscal Year 2018 Establishment	Ending Balance
October 1, 2017 (Summary Level)	$ 500,000			$ 500,000
Accounts Payable - Program A		$ 500,000	$ 400,000	$ (100,000)
Total	$ 500,000	$ 500,000	$ 400,000	$ 400,000

   In this example, total department payables would be correct at $400,000. However, reported payables at the program level would be understated by $500,000. To eliminate the effect on the detail levels reported in future years, State agencies should process an entry against the summary level transaction for the balance liquidated.

   (2) State agencies did not ensure that all transactions were properly classified, resulting in the misclassification of assets in the *SOMCAFR*.

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

Cost accounting receivables generated from the automatic reimbursement process were configured to be coded as other current assets. The SIGMA Center of Excellence noted that 98% of cost accounting receivables were due from federal sources. As a result, all federal cost accounting receivables had to be reclassified as amounts due from federal agencies. SIGMA provided guidance indicating that it was the responsibility of the State agencies to move all outstanding federal receivables at year-end to the appropriate due from federal agencies financial statement line. However:

(a) Higher Education (Treasury) did not ensure that $49.3 million year-end federal receivables were appropriately reclassified. Higher Education informed us that the required entry was not made as it was not aware of the coding issue or of the additional guidance provided. Treasury corrected this issue prior to the *SOMCAFR's* issuance.

(b) MDHHS did not ensure that the query used to identify outstanding federal receivables at year-end included all valid receivables, resulting in $22.1 million not being properly reclassified as amounts due from federal agencies. MDHHS informed us that the query used was incorrectly filtered to budget fiscal year only. MDHHS corrected this issue prior to the *SOMCAFR's* issuance.

The need to reclassify balances at year-end will continue to be a required entry. To minimize the risk of future errors, OFM should provide guidance, reminding the State agencies of the need for the entry.

b. State agencies did not establish and implement interface controls over SIGMA to ensure that all data exchanged between SIGMA and other State information systems was processed completely, accurately, and timely.

SOS issued Temporary Operating Policy & Procedure No. 0007 on November 9, 2018, after the close of fiscal year 2018, requiring agencies to reconcile data transmitted to and from SIGMA and recommending that the reconciliations be performed at the same frequency that the interfaces run in production. However, this procedure does not specify the level of detail that agencies should use when performing reconciliations, for example, record counts, dollar amounts, or fund and appropriation coding. State agencies, as the data owners, are responsible for the implementation of interface reconciliation controls.

The U.S. Government Accountability Office's (GAO's) Federal Information System Controls Audit Manual* (FISCAM) states that interface controls should be established and implemented to reasonably ensure that data transferred from a source system to a receiving system is processed timely, accurately, and completely. Also, effective interface reconciliation procedures should include the use of control totals, record counts, and other logging techniques. Interfaced data should be reconciled, and reports used in the reconciliation should provide adequate information to reconcile each transaction processed.

Specifically:

(1) The Department of Licensing and Regulatory Affairs (LARA) did not ensure that revenue transactions in the Centralized Electronic Payment Authorization System (CEPAS) reconciled to the Corporations Online Filing System (COFS). Also, LARA did not ensure that reclassified transactions that were interfaced into SIGMA reconciled to COFS. COFS interfaced $15.3 million in revenue into SIGMA during fiscal year 2018. LARA informed us that COFS replaced an old legacy system and LARA had not developed a documented reconciliation process for fiscal year 2018. LARA informed us that it has implemented a reconciliation process for fiscal year 2019.

(2) MDOT did not ensure that construction contractor expenditure transactions in American Association of State Highway and Transportation Officials software (AASHTOWare) reconciled with SIGMA after interfacing. AASHTOWare interfaced $1.2 billion in expenditures into SIGMA during fiscal year 2018. MDOT stated that it did not have a process to reconcile transactions between AASHTOWare and SIGMA during the audit period.

(3) DTMB did not document reconciliations performed between the Fleet Commander and M4 billing maintenance systems and SIGMA. As a result, DTMB could not ensure that State employee automobile usage transactions interfaced appropriately into SIGMA. Fleet Commander and M4 interfaced $71.7 million in revenue into SIGMA during fiscal year 2018. DTMB could not provide documentation showing that it performed a reconciliation between the systems and SIGMA.

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

(4) The Michigan Department of State Police (MSP) did not perform reconciliations between the Michigan Cashiering and Receivable System (MiCARS) and its source systems to ensure that the information in MiCARS was complete and accurate before interfacing into SIGMA. MSP performed reconciliations of the total records interfaced from MiCARS into SIGMA. Total dollars and other coding were not included in the reconciliation. MSP interfaced $47.5 million revenue from MiCARS into SIGMA during fiscal year 2018. MSP performed the reconciliations between MiCARS and its source systems upon our request.

(5) The Department of Natural Resources (DNR) performed reconciliations of the total dollars interfaced between MiCARS and its source systems. Record counts and other coding were not included in the reconciliation provided to us during audit fieldwork. DNR interfaced $152.0 million revenue from MiCARS into SIGMA during fiscal year 2018.

c. State agencies did not ensure that sufficient procedures existed for the approval of accounting transactions in SIGMA.

Section 18.1485 of the *Michigan Compiled Laws* states that each department shall establish and maintain an internal control system using GAAP. These controls should include a plan of organization that provides separation of duties and responsibilities among employees; a system of authorization and recordkeeping procedures to control assets, liabilities, revenues and expenditures; and a system of practices to be followed in the performance of duties and internal control techniques that are effective and efficient. Also, the GAO's FISCAM recommends that organizations implement controls to ensure that transactions are complete, accurate, and valid and that an automated workflow exists to initiate the approval process. These controls would provide assurance that transactions are reviewed and approved by authorized individuals.

Specifically:

(1) MDOT did not require workflow approvals for stock issue confirmation (CI) document codes in SIGMA to help ensure the reasonableness and propriety of SIGMA transactions.

CI documents create expenditures utilizing the SIGMA Inventory System. SIGMA did not require workflow approvals for these document codes, and

MDOT did not request workflow approvals for these document codes or set up an approval process outside of SIGMA.

The Department of Corrections also used CI documents but utilized a workflow approval process for associated stock request document codes in lieu of workflow approvals for CI document codes.

(2) MDHHS did not ensure that all accounting transactions were properly approved in SIGMA. MDHHS utilized accounting assistants or technicians to enter transactions into SIGMA that were approved by a staff in a non-manager role or an employee of the same level as the staff entering the transaction. MDHHS informed us that managers approved the transactions' documentation outside of SIGMA prior to their entry; however, a manager's approval of transactions prior to their entry into the accounting records allows for changes and processing errors to go undetected. Also, this allows for unauthorized transactions to post without a manager's approval. We identified one transaction that was properly coded and signed by the manager on the hard-copy support but was incorrectly coded when entered into SIGMA.

d. OFM should update its year-end closing procedures to ensure that guidance used during the year-end closing process is current and reflective of GAAP. Our audit disclosed the following errors, which OFM corrected prior to the *SOMCAFR's* issuance:

(1) OFM did not properly reduce the net investment in capital assets fund balance by the amount of outstanding State Building Authority (SBA) bonds related to State capital projects.

Section 2200.118 of the *Codification of Governmental Accounting and Financial Reporting Standards* (Codification), published by GASB, requires the reduction of net investment in capital assets net position by the outstanding balances of any bonds that are attributable to the acquisition, construction, or improvement of those capital assets.

During the year-end closing process, OFM records entries to properly classify the fund balances for reporting purposes. OFM reduced the net investment in capital assets fund balance by the amount of outstanding MDOT bonds related to capital projects but did not reduce the balance by the amount of outstanding SBA bonds attributable to State capital projects. As a result, the net investment in capital assets fund balance was overstated and unrestricted fund balance was understated by $895.8 million.

OFM stated that its guidance to classify fund balance was outdated.

(2) OFM did not properly account for forfeiture revenue and expenditure activity.

GASB Codification Section 1800.153 states that assets and liabilities should not be offset in the statement of net position except where a right of offset exists. When members of a State retirement system terminate employment prior to vesting in the plan, a percentage of the employer contributions are forfeited and the funds become State revenue, along with any interest earnings. The State deposits these funds into a forfeiture account and they are considered State expenditures when used to offset the employer-required contribution. However, OFM incorrectly combined these transactions and reported the net total as expenditures, resulting in the understatement of revenues and expenditures by $7.7 million in the government-wide statement of activities.

RECOMMENDATION

We recommend that State agencies and OFM improve internal control to help ensure the completeness and accuracy of the *SOMCAFR*.

AGENCY PRELIMINARY RESPONSE

OFM provided us with the following response:

OFM and the State agencies agree that internal controls should be enhanced and will work to implement the needed improvements.

FINDING #6

Continued improvements needed to processes for establishing and monitoring tax receivables and payables.

Treasury and OFM, within SBO, should continue to enhance internal control to prevent, or detect and correct, misstatements and help ensure the accuracy of tax accruals.

Section 18.1485 of the *Michigan Compiled Laws* states that each department shall establish and maintain an internal accounting and administrative control system using GAAP. These controls should include a system of authorization and recordkeeping procedures to control assets, liabilities, revenues, and expenditures. In addition, GASB Codification Sections 2250.109 and 2250.110 require that all information that becomes available prior to the issuance of the financial statements should be used in evaluating the conditions on which the estimates were based. The financial statements should be adjusted for any material changes in estimates resulting from actual results.

Our review of tax accruals for fiscal year 2018 disclosed:

a. Treasury had not developed a process to compare and evaluate significant accounting estimates with subsequent activity for tax accrual payable components, in accordance with sound business practice. The estimates for the business taxes and individual income tax (IIT) payable backlogs of the year-end tax accruals are not compared with subsequent activity to assess the reliability of the process used to develop the estimates.

   In its approval of accrual methodologies, OFM instructs State departments that it is important to evaluate the reliability of the estimated accruals in the subsequent year and adjust the estimation methodology accordingly.

   We first commented on this issue during the fiscal year 2013 *SOMCAFR* audit. OFM and Treasury continue to agree with our prior audit recommendation, and Treasury began evaluating assessed taxes receivable and receivables to be assessed estimates with subsequent activity during fiscal year 2017. Treasury informed us that it is currently refining a process to evaluate business tax payable backlogs but has not yet evaluated the IIT payable backlog.

b. Treasury did not ensure that collections relating to the sales, use, and withholding (SUW) tax and corporate income tax (CIT) were properly recorded. As a result, assets, revenues, and fund balance were overstated by $33.6 million in the General Fund and $0.4 million in the School Aid Fund. Also, assets, revenues, and net position were overstated by $34.0 million in the governmental activities of the government-wide financial statements. Treasury recorded correcting entries prior to the *SOMCAFR's* issuance.

We noted:

(1) Treasury improperly included 59 SUW tax payments received from eight taxpayers in November for tax periods that began after September 30, 2018. Treasury stated that similar payments in prior years were associated with an earlier tax filing period and that it intends to revise its accrual methodology to appropriately identify these types of payments in the future.

(2) Treasury improperly included eight CIT payments from a single taxpayer initially made through the SUW legacy system during fiscal year 2018 for tax periods that ended prior to October 1, 2018. Treasury appropriately identified these as CIT payments in November 2018 and moved these payments to the SAP system for CIT. Because Treasury's accrual methodology did not factor in such transfers, both the initial payments made during fiscal year 2018 and the transfer of the payments made in November 2018 were included as fiscal year 2018 tax revenues. Treasury stated that it intends to revise its accrual methodology to exclude these types of transfers in the future.

(3) Treasury improperly included SUW overpayments of $570,561 for two taxpayers in excess of their tax liability as of September 30, 2018. Because the overpayments do not apply to a fiscal year 2018 liability, they have yet to be earned and should not have been accrued as revenue in fiscal year 2018. Treasury agreed that these overpayments should be applied to future tax liabilities.

In addition to the known overpayments, assets, revenues, and fund balance were overstated by projected amounts of $9.2 million and $3.3 million in the School Aid Fund and General Fund, respectively. Assets, revenues, and net position were also overstated by projected amounts of $12.5 million in the governmental activities of the government-wide financial statements.

c. Treasury did not ensure that liabilities relating to the single business tax (SBT), Michigan business tax (MBT), and CIT were properly recorded. As a result, payables were understated and revenues and fund balance/net position were overstated by $15.7 million in the General Fund and governmental activities of the government-wide financial statements. Treasury recorded correcting entries prior to the issuance of the *SOMCAFR*.

We noted:

(1) Treasury improperly included two taxpayer payments as an SBT liability. The taxpayers identified its payments as SBT when they should have been identified as CIT. Treasury stated that when it corrected the taxpayer oversight, the program that is supposed to sweep payments from the legacy SBT system to the SAP system for CIT did not function as intended. As a result, the payments remained in both systems causing Treasury to believe that SBT refunds were due to the taxpayers. Treasury informed us that no refunds were ever issued to the taxpayers and that it issued a work request to investigate and fix the program malfunction.

(2) Treasury improperly excluded four CIT and two MBT unprocessed returns from the year-end liability. Each return's refund amount was in review status at Treasury's November 30 evaluation; however, subsequent to this evaluation and prior to the *SOMCAFR* opinion date, Treasury was able to determine the appropriate refund amount. Treasury's established methodology does not require reevaluating the recorded liability if the refund amount changes as the return is processed prior to the *SOMCAFR* opinion date.

d. Treasury did not ensure that October and November estimated IIT collections were properly recorded in fiscal year 2018. As a result, assets, revenues, and fund balance/net position were overstated by a known amount of $239,104 and a projected amount of $2.0 million in the General Fund and governmental activities of the government-wide financial statements.

Treasury records a receivable at fiscal year-end for IIT collections received in October and November related to tax periods ending prior to October 1. Several IIT taxpayers remit their calendar year fourth quarter estimated payments early, which may also include their September tax liability. When determining the amount of October and November IIT collections to accrue, Treasury initially accrues the entire amount collected. Beginning in fiscal year 2018, Treasury reviewed a sample of estimated IIT payments collected during October and November to identify payments for tax periods after September 30 and to adjust the month-end IIT accrued receivable accordingly. Based on Treasury's sample, it identified and reduced IIT collections receivable by $2.7 million. However, Treasury did not have a methodology to project an additional reduction based on its sample and testing results.

e. Treasury had not developed a process to identify how much sales tax revenue should be accrued to the Comprehensive Transportation Fund (CTF) at the end of the fiscal year. As a result, revenues, receivables, and fund balance were misstated in the General Fund and CTF by an undetermined amount.

   The General Sales Tax Act (Public Act 167 of 1933) requires a portion of the sales tax money collected shall be deposited into the CTF. Not less than 27.9% of 25% of the collections of the general sales tax imposed at a rate of 4% directly or indirectly on fuels sold to propel motor vehicles upon highways, on the sale of motor vehicles, and on the sale of parts and accessories of motor vehicles by new car businesses, used car businesses, accessory dealer businesses, and gasoline station businesses shall be deposited each year into the CTF.

   As part of the tax accrual process, Treasury accrued sales tax revenue amounts attributable to the CTF in the General Fund. We initially identified this issue during the fiscal year 2011 *SOMCAFR* audit. Prior to fiscal year 2018, Treasury did not have the necessary purchase date information needed to accrue a CTF receivable by fiscal year-end closing; however, this information was available for fiscal year 2018. Treasury informed us that its Office of Accounting Services and Office of Revenue and Tax Analysis are currently conducting a review to determine if it can reasonably estimate a CTF receivable by fiscal year-end closing in future years.

f. Treasury did not ensure that interest paid for various tax refunds was appropriately recorded in fiscal year 2018. As a result, expenditures/expenses and revenues were understated in the General Fund and governmental activities of the government-wide financial statements by $2.9 million. Treasury recorded correcting entries prior to the issuance of the *SOMCAFR*.

   Treasury initially records tax refund and applicable interest payments as a reduction of tax revenues. Because interest payments result from Treasury's untimely issuance of a taxpayers refund, Treasury must reclassify revenue reductions pertaining to interest payments as expenditures. Treasury did not record reclassification entries for interest paid on taxes processed in the SAP system during October 2018.

RECOMMENDATION

We recommend that Treasury and OFM continue to enhance internal control to prevent, or detect and correct, misstatements and help ensure the reasonableness and accuracy of tax accruals.

AGENCY PRELIMINARY RESPONSE

OFM provided us with the following response:

Treasury and OFM agree that internal control related to tax accruals should be enhanced. Treasury will continue to improve tax accruals by developing an evaluation process of IIT estimates to subsequent payables activity and by reviewing the tax accrual methodologies to continue to improve the accuracy of the business tax collections and liabilities recorded.

FINDING #7

Improvements needed to MDHHS procedures and communications.

MDHHS did not have sufficient procedures and enhanced communications among department staff to help ensure the accuracy of accounts receivable and accounts payable transactions. Consequently, MDHHS could not ensure that its internal control would prevent, or detect and correct, misstatements in its accounting transactions in a timely manner.

Section 18.1485 of the *Michigan Compiled Laws* states that each department shall establish and maintain an internal accounting and administrative control system using GAAP. These controls should include a system of authorization and recordkeeping procedures to control assets, liabilities, revenues, and expenditures; a system of practices to be followed in the performance of duties; qualified personnel that maintain a level of competence; and internal control techniques that are effective and efficient. Each principal department head shall document the system and assure that the system functions as intended.

We noted:

a. MDHHS did not ensure that all fiscal year 2018 payables were appropriately included in the year-end accounts payable write-off calculation, resulting in a $24.4 million understatement. MDHHS informed us that year-end payables were established using specific document codes; however, one payable was excluded from the write-off population, so it was not included in the write-off calculation. MDHHS corrected this understatement prior to the *SOMCAFR's* issuance.

b. MDHHS did not appropriately track and liquidate accounts payable and receivable balances. For example:

   (1) MDHHS could not provide support showing a reduction in draws for the liquidation of $22.0 million in unearned receipts payable due to the U.S. Department of Health and Human Services.

   (2) MDHHS could not provide support regarding the over liquidation and write-off of payables of $5.9 million.

   (3) MDHHS could not provide support regarding the over liquidation and write-off of federal receivable of $1.1 million.

   MDHHS informed us that payables and receivables were converted into SIGMA at the fund level rather than at the grant level and guidance was not provided on how to proceed with the converted balances. MDHHS processes and work sheets used in prior fiscal years to track federal draws, expenditures, and cash position were not evaluated and updated until the middle of fiscal year 2018.

As a result, it was a complicated process to combine SIGMA expenditures with overdrawn funds in the prior fiscal year to determine the amount owed to the federal government. MDHHS stopped drawing federal funds partially through the fiscal year until an updated process was established. MDHHS attempted to reconcile balances at a high level, rather than by individual grant or program level, in order to verify the overall ending balances for the federal receivables.

c. MDHHS did not have a process in place to evaluate the appropriateness of the estimates provided by county contract managers for the Title IV-D Cooperative Reimbursement Program year-end payable. In fiscal year 2018, MDHHS provided additional training and guidance to county contract managers to improve the accuracy of the year-end estimate; however, based on historical data, the guidance does not appear to be sufficient because the year-end payable is consistent with previous years. Annual payable write-offs averaged $9.5 million for fiscal years 2012 through 2017:

Fiscal Year	Year-End Payable	Write-Off	Percentage of Payable
2012	$21,543,806	$ 9,606,203	45%
2013	$19,955,869	$ 9,382,357	47%
2014	$32,771,734	$ 9,634,778	29%
2015	$32,436,069	$14,356,756	44%
2016	$24,520,072	$ 7,274,405	30%
2017	$25,879,627	$ 6,929,071	27%
2018	$28,917,082	Not available at time of testing	N/A

d. MDHHS established a payable and a receivable for the year-end Child Support Accrual. Our initial review of the accrual data identified issues between the data warehouse query and the Michigan Child Support Enforcement System (MiCSES). MDHHS and DTMB corrected the issue and ran a second query. Our review of the second query noted 3 of the 35 sampled records for which the data used in the accrual calculation did not agree with MiCSES. MDHHS and DTMB informed us that the query did not always pull the correct value when multiple assignment types existed. MDHHS and DTMB ran a third query after correcting a file join within the query; however, there were still issues with the query data. MDHHS informed us that it did not plan to revise the query because of time constraints. MDHHS based the accrual calculation on data from the second query. We estimated that the payable and the receivable were overstated by $1.6 million and $2.5 million, respectively.

e. MDHHS did not ensure that all expenditures were appropriately included in the calculation of the Child Care Fund year-end accrual, resulting in a $1.2 million overstatement. MDHHS calculated the payable using expenditures in SIGMA; however, the total amount of expenditures changed following the calculation of the accrual but prior to the *SOMCAFR's* issuance. MDHHS corrected this overstatement prior to the *SOMCAFR's* issuance.

f. MDHHS did not ensure that sufficient procedures existed for the net calculation of outstanding payables and operating advances made to non-governmental agencies, resulting in the improper calculation of $1.3 million in payables and receivables. MDHHS informed us that it had not updated its procedures for this calculation to account for changes resulting from the implementation of SIGMA. As a result, MDHHS did not include all coding elements in its calculation. MDHHS corrected this overstatement prior to the *SOMCAFR's* issuance.

g. MDHHS did not have sufficient review procedures to prevent and correct duplicate transactions. We noted:

   (1) MDHHS incorrectly recorded an entry to reverse a duplicated payable write-off. MDHHS informed us that the contracts payable section wrote-off payables at a detail level while the expenditure operations section wrote-off payables at the summary level, which did not factor in the payables written-off by the contract payable section. This lack of communication resulted in the duplicate write-off. When MDHHS calculated the reversal entry, receivables were incorrectly combined with the payables to calculate the reversal, resulting in a $1.2 million overstatement of accounts payable and an understatement of revenue. MDHHS corrected this overstatement prior to the *SOMCAFR's* issuance.

   (2) MDHHS incorrectly established an unearned receipts payable for federal expenditures that were drawn twice. Upon our request for additional information, MDHHS informed us that the original payable was calculated incorrectly, resulting in a $777,835 overstatement.

h. MDHHS did not maintain sufficient documentation to support reimbursement payments for the Adult Home Help Program. Our testing of a sample of 31 payments identified 12 payments for which documentation did not support the full payment that was made. MDHHS informed us that the current system does not have the capability of tracking services provided by hours, which is how MDHHS pays its providers. The only documentation MDHHS has to support the payment is a work verification that tracks the number of days the services were provided. This error also impacted the Medicaid accruals.

RECOMMENDATION

We recommend that MDHHS establish sufficient procedures and enhanced communications among department staff to help ensure the accuracy of accounts receivable and accounts payable transactions.

AGENCY PRELIMINARY RESPONSE

OFM provided us with the following response:

MDHHS and OFM agree that there are areas where procedures and communications should be improved. MDHHS will work to enhance applicable procedures and communications.

FINDING #8

Improvements needed to various departments' financial accounting practices.

Various State agencies did not have sufficient internal control to help ensure the accuracy of the accounting information recorded in the *SOMCAFR*.

Section 18.1485 of the *Michigan Compiled Laws* states that each department shall establish and maintain an internal accounting and administrative control system using GAAP. These controls should include: a system of authorization and recordkeeping procedures to control assets, liabilities, revenues, and expenditures; a system of practices to be followed in the performance of duties; qualified personnel that maintain a level of competence; and internal control techniques that are effective and efficient. Each principal department head shall document the system and assure that the system functions as intended.

We noted:

a. Treasury did not:

   (1) Update the Tobacco Settlement accrual methodology when statute changed to include allocations to the Community District Education Fund and the General Fund. The following misstatements of accounts receivable and deferred inflow of resources occurred, which Treasury corrected prior to the *SOMCAFR's* issuance:

      (a) Misstatements beginning in fiscal year 2015:

         - Michigan Merit Trust Fund - Overstated by $13.1 million.
         - General Fund - Understated by $13.1 million.

      (b) Misstatements beginning in fiscal year 2017:

         - Michigan Merit Trust Fund - Overstated by $54.0 million.
         - Community District Education Trust Fund - Understated by $54.0 million.

   (2) Perform a reconciliation of the offset fund to ensure that the fiscal year-end balance of $6.9 million was accurate and complete.

      We first commented on this issue during the fiscal year 2017 *SOMCAFR* audit. Treasury and OFM agreed with our prior recommendation, and Treasury planned to implement a comprehensive reconciliation process; however, that process was not completed during fiscal year 2018.

(3) Ensure that contingent liabilities were properly accounted for. Treasury corrected these issues prior to the *SOMCAFR's* issuance. Specifically:

(a) Treasury did not include all prior year tax credits in the calculation of the liability which resulted in an $18.0 million overstatement of expenditures and liabilities recorded in the entity-wide governmental activities.

(b) Treasury did not have a process to ensure that all manual payments made after September 30 were included in the liability calculation resulting in a $7.1 million overstatement of General Fund and entity-wide governmental activities revenues, $6.6 million understatement of expenditures, and a $13.7 million understatement of the tax refund payable.

b. MDOT did not:

(1) Properly classify $82.7 million of current expenditures as capital outlay expenditures.

GASB Codification Section 1800.136 requires expenditures to be classified on the basis of the fiscal period they are presumed to benefit. Current expenditures benefit the current fiscal period and capital outlay expenditures benefit both the present and future fiscal periods. The expenditures should have been classified as capital outlay expenditures because they were for capital asset construction in process projects. MDOT corrected this issue prior to the *SOMCAFR's* issuance.

(2) Properly classify $61.4 million as miscellaneous revenue related to the Gordie Howe International Bridge project because the funding originated from Canada. MDOT originally recorded this as revenue from local agencies. MDOT corrected this issue prior to the *SOMCAFR's* issuance.

(3) Properly classify $22.5 million in expenditure credits, resulting in expenditure and revenue overstatements. MDOT originally classified the $22.5 million as expenditure credits and subsequently reclassified the expenditure credits to miscellaneous revenue. MDOT corrected this issue prior to the *SOMCAFR's* issuance.

(4) Properly classify pass-through funds for local units of government. MDOT recorded unearned revenue in the Transportation Related Trust Funds ($12.8 million) and the State Aeronautics Fund ($5.5 million). Because of their pass-through characterization, these amounts are more accurately classified as accounts

payable rather than unearned revenue. MDOT corrected this issue prior to the *SOMCAFR's* issuance.

c. The Michigan Department of Education (MDE) did not:

(1) Analyze the collectability of accounts receivable prior to recording Child Care Development Fund (CCDF) recoupments for provider overpayments. The FMG (Part II, Chapter 11, Section 200) requires agencies to establish allowances for uncollectible amounts whenever it is anticipated that collection is doubtful. MDE recorded a long-term accounts receivable of $17.0 million for outstanding CCDF recoupments that it deemed were not likely to be received in fiscal year 2019. MDE ultimately concluded that these outstanding recoupments were unlikely to be collected in the future. MDE corrected this issue prior to the *SOMCAFR's* issuance.

(2) Reconcile current and prior year CCDF expenditures and revenues by individual grant to ensure the accuracy of federal accounts receivable. As a result, MDE was unable to provide supporting documentation for $10.8 million of the CCDF federal receivable.

The FMG (Part II, Chapter 11, Section 200) requires agencies to record an accounts receivable write-off when the agency determines a receivable established in a prior fiscal year to be uncollectible. MDE stated that it would complete CCDF reconciliations during fiscal year 2019 to determine how much of the CCDF federal receivable should be written off.

RECOMMENDATION

We recommend that State agencies establish sufficient internal control to help ensure the accuracy of the accounting information recorded in the *SOMCAFR*.

AGENCY PRELIMINARY RESPONSE

OFM provided us with the following response:

State agencies and OFM agree that internal controls should be enhanced and will work to implement the needed improvements.

FINDING #9

Improvements needed to MDOT accounts payable.

MDOT did not have sufficient internal control in place to evaluate the dates of service when processing payments and liquidating prior year accounts payable estimates. Consequently, expenditures were recorded in the wrong fiscal year.

The FMG (Part II, Chapter 14, Section 100) requires agencies to record payables for goods or services received by September 30. Local agencies, MDOT project managers, and external consultants submit estimated accounts payable work sheets for compilation by MDOT staff at the end of the fiscal year. MDOT's practice is to apply payments made during the current fiscal year against the established payable until the balance is reduced to zero. The actual work date of service is not taken into consideration. If payments in the current fiscal year are less than the estimated payable, the remaining payable balance is written off.

MDOT wrote off an average of 17% ($30.4 million) of the estimated payables established for fiscal years 2015 through 2017. The write-off percentage is most likely understated because of MDOT's practice of applying payments made during the current fiscal year against the estimated payable regardless of the work date of service. Also, MDOT records an associated receivable for the federal and local share of the estimated payable, when applicable. MDOT wrote off an average of $15.8 million of the associated receivable in fiscal years 2016 through 2018 that was established in the prior year based upon the estimated payable:

	Write Off	
	Payable	Associated Receivable
2016	$ 18,039,258	$ 9,474,517
2017	$ 25,827,634	$ 11,699,754
2018	$ 47,255,897	$ 26,235,355
Average	$ 30,374,263	$ 15,803,209

We evaluated payable service dates and noted:

a. MDOT understated an estimated payable by $8.2 million for fiscal year 2018 expenditures with dates of service in fiscal year 2018 that did not have an associated fiscal year 2018 payable.

b. MDOT overstated an estimated payable by $6.6 million for fiscal year 2018 expenditures with dates of service in fiscal year 2018 that did not match the actual payments made in fiscal year 2019.

c. MDOT overstated an estimated payable by $2.7 million for fiscal year 2018 expenditures. We randomly and judgmentally sampled fiscal year 2018 estimated contractor payables and reviewed the fiscal year 2019 payment dates of service. MDOT processed a correcting entry related to the sampled estimated contractor payables that were in error.

In the fiscal year 2017 *SOMCAFR* report on internal control, compliance, and other matters, we reported that MDOT and OFM agreed that comprehensive consideration of the dates of service when processing contractor payments might lead to accounts payable transactions that are more accurate. However, MDOT also indicated that it would review the methodology used to estimate and track contractor payables and determine if there were opportunities for improvements where the cost to implement the improvements did not significantly exceed the benefits derived. However, MDOT made no changes to the payable estimation methodology.

RECOMMENDATION

We recommend that MDOT improve internal control to help ensure the evaluation of dates of service when processing payments and liquidating prior year accounts payable estimates.

AGENCY PRELIMINARY RESPONSE

OFM provided us with the following response:

MDOT and OFM agree that comprehensive consideration of the dates of service when processing contractor payments might lead to accounts payable transactions that are more accurate. However, the service dates mentioned in the recommendation are not readily available to central office contractor payment staff and efficient access would require system changes. MDOT will continue to review the methodology used to estimate and track contractor payables and determine if there are opportunities for improvements where the cost to implement the improvements do not significantly exceed the benefits derived.

FINDING #10

Improvements needed to State compliance with revenue allocations.

Treasury and MDOT did not have sufficient internal control to help ensure compliance with various sections of the *Michigan Compiled Laws* related to the allocation of revenues and, as a result, tax revenue was incorrectly allocated and was not available for its intended purpose.

We noted:

a. Treasury did not exclude the local community stabilization authority share from the State share when determining the proper use tax revenue allocation between the School Aid Fund (SAF) and the General Fund in fiscal year 2016. As a result, Treasury restated beginning fund balance in fiscal year 2018, which increased the SAF and decreased the General Fund by $32.1 million.

   Section 205.93 of the *Michigan Compiled Laws* sets the use tax rate at 6% of the price of property or services and for fiscal year 2016 required that the State share tax rate was to be calculated by subtracting the local community stabilization share ($96.4 million) from the total 6% tax. Section 205.111 of the *Michigan Compiled Laws* requires that of the remaining use tax revenue collected, one-third would be allocated to the SAF and the remaining two-thirds, less other exceptions, would be deposited in the General Fund.

b. Treasury did not ensure that the SAF received the proper income tax revenue allocation in fiscal year 2018. As a result, revenue allocated to the SAF was understated and the General Fund was overstated by $3.0 million.

   Section 206.51 of the *Michigan Compiled Laws* requires that 23.81% of the gross income tax collections before refunds is to be deposited in the SAF, calculated by dividing 1.012% by the fiscal year 2018 income tax rate of 4.25%.

   At fiscal year-end, Treasury allocated income tax revenue between the SAF and the General Fund; however, it did not ensure that activity impacting income tax revenue subsequent to the fiscal year-end entry was properly allocated.

   Treasury processed a correcting entry prior to the *SOMCAFR's* issuance.

c. MDOT did not ensure that the proper gasoline tax rate was used for the Michigan Transportation Fund (MTF) revenue allocation, resulting in a $2.1 million inaccurate allocation of gasoline tax revenue.

   Section 207.1008 of the *Michigan Compiled Laws* imposes a gasoline tax for fiscal year 2018 of 26.3 cents per gallon for motor fuel imported into or sold, delivered, or used in the State. Section 247.660 of the *Michigan Compiled Laws* requires three separate deductions from the gasoline tax revenue:

- 3.0 cents to the local agency wetland mitigation board fund.
- 0.5 cents to the State Trunkline Fund for the repair of state bridges.
- 0.5 cents to the local bridge fund.

In allocating the $1.2 billion gasoline tax for fiscal year 2018, MDOT used 26.0 cents per gallon in the MTF allocation calculation, rather than the required 26.3 cents per gallon, based on its interpretation of Section 207.1014 of the *Michigan Compiled Laws*, which allows for gasoline suppliers, when computing the tax remitted to Treasury, to deduct 1.5% of the quantity of gasoline removed by the supplier to allow for the cost of remitting the tax. However, the 1.5% deduction is related to the volume of gasoline that is subject to the gasoline tax rather than a reduction of the tax levied per gallon. Because MDOT used the lower overall tax rate (26.0 rather than 26.3), the number of allocated gallons was overstated, resulting in allocation overstatements for the three deductions.

RECOMMENDATION

We recommend that Treasury and MDOT develop sufficient internal control to help ensure compliance with various sections of the *Michigan Compiled Laws* related to the allocation of revenues.

AGENCY PRELIMINARY RESPONSE

OFM provided us with the following response:

a. and b. Treasury and OFM agree that internal controls to ensure compliance with various sections of the Michigan Compiled Laws *should be enhanced. Treasury plans to update procedures related to the Statutory Allocations for Sales and Use Tax and the regular School Aid Fund Income Tax Transfers completed at year end close.*

c. MDOT and OFM agree that a 26.3 cent per gallon gasoline tax rate should be used in the MTF allocation calculation and MDOT will make applicable changes in its allocation calculation.

FINDING #11

Improvement needed to statutory revenue allocations among State funds.

Treasury should further establish a process to help ensure the accuracy of statutory sales tax revenue allocations among State funds. Treasury did not comprehensively evaluate the accuracy of the estimated amount of sales tax revenue received for residential utilities to the actual amounts received, which may impact an aspect of the annual allocation of sales tax revenue among the statutory funds.

Sales tax revenue consists of a 4% sales tax component and a 2% sales tax component. The 4% component is allocated 60% to the SAF and the remaining 40% is split based upon statutory earmarks and the General Fund. The 2% component is allocated 100% to the SAF. While the vast majority of goods and services are subject to both the 4% and 2% sales tax components, residential utilities are exempt from the 2% component.

Treasury collects sales tax revenue from taxpayers during the fiscal year and records the collections based on information provided by the taxpayer. At year-end, Treasury makes an adjusting entry to reallocate revenue amounts between the SAF and the General Fund based upon total sales tax revenue collected during the fiscal year, net of refunds, and Treasury's estimated sales tax revenue received for residential utility payments. Treasury informed us that the estimated sales tax revenue received for residential utility payments is currently based on nationally recognized externally published sources. Treasury estimated fiscal year 2018 residential utility sales tax payments of $337.7 million. Below is the impact of a $1.0 million variance to the residential utilities sales tax estimate:

Estimate Overstated (Understated)	Impact on General Fund	Impact on SAF
($1,000,000)[1]	($133,000)	$133,333
$1,000,000[2]	$133,333	($133,333)

[1] If the estimate was understated by $1 million, then the excess revenue was treated at 6% and SAF benefitted.

[2] If the estimate was overstated by $1 million, then the excess revenue was treated at 4% and the General Fund benefitted.

During fiscal year 2015, Treasury implemented a new sales, use, and withholding system which utilizes the SAP system to reallocate sales tax revenue for residential utility taxpayers only subject to the 4% sales tax component. Treasury provided the following data from the SAP system related to 4% sales tax payments:

Fiscal Year	Residential Utility Estimate	Residential Utility Amount in the SAP System
2016	$319,300,000	$110,770,324
2017	$311,500,000	$319,708,637
2018	$337,700,000	$ 41,947,200

Treasury stated that the SAP system residential utility tax payment amounts reflect the payments and returns remitted by taxpayers. Various factors may impact the accuracy of the amount of 4% sales tax revenue for each fiscal year, such as when payments were made, when returns were processed, or if the taxpayer did not properly identify the sales tax payments as residential utility tax payments. Treasury also informed us that during the audit period it was unable to determine in a timely manner the actual amount of sales tax revenue received from residential utilities, making a potential financial statement error not estimable.

RECOMMENDATION

We recommend that Treasury further establish a process to help ensure the accuracy of sales tax revenue allocations.

AGENCY PRELIMINARY RESPONSE

OFM provided us with the following response:

Treasury and OFM agree that Treasury should further establish a process to ensure the accuracy of the sales tax revenue allocations. Treasury will review the estimation methodology in comparison to the actual residential utility amounts received by August 31, 2019. If Treasury determines any changes need to be made to the estimation methodology based off this review, these changes will be implemented within the fiscal year 2019 year-end sales tax revenue allocation.

FISCAL YEAR 2017
REPORT ON INTERNAL CONTROL,
COMPLIANCE, AND OTHER MATTERS
FOLLOW-UP

Below is the status of the reported findings from the 2017 *SOMCAFR* report on internal control, compliance, and other matters:

Prior Audit Finding Number	Topic Area	Current Status	Current Finding Number
1a - 1c	MDHHS - Internal Control	Complied	Not applicable
1d	MDHHS - Lack of Proper Approval of Transactions	Repeated*	5c
2a - 2h	MDHHS - Accounts Payable and Accounts Receivable Errors	Complied	Not applicable
2i	MDHHS - Supporting Documentation for Adult Home Help Program	Repeated	7h
3a	Tax Accruals - GASB 34 Estimated Accounts Receivable Calculation	Complied	Not applicable
3b	Tax Accruals - Evaluation of Accounting Estimates	Repeated	6a
3c	Tax Accruals - Properly Recording Liabilities for SUW taxes and CIT	Rewritten*	6b
3d	Tax Accruals - Properly Recording IIT Collections	Repeated	6d
4	Treasury - Controls Over Offset Fund	Repeated	8a(2)
5	MDOT - Overstatement of Estimated Payables	Repeated	9
6	DTMB Financial Accounting	Complied	Not applicable

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

GLOSSARY OF ABBREVIATIONS AND TERMS

AASHTOWare	American Association of State Highway and Transportation Officials software.
AICPA	American Institute of Certified Public Accountants.
auditor's comments to agency preliminary response	Government auditing standards require auditors to evaluate the validity of the audited entity's response when it is inconsistent or in conflict with the findings, conclusions, or recommendations. If the auditors disagree with the response, they should explain in the report their reasons for disagreement. Therefore, when this situation arises, the OAG includes auditor's comments to comply with this standard.
CCDF	Child Care Development Fund.
CI	stock issue confirmation.
CIP	construction in progress.
CIT	corporate income tax.
Code of Federal Regulations (CFR)	The codification of the general and permanent rules published by the departments and agencies of the federal government.
COFS	Corporations Online Filing System.
CTF	Comprehensive Transportation Fund.
deficiency in internal control over financial reporting	The design or operation of a control that does not allow management or employees, in the normal course of performing their assigned functions, to prevent, or detect and correct, misstatements on a timely basis.
DNR	Department of Natural Resources.
DTMB	Department of Technology, Management, and Budget.

Federal Information System Controls Audit Manual (FISCAM)	A methodology published by the U.S. Government Accountability Office (GAO) for performing information system control audits of federal and other governmental entities in accordance with *Government Auditing Standards.*
financial audit	An audit that is designed to provide reasonable assurance about whether the basic financial statements of an audited entity are presented fairly, in all material respects, in accordance with the applicable financial reporting framework.
FMG	State of Michigan Financial Management Guide.
GAL	Garnishment and Levies.
GAO	U.S. Government Accountability Office.
generally accepted accounting principles (GAAP)	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 governmental entities.
HIPAA	Health Insurance Portability and Accountability Act.
IIT	individual income tax.
internal control	A process, effected by those charged with governance, management, and other personnel, designed to provide reasonable assurance about the achievement of the entity's objectives with regard to the reliability of financial reporting, effectiveness and efficiency of operations, and compliance with applicable laws and regulations.
IT	information technology.
LARA	Department of Licensing and Regulatory Affairs.

material misstatement	A misstatement in the basic financial statements that causes the statements to not present fairly the financial position or the changes in financial position, and, where applicable, cash flows thereof, in accordance with the applicable financial reporting framework.
material weakness in internal control over financial reporting	A deficiency, or a combination of deficiencies, in internal control such that there is a reasonable possibility that a material misstatement of the basic financial statements will not be prevented, or detected and corrected, on a timely basis.
MBT	Michigan business tax.
MDE	Michigan Department of Education.
MDHHS	Michigan Department of Health and Human Services.
MDOT	Michigan Department of Transportation.
MiCARS	Michigan Cashiering and Receivable System.
Michigan Administrative Information Network (MAIN)	The State's automated administrative management system that supported accounting, purchasing, and other financial management activities through fiscal year 2017.
MiCSES	Michigan Child Support Enforcement System.
MiSACWIS	Michigan Statewide Automated Child Welfare Information System.
MSP	Michigan Department of State Police.
MTF	Michigan Transportation Fund.
OAG	Office of the Auditor General.
OFM	Office of Financial Management.
OIAS	Office of Internal Audit Services.

repeated The same problem was noted in the current audit, and the wording of the current recommendation remains essentially the same as the prior audit recommendation.

rewritten The recurrence of similar conditions reported in a prior audit in combination with current conditions that warrant the prior audit recommendation to be revised for the circumstances.

SAF School Aid Fund.

SBA State Building Authority.

SBO State Budget Office.

SBT single business tax.

significant deficiency in internal control over financial reporting 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.*

SOS SIGMA Operations and Support.

Statewide Integrated Governmental Management Applications (SIGMA) The State's enterprise resource planning business process and software implementation that support budgeting, accounting, purchasing, human resource management, and other financial management activities.

SUW sales, use, and withholding.

System and Organization Controls (SOC) report Designed to help organizations that provide services to user entities build trust and confidence in their delivery processes and controls through a report by an independent certified public accountant (CPA). Each type of SOC report is designed to meet specific user needs:

- SOC 1 (Report on Controls at a Service Organization Relevant to User Entities' Internal Control Over Financial Reporting) - Intended for user entities and the CPAs auditing their financial statements in evaluating the effect of the service organization's controls on the user entities' financial statements.

- SOC 2 (Report on Controls at a Service Organization Relevant to Security, Availability, Processing Integrity, Confidentiality, or Privacy) - Intended for a broad range of users that need information and assurance about a service organization's controls relevant to any combination of the five predefined control principles.

  There are two types of SOC 1 and SOC 2 reports:

  - Type 1 - Reports on the fairness of management's description of a service organization's system and the suitability of the design of the controls to achieve the related control objectives included in the description, as of a specified date.

  - Type 2 - Includes the information in a type 1 report and also addresses the operating effectiveness of the controls to achieve the related control objectives included in the description, throughout a specified period.

- SOC 3 (Trust Services Report for a Service Organization) - Intended for those needing assurance about a service organization's controls that affect the security, availability, or processing integrity of the systems a service organization employs to process user entities' information, or the confidentiality or privacy of that information, but do not have the need for or the knowledge necessary to make effective use of a SOC 2 report.

- SOC for Cybersecurity. Intended to communicate relevant information about the effectiveness of an organization's cybersecurity risk management programs.

Treasury Department of Treasury.

unmodified opinion The opinion expressed by the auditor when the auditor, having obtained sufficient appropriate audit evidence, concludes that the basic financial statements are presented fairly, in all material respects, in accordance with the applicable financial reporting framework.

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