

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

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**State of Michigan**  
**Comprehensive Annual Financial Report**  
State Budget Office

Fiscal Year Ended September 30, 2019

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

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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*

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# OAG

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, 2019*

**Report Number:**  
**071-0010-20**

**Released:**  
**May 2020**

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 March 6, 2020.

<b>Findings Related to Internal Control, Compliance, and Other Matters</b>	<b>Material Weakness</b>	<b>Significant Deficiency</b>	<b>Agency Preliminary Response</b>
The State should enhance its oversight of third party service organizations. State departments did not effectively apply the Office of Internal Audit Services' guidance ( <a href="#">Finding #1</a> ).	X		Agree
Various State agencies 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 ( <a href="#">Finding #2</a> ).		X	Agree
The Department of Treasury and the Office of Financial Management (OFM) should continue to enhance internal control to prevent, or detect and correct, misstatements and help ensure the accuracy of tax accruals ( <a href="#">Finding #3</a> ).		X	Agree
Various State agencies should improve the Michigan Cashiering and Receivable System (MiCARS) internal control to help ensure the completeness and accuracy of the SOMCAFR. State agencies interfaced \$1.3 billion in revenue between MiCARS and SIGMA in fiscal year 2019 ( <a href="#">Finding #4</a> ).		X	Agree

<b>Findings Related to Internal Control, Compliance, and Other Matters (Continued)</b>	<b>Material Weakness</b>	<b>Significant Deficiency</b>	<b>Agency Preliminary Response</b>
The Michigan Department of Transportation (MDOT) and the Michigan Department of State Police did not establish and implement complete interface controls over SIGMA to ensure that all data exchanged between SIGMA and other State information systems was processed completely, accurately, and timely ( <u>Finding #5</u> ).		X	Agree
Various State agencies and OFM did not have sufficient internal control to help ensure the accuracy of the accounting information recorded in the SOMCAFR ( <u>Finding #6</u> ).		X	Partially agree
Various State agencies and OFM did not have sufficient internal control in place to help ensure the existence and accuracy of the State's capital assets recorded in the SOMCAFR ( <u>Finding #7</u> ).		X	Agree
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 ( <u>Finding #8</u> ).		X	Agree
The Michigan Department of Health and Human Services should enhance internal control to prevent, or detect and correct, misstatements and help ensure the accuracy of Medicaid accruals ( <u>Finding #9</u> ).		X	Agree

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**Doug A. Ringler, CPA, CIA**  
Auditor General

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# OAG

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**Doug A. Ringler, CPA, CIA**  
Auditor General

May 12, 2020

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, 2019.

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 Office 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,

A handwritten signature in black ink that reads "Doug Ringler". The signature is written in a cursive, flowing style.

Doug Ringler  
Auditor General



## TABLE OF CONTENTS

### STATE OF MICHIGAN COMPREHENSIVE ANNUAL FINANCIAL REPORT

	<u>Page</u>
Report Summary	1
Report Letter	3
Independent Auditor's Report on Internal Control Over Financial Reporting and on Compliance and Other Matters	8
Fiscal Year 2019 Findings, Recommendations, and Agency Preliminary Responses	
1. Third party service organization monitoring.	12
2. Access limitations for confidential information in SIGMA.	15
3. Establishment and monitoring of tax receivables and payables.	18
4. MiCARS internal control improvements.	22
5. MDOT and MSP interface controls.	24
6. Various departments' financial accounting practices.	26
7. Financial accounting practices related to capital assets.	32
8. MDOT accounts payable.	34
9. Accuracy of Medicaid receivables and payables.	36
Fiscal Year 2018 Report on Internal Control, Compliance, and Other Matters Follow-Up	40
Glossary of Abbreviations and Terms	42



# INDEPENDENT AUDITOR'S REPORT ON INTERNAL CONTROL AND COMPLIANCE



# OAG

Office of the Auditor General

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**Doug A. Ringler, CPA, CIA**  
Auditor General

## 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, 2019 and the related notes to the financial statements, which collectively comprise the State's basic financial statements, and have issued our report thereon dated March 6, 2020. 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
- Farm Produce Insurance Authority
- Mackinac Bridge Authority
- Mackinac Island State Park Commission
- Michigan Early Childhood Investment Corporation
- Michigan Education Trust
- State Bar of Michigan
- Venture Michigan Fund
- Central Michigan University
- Eastern Michigan University
- Western 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 #9 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  
Auditor General  
March 6, 2020



FISCAL YEAR 2019  
FINDINGS, RECOMMENDATIONS,  
AND AGENCY PRELIMINARY RESPONSES

## FINDING #1

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

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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 on how to assess and manage risks associated with the departments' service organizations. 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 the results of 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 and effectiveness of controls over the State's bank account for the entire fiscal year. Treasury did not obtain a SOC 1 report for the State's bank applicable to fiscal year 2019.

Treasury did obtain an AT-C 205 report. However, this report covered only the last 4 months of fiscal year 2019.

- 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 <https://audgen.michigan.gov/wp-content/uploads/2019/03/r071059518-2222.pdf>, identified concerns in Finding #6, parts a., b., and c. We reported 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 2019 and determined that the same conditions still exist.

\* See glossary at end of report for definition.

c. State agencies did not:

- (1) Obtain SOC reports that provided sufficient coverage during the audit period for all high risk third party service providers. We noted:
  - (a) An agency did not obtain a SOC report for one service provider because the service provider was not considered high risk, even though the agency did obtain a SOC report for the subservice provider, which was considered high risk.
  - (b) An agency obtained a SOC 1 Type 1 report from one third party service provider. Type 1 reports are "as of" a specific date and the independent auditors do not test the operating effectiveness of the controls. As a result, these reports do not provide sufficient assurances to address the State's needs.
  - (c) Agencies did not provide 4 (9%) of the 45 SOC reports requested because the reports providing coverage during fiscal year 2019 were not available.
- (2) Obtain bridge letters in appropriate circumstances for 10 (56%) of 18 SOC reports. Also, 2 (25%) of the 8 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 3 (8%) of the 40 fiscal year 2019 SOC reports. Also, 23 (62%) of the 37 documented reviews were not done within 60 days. In three cases, an entire year passed before the State agencies reviewed the SOC reports. Timely review is essential to ensure that the SOC does not identify weaknesses that require the State's immediate attention.
- (4) Consider the need to obtain SOC reports for the vendor's subservice providers for 8 (35%) of the 23 SOC reports reviewed that referenced subservice providers.

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Timely review of SOC reports enables agencies to take action on identified weaknesses, limiting the State's risk.

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- (5) Document the State agencies' review of complementary user-entity controls for 4 (11%) of the 35 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.

We commented on these issues during the fiscal year 2018 *State of Michigan Comprehensive Annual Financial Report (SOMCAFR)* audit. OIAS stated that it would continue to enhance the FMG and facilitate discussions between key agency stakeholders to identify opportunities for improved guidance and oversight that will improve practices to obtain proper assurances from third party service organizations. Also, SBO agreed with the need to continually assess the level of coverage obtained in the annual security review for SIGMA but did not agree that the level of coverage obtained was not sufficiently assessed. FMG updates had not been finalized as of the fiscal year 2019 *SOMCAFR* opinion date.

## **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 continue to be enhanced. OIAS will review all 2019 SOC report review templates for correct scope and reporting periods and collaborate with the departments to address these areas prior to the fiscal year 2020 CAFR audit cycle. In addition, OIAS will review these templates on an annual basis prior to submission to the OAG.*

*Regarding part b, database administration controls have been added to the scope of the SOC review for fiscal year 2020 and will remain in scope going forward. SBO agrees with the need to continually assess the level of coverage obtained in the annual security review security level requirement but does not agree with the assertion that the level of coverage obtained was not sufficiently assessed. Processing integrity, confidentiality and privacy principles do not need to be covered in the SOC 2 review because we have enough assurances as a result of compensating controls and the additional controls provided by the Annual 3rd Party Vulnerability Exam and FEDRamp Certification processes.*

## FINDING #2

### Improvements needed to limit access to confidential information in SIGMA.

Various State agencies 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.

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. Also, Section 205.28(1)(f) of the *Michigan Compiled Laws* strictly prohibits employees of Treasury from disclosing confidential tax information to anyone other than the individual taxpayer or his or her authorized representative.

The SIGMA Project communicated 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." However, agencies included confidential information in SIGMA without a written agreement.

We noted:

- a. State agencies did not provide sufficient guidance to staff to ensure the omission of confidential information in SIGMA transaction support.

We noted:

- (1) The Michigan Department of Corrections (MDOC) included certain confidential information related to prisoners.

MDOC informed us that it will redact confidential information from future SIGMA transaction support. We identified 1,307 Statewide SIGMA users with access to view MDOC transactions in SIGMA.

- (2) Treasury included certain confidential information related to taxpayer information. We identified 615 Statewide SIGMA users with access to view Treasury transactions. Title 5, section 552a of the *United States Code* states that each agency shall establish appropriate administrative, technical, and physical safeguards to ensure the security and confidentiality of records. Treasury informed us that it will redact taxpayer information from future SIGMA transaction support.

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

The Michigan Department of Health and Human Services (MDHHS) interfaced transactions from the Adult Services Authorized Payments (ASAP) system to SIGMA that displayed certain identifying information within the check description field in SIGMA. We identified 1,510 Statewide SIGMA users with access to view MDHHS transactions in SIGMA. Federal and State regulations protect the confidentiality of 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 beneficiary the payment relates to and is working to fix the issue.

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

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## RECOMMENDATION

We recommend that State agencies limit access to confidential information to appropriate users of the information.

## AGENCY PRELIMINARY RESPONSE

OFM provided us with the following response:

*DOC, Treasury, MDHHS and OFM agree that State agencies should limit access to confidential information to appropriate users of the information.*

- a. (1) *MDOC has provided notification to staff to remove or redact Personally Identifiable Information (PII), Protected Health Information, or any other confidential information from attachments in SIGMA. MDOC has completed a review of SIGMA attachments and successfully removed or redacted affected attachments for most documents identified by the review. Certain documents cannot be modified after they have been recorded and, as such, require technical intervention to remove the attachments. MDOC notified the SIGMA Center of Excellence of the document codes requiring technical assistance and SIGMA Operations and Support is working on a solution.*

\* See glossary at end of report for definition.

- a. (2) *Treasury has updated its processes and is now redacting the confidential information. The documents that already have confidential information included as support cannot be modified after they have been recorded and, as such, require technical intervention to remove the attachments. Treasury notified the SIGMA Center of Excellence of the document codes requiring technical assistance and SIGMA Operations and Support is working on a solution.*
  
- b. *MDHHS' Financial Support Division has continued to work collaboratively with subsystem leads, MDHHS Compliance, the Department of Technology, Management, and Budget (DTMB), DataStage, and SIGMA to discuss the best approach to mitigate PII information in SIGMA Financials. MDHHS has determined the most efficient and cost-effective way to mitigate PII information within SIGMA is with modifications to the data by Data Stage and not the individual subsystems. In addition, modifications will be made to SIGMA Vendor to accommodate the EFT remittance advice. Statement of Work, Business Requirements, and other required documents have been completed. MDHHS is currently working with all parties to establish a timeline for coordinating the necessary efforts to mitigate displaying of any PII information within SIGMA Financials.*

## FINDING #3

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

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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 generally accepted accounting principles\* (GAAP). These controls should include a system of authorization and recordkeeping procedures to control assets, liabilities, revenues, and expenditures. In addition, Sections 2250.109 and 2250.110 of the *Codification of Governmental Accounting and Financial Reporting Standards* (Codification) published by the Governmental Accounting Standards Board\* (GASB) 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 2019 disclosed:

- a. Treasury and OFM did not ensure that GASB Statement No. 34 estimated receivables were properly calculated for various taxes. As a result, assets and deferred inflows of resources were overstated by \$10.8 million in the General Fund and \$44.8 million in the School Aid Fund. Also, assets, revenue, and net position were overstated by \$55.5 million in the governmental activities of the government-wide financial statements.

Treasury provides tax receivable information that OFM uses to reverse the prior year receivables and record the current year receivables. This information consists of complex calculations to estimate percentages of taxpayer liability that is expected to be collected by the State in future fiscal years based on historical tax return data. OFM applies these estimated percentages to current fiscal year tax collections to estimate future tax collections. In fiscal year 2019, Treasury and OFM improperly calculated the reversal amounts for individual income tax (IIT), corporate income tax (CIT), and withholding tax and improperly calculated the current year use and withholding tax receivables. Treasury and OFM recorded correcting entries prior to the *SOMCAFR*'s issuance.

- b. Treasury had not developed a detailed GASB Statement No. 34 receivable estimation methodology that was consistently applied each year. This resulted in significant reporting changes that were not always documented and communicated in a timely manner.

\* See glossary at end of report for definition.

Treasury developed reports to extract CIT and sales, use, and withholding collection data from multiple database tables in the SAP and legacy systems to calculate the GASB Statement No. 34 receivables estimate. Treasury informed us late in audit fieldwork that it has made significant changes to improve the accuracy of the collection activity extracted from SAP. However, Treasury did not incorporate the changes made into the report methodology.

- c. Treasury had not completed a process to revise significant accounting estimation methodologies after comparing prior year estimates to subsequent activity for business taxes and IIT accruals.

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 have agreed with our prior audit recommendations. Treasury began evaluating assessed taxes receivable during fiscal year 2017 and plans to determine if methodology revisions are necessary now that three years of comparison data is available. In fiscal year 2019, Treasury began comparing the IIT payable backlogs estimate with subsequent activity, noting that the fiscal year 2018 IIT payable backlog was understated by \$10.2 million (86%). Treasury informed us that it will continue to review this estimate for the next two fiscal years before determining whether to make any adjustments to the current methodology once three years of comparison data is available. Treasury is currently refining a process to evaluate business tax payable backlogs.

- d. Treasury did not ensure that October and November estimated IIT collections were properly recorded in fiscal year 2019. Therefore, assets, revenues, and fund balance/net position were overstated by a known amount of \$31,364 and a projected amount of \$4.1 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 \$1.3 million. However, Treasury did not project an additional reduction based on its sample and testing results.

- e. Treasury did not adjust November tax estimates when actual amounts were known, which caused assets to be overstated by \$0.6 million, liabilities to be overstated by \$1.7 million, and revenues and fund balance/net position each to be understated by \$1.1 million in the Michigan Transportation Fund and governmental activities of the government-wide financial statements.

Treasury records estimated November tax receivable and payable amounts for various taxes based on a percentage of known historical October amounts. However, Treasury does not compare the estimated and actual amounts and adjust the November estimated tax receivables and payables even though the actual collection amounts are known prior to the *SOMCAFR*'s issuance.

- f. Treasury did not ensure that the State Education Tax (SET) estimated receivables were properly recorded. As a result, assets, revenues, and fund balance were overstated by \$1.6 million in the School Aid Fund and in the governmental activities of the government-wide financial statements.

Each year in early December, Treasury conducts a survey of local units of government that collect SET on behalf of the State to determine the amount of SET collections in their possession as of the last business day of November. Treasury uses the survey information to estimate the State's SET receivable. In fiscal year 2019, Treasury transposed a portion of the data used to estimate the receivable, which overstated the estimated SET collections in possession of the local units. Treasury corrected this overstatement prior to the *SOMCAFR*'s issuance.

- g. 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. This results in revenues, receivables, and fund balance to be misstated in the General Fund and CTF by an undetermined amount.

The General Sales Tax Act (Public Act 167 of 1933, as amended) 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 beginning in fiscal year 2018. Treasury informed us that it intends to review this issue further during fiscal year 2020.

- h. Treasury did not have sufficient internal control in place to ensure that the November payables for business taxes included refunds pending issuance as of November 30. As part of the year-end process, Treasury runs several custom reports from its business tax system to determine the total payable that should be accrued to the prior fiscal year. We noted that the refunds pending issuance report combined two distinct data fields into one column, resulting in a misstatement of the November payable amount. Treasury informed us that it was in the process of correcting the report to separately display the two distinct data fields.

**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 controls related to tax accruals should continue to be improved and will work to implement needed improvements.*

## FINDING #4

### Improvements needed to MiCARS internal control.

Various State agencies should improve the Michigan Cashiering and Receivable System (MiCARS) internal control to help ensure the completeness and accuracy of the *SOMCAFR*. State agencies interfaced \$1.3 billion in revenue between MiCARS and SIGMA in fiscal year 2019.

We noted:

- a. The Michigan Department of State Police (MSP) did not maintain sufficient segregation of duties\* over the reconciliation of the interface between MiCARS and SIGMA.

Section 18.1485(2)(a) of the *Michigan Compiled Laws* requires each internal accounting and administrative control system to include a plan of organization that provides segregation of duties and responsibilities among employees. Also, the U.S. Government Accountability Office's (GAO's) *Federal Information System Controls Audit Manual\** (FISCAM) Section 3.4 states that work responsibilities should be segregated so that one individual does not control all critical stages of a process.

MSP uses MiCARS to establish invoices and record cash receipts, credits, refunds, and other adjustments against those invoices. MiCARS information interfaces daily into SIGMA, and MSP performs a daily reconciliation of the interfaced data. For the 5 months of daily reconciliation logs reviewed, we noted that the MSP head cashier conducted all of the reconciliations while also having the ability to write-off and adjust invoices in MiCARS. Also, the head cashier had the ability to assign user roles in MiCARS.

MSP informed us that resource limitations prevented a sufficient segregation of duties.

- b. State agencies utilizing MiCARS (Michigan Department of Transportation (MDOT); MSP; MDHHS; Michigan Department of Agriculture and Rural Development; Department of Environment, Great Lakes, and Energy; and Department of Natural Resources (DNR)) did not ensure that all MiCARS invoices received management approval prior to creating a receivable 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 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 Section 4.2 recommends that organizations implement controls to ensure that the transactions are complete, accurate, and

\* See glossary at end of report for definition.

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.

Management approval would help ensure that all invoices are authorized, complete, and accurate. State agencies informed us that MiCARS does not allow for invoice approval within MiCARS and a compensating control had not been established to approve invoices outside of MiCARS.

**RECOMMENDATION**

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

**AGENCY  
PRELIMINARY  
RESPONSE**

OFM provided us with the following response:

*Regarding part a., MSP and OFM agree with the finding, however, prior year write-offs have a separation of duties with a different individual completing the write-off in SIGMA. MSP will write additional procedures to ensure that there are compensating controls for segregation of duties for reconciliation of interface transactions between MICARS and SIGMA and invoice adjustments.*

*Regarding part b., State agencies and OFM agree in part. Many of the invoices are created by customers directly through source systems and would not require management approval. For those invoices not created by customers, some were approved by management, but the approvals were not documented. State agencies will work to ensure all applicable invoices are adequately approved and work to better document existing approvals and related procedures.*

**AUDITOR'S  
COMMENTS TO  
AGENCY  
PRELIMINARY  
RESPONSE\***

Regarding part a., the process of reconciling the two systems and initiating write-offs in MiCARS should be completed by two different staff to provide the necessary level of assurance that the write-off was proper before entries are made in SIGMA. The finding stands as written.

\* See glossary at end of report for definition.

## FINDING #5

### Improvements needed for interface controls.

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

The GAO's 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. 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.

SIGMA Operations and Support (SOS) issued Temporary Operating Policy & Procedure No. 0007 on November 9, 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.

Specifically:

- a. MDOT did not ensure that construction contractor expenditure transactions in American Association of State Highway and Transportation Officials software (AASHTOWare) reconciled with SIGMA after daily interface. AASHTOWare interfaced \$1.4 billion in expenditures into SIGMA during fiscal year 2019.

We commented on this issue during the fiscal year 2018 *SOMCAFR* audit. MDOT's Corrective Action Plan reported that it had implemented a reconciliation process and log to address the issue. Although MDOT implemented a weekly comparison of voucher numbers generated from AASHTOWare to the document numbers in SIGMA, MDOT does not have a process to reconcile the dollar amounts or record counts between AASHTOWare and SIGMA after daily interface.

- b. MSP performed reconciliations of the total records interfaced from MiCARS into SIGMA. Control totals and other coding were not included in the reconciliation. MSP interfaced \$38.7 million in revenue from MiCARS into SIGMA during fiscal year 2019.

We commented on MSP system interface during the fiscal year 2018 *SOMCAFR* audit. In response, MSP did implement interface controls between MiCARS and its source systems.

**RECOMMENDATION**

We recommend that MDOT and MSP establish and implement complete interface controls over SIGMA.

**AGENCY  
PRELIMINARY  
RESPONSE**

OFM provided us with the following response:

*MDOT, MSP and OFM agree that complete interface controls over SIGMA should be established and implemented.*

- a. MDOT implemented a daily reconciliation process on January 1, 2020 that reconciles expenditure transactions in AASHTOWare to expenditure transactions in SIGMA. This new process reconciles both dollar amounts and record counts.*
- b. MSP agrees with the finding and will establish and implement additional interface controls.*

## FINDING #6

### Improvements needed to various departments' financial accounting practices.

Various State agencies and OFM, within SBO, did not have sufficient internal control to help ensure the accuracy of all 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 ensure that the system functions as intended.

We noted:

- a. OFM did not ensure that the data used for calculating the compensated absence liabilities was complete and accurate. Expenditure data for fiscal year 2018 was included with the fiscal year 2019 data, resulting in a \$41.7 million overstatement of accounts payable and other liabilities and an understatement of the non-current portion of other long-term obligations. Also, the formula used to calculate sick leave reductions was incorrect, resulting in the \$16.9 million overstatement of the non-current portion of other long-term obligations. OFM corrected these issues prior to the *SOMCAFR*'s issuance.
- b. DTMB did not:
  - (1) Properly classify \$26.2 million in unearned revenue in the Information Technology Fund, resulting in an overstatement of noncurrent unearned revenue and an understatement in current unearned revenue. DTMB omitted certain types of capital assets while determining the current portion of the total unearned revenue. DTMB corrected this issue prior to the *SOMCAFR*'s issuance.
  - (2) Properly classify \$16.7 in prepaid expenditures in the Information Technology Fund, resulting in an overstatement of other current assets and an understatement of other noncurrent assets. DTMB treated all prepaid expenditures as current assets, including prepayments that extended over multiple fiscal years. DTMB corrected this issue prior to the *SOMCAFR*'s issuance.
- c. The Michigan Department of Education (MDE) did not record a \$13.9 million accounts payable in the School Aid Fund (SAF) because of an oversight while recording the SAF year-end accruals. MDE corrected this issue prior to the *SOMCAFR*'s issuance.

d. Treasury did not:

- (1) Perform a reconciliation of the offset fund to ensure that the fiscal year-end balance of \$7.5 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 recommendations, and Treasury planned to implement a comprehensive reconciliation process; however, that process was not completed during fiscal years 2018 or 2019.

- (2) 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.

We first commented on this issue during the fiscal year 2018 *SOMCAFR* audit. Treasury and OFM agreed with the prior recommendation, and Treasury planned to review the estimation methodology in comparison with the actual residential utility amounts received by August 31, 2019 and determine if changes need to be made to the estimation methodology for the fiscal year 2019 year-end sales tax revenue allocation. However, Treasury did not complete this comparison until our request in January 2020.

- (3) Ensure that contingent liabilities were properly accounted for. Treasury did not have a process to ensure that all payments made after September 30 were included in the liability calculation, resulting in a \$14.3 million understatement of entity-wide governmental activities expenditures and liabilities. Treasury corrected this issue prior to the *SOMCAFR*'s issuance.

We first commented on this issue during the fiscal year 2018 *SOMCAFR* audit. Treasury and OFM agreed with the prior recommendation, and Treasury planned to enhance communication with major business areas related to information provided to OFM for contingencies.

e. MDHHS did not:

- (1) Have a process in place to evaluate the appropriateness of the estimates provided by county contract managers for the Supplemental Nutrition Assistance Program - Education year-end payable. In fiscal year 2019, 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 not consistent with actual activity. Monthly costs from October 2018 through August 2019 averaged \$1.1 million while the year-end payable for September 2019 was recorded at \$3.1 million. The actual payable write-off in fiscal year 2020 was \$2.2 million. MDHHS corrected this overstatement prior to the *SOMCAFR's* issuance.

- (2) Validate the accuracy of the data warehouse query results used to establish a payable and a receivable for the year-end Child Support. A review of the query by SBO, through OIAS, identified 2 errors in a review of 45 sampled records. MDHHS and DTMB informed us that the query did not always pull the correct value when certain conditions existed. As a result of the 2 errors, we estimated that the payable and the receivable were overstated by \$2.2 million and \$3.5 million, respectively.
  - (3) Maintain sufficient documentation to support reimbursement payments for the Adult Home Help Program. Our testing of a sample of 25 payments identified 7 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.
- f. MDOC did not ensure that contingent liabilities were properly accounted for. MDOC recorded a \$2.2 million payable related to estimated lawsuit settlements within the General Fund for cases that were still pending. MDOC corrected this issue prior to the *SOMCAFR's* issuance.
  - g. MSP did not sufficiently evaluate and write-off prior year outstanding accounts payable at fiscal year-end, resulting in a \$1.8 million overstatement of accounts payable. MSP corrected this issue prior to the *SOMCAFR's* issuance.
  - h. MDOT did not:
    - (1) Record amounts due from local transit authorities (LTAs) on September 30, 2019. Rather, MDOT netted amounts due from LTAs against amounts due to other LTAs where no right of offset exists.

GASB Statement No. 62 (Section 501) states that "assets and liabilities should not be offset in the statement of net assets (net position) except where a right of offset exists." We estimate the netting of these amounts due to and due from LTAs resulted in a \$1.5 million understatement of MDOT's reported assets and liabilities.

- (2) Limit access to submit and approve inspector daily reports (IDRs) in the Field Manager System to users with a documented business need. IDRs report the quantity of material used each day on a specific project and support the bi-weekly payments made to construction contractors. DTMB Technical Standard 1340.00.020.01 states that the State employs the concept of least privilege which permits only authorized accesses for users who are necessary to accomplish assigned tasks in accordance with roles and responsibilities of job functions. We noted that MDOT did not maintain documentation to support a business need for 16 (64%) of 25 selected users with access to submit and approve IDRs.
- (3) Ensure the proper segregation of duties over the approval and submission of IDRs. Section 18.1485(2)(a) of the *Michigan Compiled Laws* requires each internal accounting and administrative control system to include a plan of organization that provides segregation of duties and responsibilities among employees. Also, the GAO's FISCAM Section 3.4 states that work responsibilities should be segregated so that one individual does not control all critical stages of a process. We noted that 11 (17%) of 66 IDRs selected were approved by the submitter.

## 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 needed improvements.*

*Regarding part d(2), Treasury and OFM agree that comparing the estimated amount of sales tax revenue for residential utilities to actual amounts received would help support the established estimation methodology. However, a comparison to actual could not have been completed until the majority of tax returns were received and processed which was in January 2020. Once the*

*comparison to actual was completed, the results further supported that the estimation methodology used was accurate and reliable.*

*Regarding part h(1), MDOT and OFM disagree that a receivable based on an estimate to the various LTA's should be recorded. There are certain factors that make it difficult to determine what the actual grant receivable from the applicable LTA's would be for a given fiscal year. The primary factor is that the actual receivable from an individual LTA will not be known until the expenditures have been audited, which is completed at least a couple years after the end of the grant award period. Also, the amount available for redistribution changes significantly from one grant period to the next. Therefore, the overall gross receivables from the LTA's are not consistent and can fluctuate significantly from year to year. In addition, MDOT has procedures in place to limit overpayments, which limits the amount of funds that need to be collected and redistributed from the LTA's and prevents any material misstatements to the financial statements. Due to these factors, recording an estimate would not be reliable or practical.*

*Regarding part h(3), MDOT partially agrees with the finding. Although there may be instances in the IDR creation and approval tasks that gives the perception that there is not a separation of duties, that perception is incorrect if one considers the process as a whole.*

*After IDRs are approved, the office technician prepares the construction payment estimate by collecting the pay item quantities from approved IDRs. The office technician reviews the estimate prior to submission to the engineer for approval. The engineer must review and approve each estimate and, ultimately, each estimate is processed by someone else. Pay item quantities are reviewed several times by several different staff members during the overall process and no contractor payments can be made unilaterally by a single individual. However and regardless, MDOT is developing specific controls in the new software, AASHTOWare Construction and Materials, that will prevent an individual from approving their own IDR. This software is being piloted and statewide rollout is targeted for fiscal year 2022.*

**AUDITOR'S  
COMMENTS TO  
AGENCY  
PRELIMINARY  
RESPONSE**

Regarding part d.(2), Treasury had processed all but two of the most significant returns by October 17, 2019. In December 2019, Treasury provided the rationale behind the estimation methodology but had not compared actual results with prior estimates. Upon our request in January 2020, Treasury compared the estimate with the actual revenue. Treasury did not provide any information regarding the dates that the remaining two returns were received and processed. The finding stands as written.

Regarding part h.(1), MDOT and OFM state that a receivable should not be recorded because certain factors make it difficult, amounts can fluctuate from year to year, and it has procedures to prevent material overpayments to an LTA. The OAG believes

that the procedures designed to contain overpayments provide MDOT with information necessary to identify and record the appropriate receivable and payable by individual LTA at the close of the fiscal year. These initial recordings could then be adjusted as more finalized LTA expenditure amounts are received. Therefore, the finding stands as written.

Regarding part h.(3), the MDOT Construction Manual states that the single most important type of project documentation is the IDR. The person reviewing the IDR should not be the author of the IDR. The finding stands as written.

## FINDING #7

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### Improvement needed for financial accounting practices related to capital assets.

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Various State agencies and OFM, within SBO, did not have sufficient internal control in place to help ensure the existence and accuracy of the State's capital assets recorded in the *SOMCAFR*.

The FMG (Part II, Chapter 21, Section 120) requires departments to perform an annual physical inventory of equipment for all locations to ensure the accuracy of capital asset listings. Also, OFM's year-end capital asset reporting memorandum instructs State agencies to review SIGMA asset and lease reports to confirm the accuracy of capital asset and lease information and update SIGMA for any changes and/or corrections noted during the review of capital assets and leases. In addition, State agencies must sign and submit the Asset Certification Statement to OFM certifying that they completed all necessary changes required to accurately reflect asset ending balances and classifications.

We noted:

- a. Various State agencies (DTMB, DNR, Department of Labor and Economic Opportunity, and MDHHS) did not ensure that equipment was removed from SIGMA upon disposal. We noted 9 (24%) of 38 randomly and judgmentally sampled SIGMA equipment assets, from a population of assets with no acquisition date or acquisition dates prior to October 1, 2013, were no longer State assets at September 30, 2019. We estimated that buildings, equipment, and other depreciable assets and related accumulated depreciation were overstated by \$199.4 million and \$185.0 million, respectively.
- b. Various State agencies (DOC, DTMB, Department of State, MDHHS, and MSP), in conjunction with OFM, did not ensure the existence and accuracy of the capital lease asset inventory in SIGMA. Our review disclosed that 13 (22%) of 59 closed Statewide capital lease assets were not properly removed from SIGMA, resulting in an \$18.4 million overstatement of buildings, equipment, and other depreciable assets and a \$17.4 million overstatement of related accumulated depreciation. We noted:
  - (1) State agencies did not process the fixed asset disposal documents in SIGMA to remove the capital asset balances for the 13 closed leases.

When a capital lease closes, the fixed asset associated with the lease requires removal from SIGMA to properly reflect capital asset balances. However, all five State agencies certified to OFM that they made all necessary changes required to accurately reflect lease balances and that all fixed assets linked to closed leases had been removed from SIGMA.

- (2) OFM's SIGMA report did not properly identify closed leases with linked assets that needed to be removed from SIGMA.

The State agencies and OFM corrected these issues prior to the *SOMCAFR*'s issuance.

**RECOMMENDATION**

We recommend that State agencies and OFM establish sufficient internal control to ensure the existence and accuracy of the State's capital assets 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 #8

### 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 20% (\$33.9 million) of the estimated payables established for fiscal years 2016 through 2018. 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 \$16.2 million of the associated receivable in fiscal years 2017 through 2019 that was established in the prior year based upon the estimated payable:

	Write Off	
	Payable	Associated Receivable
2017	\$25,827,634	\$11,699,754
2018	\$47,255,897	\$26,235,355
2019	\$28,742,826	\$10,741,054
Average	\$33,942,119	\$16,225,388

We evaluated selected payable service dates and noted:

- a. MDOT overstated an estimated payable by \$5.3 million for fiscal year 2019 expenditures. We randomly and judgmentally sampled fiscal year 2019 estimated consultant payables and reviewed the actual payments made in fiscal year 2020.
- b. MDOT overstated an estimated payable by \$10.5 million for fiscal year 2019 expenditures. We randomly and judgmentally sampled fiscal year 2019 estimated contractor payables and reviewed the fiscal year 2020 payment dates of service.

In fiscal year 2018, 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. MDOT also indicated that it would continue to 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 fiscal year 2019 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 the process used to establish these payables should be refined. As it relates to Construction Contract payables, MDOT will be incorporating a report into the payable establishment process that identifies work that the contractor has performed, but MDOT has either not yet accepted or paid for. As it relates to Consultant Contract payables, MDOT has reached out to the Consultant community stakeholders and will be providing additional guidance and direction to them to ensure that they are estimating payables in accordance with established accounting standards.*

## FINDING #9

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### Improvements needed to processes for establishing and monitoring Medicaid payables and receivables.

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MDHHS should enhance internal control to prevent, or detect and correct, misstatements and help ensure the accuracy of Medicaid 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 disclosed:

- a. MDHHS did not ensure that its methodology for the inpatient hospital accrual component was evaluated based upon a comparison of prior year accruals with subsequent activity, resulting in a \$20.9 million overstatement of the accounts payable. MDHHS recorded correcting entries prior to the *SOMCAFR's* issuance.
- b. MDHHS had not developed a sufficient process to evaluate and adjust the financial statements as additional information became available prior to the issuance of the *SOMCAFR*. MDHHS estimated a \$126.7 million fiscal year 2019 Special Needs Access Fund (SNAF) payable based on an average of \$108.4 million SNAF payments made for the first three quarters of fiscal year 2019 and \$18.3 million fiscal year 2019 SNAF payments not yet made to one public entity. Prior to the issuance of the *SOMCAFR*, the fourth quarter fiscal year 2019 SNAF payments were known to be \$113.1 million and revised fiscal year 2019 SNAF payments not yet made of \$17.2 million, resulting in an understatement of the payable of \$3.6 million. MDHHS recorded correcting entries prior to the *SOMCAFR's* issuance.
- c. MDHHS did not ensure that the health plans services (HPS) accrual workbook was properly completed, resulting in a \$4.9 million payable overstatement. MDHHS estimates a payable for the HPS performance bonus withheld from payments made during the fiscal year and estimates an additional amount to be withheld from future payments related to fiscal year 2019. When estimating the additional amount withheld from future payments, MDHHS used the incorrect rates. MDHHS recorded correcting entries prior to the *SOMCAFR's* issuance.

- d. MDHHS did not ensure that the full cost clinic accrual workbook was properly completed. We noted:
- (1) A \$1.1 million receivable overstatement and a \$227 thousand payable understatement due to an incorrect estimated liability for three fiscal year settlements for one clinic. MDHHS recorded correcting entries prior to the *SOMCAFR's* issuance.
  - (2) A \$843 thousand payable and receivable overstatement due to a mismatch of interim payments reported for multiple clinics over multiple fiscal years. MDHHS recorded correcting entries prior to the *SOMCAFR's* issuance.

**RECOMMENDATION**

We recommend that MDHHS enhance internal control to prevent, or detect and correct, misstatements and help ensure the accuracy of Medicaid accruals.

**AGENCY  
PRELIMINARY  
RESPONSE**

OFM provided us with the following response:

*MDHHS and OFM agree that internal controls related to Medicaid accruals should be enhanced and will work to implement needed improvements.*



FISCAL YEAR 2018  
REPORT ON INTERNAL CONTROL,  
COMPLIANCE, AND OTHER MATTERS  
FOLLOW-UP

Below is the status of the reported findings from the 2018 *SOMCAFR* report on internal control, compliance, and other matters:

Prior Audit Finding Number	Topic Area	Current Status	Current Finding Number
1	Third Party Service Organization Oversight	Repeated*	1
2	Treasury - Cash Deposits	Complied	Not applicable
3	Confidential Information in SIGMA	Repeated	2
4	Capital Asset Financial Accounting Practices	Rewritten*	7
5a(1)	SIGMA Fund Balance Conversions	Not applicable	
5a(2)	Federal Receivable Classification	Complied	Not applicable
5b	Interface Controls	Repeated	5
5c	Transaction Approvals	Complied	Not applicable
5d	OFM - Closing Procedure Compliance with GAAP	Complied	Not applicable
6a	Tax Accruals - Evaluation of Accounting Estimates	Rewritten	3c
6b - 6c	Tax Accruals - Various Tax Collections, Liabilities, and Overpayments	Complied	Not applicable
6d	Treasury - IIT Collections	Repeated	3d
6e	Treasury - Sales Tax Revenue	Repeated	3g
6f	Treasury - Tax Refund Interest	Complied	Not applicable
7a - 7c	MDHHS - Accounts Payable and Receivable Errors	Complied	Not applicable
7d	MDHHS - Child Support Accrual	Repeated	6e(2)
7e - 7g	MDHHS - Transaction Errors	Complied	Not applicable
7h	MDHHS - Adult Home Help Program Documentation	Repeated	6e(3)
8a(1)	Treasury - Tobacco Settlement Accrual	Complied	Not applicable
8a(2)	Treasury - Offset Fund Reconciliation	Repeated	6d(1)

\* See glossary at end of report for definition.

Prior Audit Finding Number	Topic Area	Current Status	Current Finding Number
8a(3)	Treasury - Contingent Liabilities - Tax Credits	Repeated	6d(3)
8b - 8c	Various Agencies - Financial Accounting Practices	Complied	Not applicable
8b(1)	MDOT - Expenditure Classification	Complied	Not applicable
8b(2)	MDOT - Miscellaneous Revenue Classification	Complied	Not applicable
8b(3)	MDOT - Expenditure Credit Classification	Complied	Not applicable
8b(4)	MDOT - Pass-Through Fund Classification	Complied	Not applicable
8c(1)	MDE - CCDF Provider Overpayments	Complied	Not applicable
8c(2)	MDE - CCDF Federal Accounts Receivable	Complied	Not applicable
9	MDOT - Accounts Payable	Repeated	8
10	Treasury/MDOT - Allocation of Tax Revenues	Complied	Not applicable
11	Treasury - Accuracy of Sales Tax Revenue Collections	Rewritten	6d(2)

## GLOSSARY OF ABBREVIATIONS AND TERMS

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AASHTOWare	American Association of State Highway and Transportation Officials software.
AICPA	American Institute of Certified Public Accountants.
ASAP	Adult Services Authorized Payments.
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.
CIT	corporate income tax.
<i>Code of Federal Regulations (CFR)</i>	The codification of the general and permanent rules published by the departments and agencies of the federal government.
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 <i>Government Auditing Standards</i> .
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.
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.
IDR	inspector daily report.
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.
LTA	local transit authority.
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.
MDE	Michigan Department of Education.

MDHHS	Michigan Department of Health and Human Services.
MDOC	Michigan Department of Corrections.
MDOT	Michigan Department of Transportation.
MiCARS	Michigan Cashiering and Receivable System.
MSP	Michigan Department of State Police.
OAG	Office of the Auditor General.
OFM	Office of Financial Management.
OIAS	Office of Internal Audit Services.
PII	personally identifiable information.
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.
SBO	State Budget Office.
segregation of duties	Assigning different people the responsibilities of authorizing transactions, recording transactions, and maintaining custody of assets to reduce the opportunities to allow any person to be in a position to both perpetrate and conceal errors or fraud in the normal course of his or her duties. Proper segregation of duties requires separating the duties of reporting, review and approval of reconciliations, and approval and control of documents.
SET	State Education 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.

SNAF      Special Needs Access Fund.

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.

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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