

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

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

Fiscal Year Ended September 30, 2020

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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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Office of the Auditor General

## Report Summary

*Report on Internal Control, Compliance, and Other Matters  
State of Michigan Comprehensive Annual Financial Report (Annual Report)  
State Budget Office  
Fiscal Year Ended September 30, 2020*

**Report Number:**  
**071-0010-21**

**Released:**  
**May 2021**

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 *Annual Report* dated March 19, 2021.

<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 Office of Financial Management (OFM) and the Michigan Department of Health and Human Services should update their year-end closing procedures to ensure that they are current and reflective of generally accepted accounting principles and State policy ( <u>Finding #1</u> ).		X	Agree
Various State agencies and OFM did not have sufficient internal control in place to monitor the existence and accuracy of the State's capital assets recorded in the <i>Annual Report</i> ( <u>Finding #2</u> ).		X	Agree
Various State agencies did not sufficiently limit access to confidential information in the Statewide Integrated Governmental Management Applications (SIGMA) to only appropriate users ( <u>Finding #3</u> ).		X	Agree
The Department of Treasury should continue to enhance internal control to prevent, or detect and correct, misstatements and help ensure the accuracy of tax accruals ( <u>Finding #4</u> ).		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>
Various State agencies should improve the Michigan Cashiering and Receivable System (MiCARS) internal control to help ensure the completeness and accuracy of the <i>Annual Report</i> . State agencies interfaced \$1.3 billion in transactions between MiCARS and SIGMA in fiscal year 2020 ( <u>Finding #5</u> ).		X	Agree
Various State agencies did not have sufficient internal control to help ensure the accuracy of all accounting information recorded in the <i>Annual Report</i> ( <u>Finding #6</u> ).		X	Agree
The State should continue to enhance its oversight of third party service organizations. State departments did not effectively apply the Office of Internal Audit Services' guidance ( <u>Finding #7</u> ).		X	Agree

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

May 28, 2021

Mr. David P. Massaron, State Budget Director  
State Budget Office  
George W. Romney Building  
Lansing, Michigan

Dear Mr. Massaron:

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, 2020.

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 the 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  
Auditor General



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# INDEPENDENT AUDITOR'S REPORT ON INTERNAL CONTROL AND COMPLIANCE



# OAG

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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. David P. Massaron, State Budget Director  
State Budget Office  
George W. Romney Building  
Lansing, Michigan

Dear Mr. Massaron:

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, 2020 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 19, 2021. 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
- Michigan Education Savings Program
- Michigan Achieving a Better Life Experience Program
- Michigan Finance Authority
- Michigan State Housing Development Authority
- Farm Produce Insurance Authority
- Mackinac Island State Park Commission
- Michigan Early Childhood Investment Corporation
- 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) as a basis for designing 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.

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. 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.

Our consideration of internal control was for the limited purpose described in the first paragraph of this section 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. Given these limitations, during our audit we did not identify any deficiencies in internal control that we consider to be material weaknesses. We did identify certain deficiencies in internal control, as described in Findings #1 through #7, that we consider 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 financial statements. 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 19, 2021



FISCAL YEAR 2020  
FINDINGS, RECOMMENDATIONS,  
AND AGENCY PRELIMINARY RESPONSES

## **FINDING #1**

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### **Improvements needed for calculating fund balance and net position.**

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The Office of Financial Management (OFM) and the Michigan Department of Health and Human Services (MDHHS) should update their year-end closing procedures to ensure that they are current and reflective of generally accepted accounting principles\* (GAAP) and State policy.

During the year-end closing process, OFM records entries to properly classify the fund balance and net position for reporting purposes. State agencies are responsible for recording encumbrances using established contracts.

We noted:

- a. OFM did not have sufficient controls over the calculation of the net investment in capital assets (NICA) net position. Specifically, OFM:

- (1) Used the full amount of outstanding State Building Authority (SBA) bonds rather than splitting the amount between State capital projects and university and community college projects. OFM should have only used the State capital projects portion in the NICA calculation.

After OFM calculated the SBA bond split, we determined that it did not apply a consistent methodology to all of the outstanding SBA bonds. This affected the unspent bond proceeds and the net bonded debt portions of the NICA calculation. As a result, the NICA and restricted net position were understated by \$2.2 billion and \$42.5 million, respectively, and unrestricted net position was overstated by \$2.3 billion.

- (2) Did not appropriately calculate the debt attributable to unspent proceeds for the outstanding Michigan Department of Transportation (MDOT) bonds. Equity in common cash is a component of the unspent proceeds calculation and, for reporting purposes, outstanding payments are a reduction to the equity in common cash. OFM inadvertently excluded outstanding payments from its calculation, resulting in the NICA net position being overstated and restricted net position being understated by \$2.8 million.
- (3) Did not update the MDOT financed infrastructure liability amount to account for changes that occurred to the liability after the original calculation. As a result, the NICA net position was overstated and unrestricted net position was understated by \$4.8 million.

\* See glossary at end of report for definition.

Section 2200.118 of the *Codification of Governmental Accounting and Financial Reporting Standards\** (Codification), published by the Governmental Accounting Standards Board\* (GASB), requires the reduction of NICA net position by the outstanding balances of any bonds or other borrowings attributable to the acquisition, construction, or improvement of those capital assets. Also, the portion of the debt attributable to unspent proceeds from the outstanding bonds should be reduced from the NICA net position and instead be reported in the same net position component as the unspent amount.

Although OFM does have a procedure for the NICA calculation, additional controls over the components used in the calculation and subsequent managerial review of the entry would help to ensure that the NICA balance is appropriately stated.

- b. OFM did not appropriately classify \$22.6 million of the General Fund fund balance because of a misclassification of a long-term receivable. When the revenue is collected from this receivable, it will not be restricted, committed, or assigned; therefore, the receivable balance should be classified as nonspendable. This misclassification resulted in an overstatement in restricted fund balance and an understatement in nonspendable fund balance.

GASB Codification Section 1800.166 states that nonspendable fund balance includes amounts that cannot be spent because they are not in spendable form, which includes the long-term amount of loans and notes receivable. However, if the use of the proceeds from the collection of those receivables is restricted, committed, or assigned, it should be included in the appropriate fund balance classification, rather than nonspendable fund balance.

- c. OFM did not properly classify \$2.5 million of the General Fund fund balance because of an oversight while recording the year-end entries. During fiscal year 2020, an agency combined two separate funds into a single fund with different fund balance classifications. OFM did not assign the new fund balance appropriately between the restricted and nonspendable classifications, which resulted in restricted fund balance and committed fund balance being overstated and understated, respectively.

Section 18.1485 of the *Michigan Compiled Laws* states that each department shall establish and maintain an internal accounting and administrative control system

\* See glossary at end of report for definition.

using GAAP. These should include internal control\* techniques that are effective and efficient.

- d. MDHHS improperly established a \$2.5 million encumbrance to carry forward spending authority into fiscal year 2021 without an underlying contract.

The State of Michigan Financial Management Guide (FMG) (Part II, Chapter 15, Section 200) requires a signed and dated contract established prior to September 16th for all qualifying encumbrances.

OFM and MDHHS corrected these items prior to the *State of Michigan Comprehensive Annual Financial Report's (Annual Report's)* issuance.

**RECOMMENDATION**

We recommend that OFM and MDHHS update their year-end closing procedures to ensure that guidance used during the year-end closing process is current and reflective of GAAP and State policy.

**AGENCY  
PRELIMINARY  
RESPONSE**

OFM provided us with the following response:

*OFM and DHHS agree that year-end closing procedures should be updated to ensure that guidance used during the year-end closing process is current and reflective of GAAP and State policy.*

\* See glossary at end of report for definition.

## FINDING #2

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

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Various State agencies and OFM did not have sufficient internal control in place to monitor the existence and accuracy of the State's capital assets recorded in the *Annual Report*.

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 confirm the accuracy of capital assets and update the Statewide Integrated Governmental Management Applications\* (SIGMA) for any changes and/or corrections noted during the review of capital assets. 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 did not perform sufficient monitoring to ensure that equipment was properly removed from SIGMA upon disposal. We noted:
  - (1) 3 (8%) of 38 randomly sampled SIGMA equipment assets (impacting the Departments of Technology, Management, and Budget [DTMB] and Natural Resources [DNR]) were no longer State assets as of September 30, 2020. We estimated that buildings, equipment, and other depreciable assets and related accumulated depreciation were overstated by \$153.0 million and \$104.4 million, respectively.
  - (2) DTMB did not remove \$110.8 million in radio equipment from SIGMA upon replacement through a lease. DTMB corrected this issue prior to the *Annual Report's* issuance.
- b. Various State agencies did not perform sufficient monitoring related to capital assets recorded in SIGMA. We noted:
  - (1) MDOT and OFM did not ensure that construction in progress was accurately recorded, resulting in an overstatement of \$154.2 million.

MDOT and OFM incorrectly calculated the amount of construction in progress to be capitalized for 3 road projects and 1 bridge project.
  - (2) DTMB and DNR did not ensure that land and other non-depreciable assets were accurately recorded when acquired, resulting in an overstatement of \$6.8 million.

\* See glossary at end of report for definition.

DTMB inappropriately capitalized \$5.0 million in training and maintenance costs when developing software on 3 projects. DNR recorded \$1.8 million in land as both land and a building.

- (3) The Michigan Department of Corrections (MDOC) and the Michigan Department of State Police (MSP) did not ensure that buildings and equipment were accurately recorded when acquired, resulting in a net overstatement of \$2.0 million.

MDOC did not record a building (\$13.9 million understatement) that was transferred to it from another department, and MSP recorded the purchase of a genetic analyzer worth \$0.2 million for \$16.1 million (\$15.9 million overstatement).

The impacted agencies and/or OFM corrected these items prior to the *Annual Report's* issuance.

**RECOMMENDATION**

We recommend that State agencies and OFM establish sufficient internal control to monitor the existence and accuracy of the State's capital assets recorded in the *Annual Report*.

**AGENCY  
PRELIMINARY  
RESPONSE**

OFM provided us with the following response:

*State agencies and OFM agree that internal controls related to the existence and accuracy of the State's capital assets should be improved.*

## **FINDING #3**

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

Various State agencies did not sufficiently limit access to confidential information in SIGMA to only appropriate users. 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.

The SIGMA Project Team 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.

- (1) MDOC included certain confidential information related to prisoner health treatment.

We identified 1,296 Statewide SIGMA users with access to view MDOC transactions in SIGMA. We commented on this issue during the fiscal year 2019 *Annual Report* audit. MDOC agreed with the recommendation and attempted to use redaction to correct this issue. However, the redaction performed still allowed the data to be visible. MDOC informed us that it will ensure the proper redaction of protected health information immediately from future SIGMA transaction support.

- (2) The Department of State included certain confidential information related to driver's licenses.

We identified 541 Statewide SIGMA users with access to view Department of State transactions in SIGMA. The Department of State informed us that there was a technical error that allowed certain confidential information to become unmasked for a short period of time.

- 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.

- (1) MDHHS interfaced transactions from the Adult Services Authorized Payments (ASAP) system and

the Michigan Statewide Automated Child Welfare Information System (MiSACWIS) to SIGMA that displayed certain identifying information within the check description field in SIGMA.

We identified 1,522 Statewide SIGMA users with access to view MDHHS transactions in SIGMA. We commented on this issue during the fiscal year 2019 *Annual Report* audit.

- (2) The Michigan Department of Education (MDE) interfaced transactions from the Bridges Integrated Automated Eligibility Determination System (Bridges) to SIGMA that displayed certain confidential information related to child care licensed exempt providers.

We identified 644 Statewide SIGMA users with access to view MDE transactions in SIGMA.

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

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.

**RECOMMENDATION**

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

**AGENCY  
PRELIMINARY  
RESPONSE**

OFM provided us with the following response:

*State agencies and OFM agree and will implement procedures to limit access to confidential information to appropriate users of the information.*

\* See glossary at end of report for definition.

## **FINDING #4**

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### **Improvements needed for establishing and monitoring tax receivables and payables.**

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The Department of Treasury (Treasury) 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. Also, 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 2020 disclosed:

- a. Treasury did not ensure that estimated receivables were properly calculated for various taxes. As a result, adjustments were necessary to accurately record the estimated receivable for corporate income taxes (CITs), sales taxes, and use taxes.

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 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.

We noted:

- (1) Treasury did not properly classify \$37.6 million of annual sales tax revenue as related to fiscal year 2019 liabilities. Therefore, assets and deferred inflows of resources were understated by \$1.4 million in the General Fund and \$3.1 million in the School Aid Fund. Also, assets, revenues, and net position were understated by \$4.5 million in the governmental activities of the government-wide financial statements.
- (2) Treasury did not include \$10.3 million of CIT revenue in the calculation of the estimated receivable resulting in an understatement of the General Fund assets and deferred inflows of resources and an understatement of assets, revenues, and net position in the governmental activities of the government-wide financial statements of \$4.6 million.
- (3) Treasury did not ensure the accuracy of use tax revenues included in the calculation of the

estimated receivable. Treasury double counted \$38.5 million of use tax revenues distributed to the Local Community Stabilization Authority. As a result, assets and deferred inflows of resources were overstated by \$1.8 million in the General Fund and \$0.9 million in the School Aid Fund. Also, assets, revenues, and net position were overstated by \$2.6 million in the governmental activities of the government-wide financial statements.

Treasury corrected these items prior to the *Annual Report's* issuance.

- b. Treasury had not developed a process to reconcile the individual income tax (IIT) legacy system and SIGMA. As a result, processes that utilize data from the IIT legacy system to determine the year-end accruals may not be fully accurate and the General Fund balances in the *Annual Report* may be misstated.

Treasury utilizes data from the IIT legacy system to determine the estimated receivable. Based on our review of the differences between the IIT revenue in the IIT legacy system and SIGMA for fiscal years 2019 and 2020, we determined that the assets and deferred inflows of resources may be understated by \$9.3 million in the General Fund and \$2.9 million in the School Aid Fund. Also, assets, revenues, and net position in the governmental activities of the government-wide financial statements may be understated by \$12.2 million. Treasury informed us that it does not complete a reconciliation because the IIT system does not contain the necessary general ledger information.

- c. Treasury did not ensure that collections relating to withholding taxes were properly recorded. As a result, assets, revenues, and fund balance/net position were understated by \$8.8 million in the General Fund and in the governmental activities of the government-wide financial statements.

Treasury excluded withholding payments received from State departments for fiscal year 2020 pay periods that should have been accrued. Treasury informed us that while it relied on the return period provided by the State departments, it did not provide guidance on how to determine the return period. Treasury corrected this item prior to the *Annual Report's* issuance.

- d. Treasury did not ensure that liabilities relating to CIT were properly recorded. As a result, payables were understated and revenues and fund balance/net position were overstated by \$4.6 million in the General Fund and

governmental activities of the government-wide financial statements.

Treasury performs an evaluation of unprocessed returns that are requesting a refund and determines which refunds to accrue. Treasury excluded one CIT unprocessed return requesting a \$4.6 million refund from the year-end liability because the accuracy of the refund amount could not be determined as of the time of Treasury's evaluation. However, after this evaluation and prior to the *Annual Report's* 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 prior to the *Annual Report's* opinion date. Treasury corrected this item prior to the *Annual Report's* issuance.

- e. Treasury had not fully developed a process to compare and evaluate significant accounting estimates with subsequent activity for tax accrual receivables and payables. As a result, Treasury may not be able to determine if significant differences exist between the estimates and actual amounts requiring adjustments to the tax accrual methodology.

In its approval of accrual methodologies, OFM advises State departments that it is important to evaluate the reliability of the estimated accruals in the subsequent year and adjust the estimation methodology accordingly. Also, the FMG (Part II, Chapter 1, Section 300) requires departments to validate accrual methodologies by comparing the estimated accrual with current year actual expenditures and determine if a change to the methodology is needed.

We first commented on this issue during the fiscal year 2013 *Annual Report*. Treasury agreed with our prior recommendations. Treasury did not include all subsequent activity in its comparison of estimated to actual activity for IIT payable backlogs and business tax payable backlogs. Although Treasury did perform the comparisons and recorded an \$8.5 million adjustment for the IIT backlogs, Treasury cannot ensure that additional adjustments were not necessary without including all of the subsequent activity in the review. Also, no changes were made to the estimation methodologies to make the estimates more accurate in future years for either the IIT or business tax backlogs. In addition, differences at the fund level were not evaluated during the review of business tax backlogs.

Further, Treasury began comparing the estimate for the assessed tax receivables and receivables to be assessed with subsequent activity in fiscal year 2017. In fiscal year 2019, Treasury indicated that it needed at least three

years of analysis to determine if adjustments to the methodology were necessary. However, Treasury informed us that it did not perform this comparison during fiscal year 2020 due to the lack of trained staff available to perform the analysis.

- f. Treasury had not fully developed a process to compare the November estimated receivables and payables to the actual amounts. 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 receivables and payables even though the actual collection amounts are known prior to the *Annual Report'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. 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, 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 *Annual Report* 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, Treasury informed us that this information was available beginning in fiscal year 2018 and that it would work with its Office of Revenue and Tax Analysis to determine if an accrual amount could be reasonably estimated. During fiscal year 2020, Treasury informed us that it had not yet determined the availability and accuracy of the sales data received from the Department of State to determine the amount of the CTF accrual.

- h. Treasury did not have an effective process to ensure that the State Education Tax (SET) estimated receivables were properly recorded.

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 receivables. Treasury transposed a portion of the data used to calculate the estimated receivable, which resulted in an overstatement of \$1.6 million in fiscal year 2019 and a trivial misstatement in fiscal year 2020 in the School Aid Fund and in the governmental activities of the government-wide financial statements. Continued data transpositions could result in material differences to future SET receivable estimates.

**RECOMMENDATION**

We recommend that Treasury 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 continue to be improved.*

## **FINDING #5**

---

### **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 *Annual Report*. State agencies interfaced \$1.3 billion in transactions between MiCARS and SIGMA in fiscal year 2020.

We noted:

- a. MSP did not establish and implement complete interface reconciliations from MiCARS into SIGMA. MSP interfaced \$32.8 million in revenue from MiCARS into SIGMA during fiscal year 2020.

The U.S. Government Accountability Office's (GAO's) Federal Information System Controls Audit Manual\* (FISCAM) Section 4.3 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 completely, accurately, and timely. 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.

MSP updated its reconciliation process in February 2020 to include transaction totals; however, for the six daily reconciliation logs we reviewed, reconciliations did not always include accurate transaction totals.

We commented on MSP's reconciliation process during the fiscal year 2019 *Annual Report* audit. Although MSP did update its reconciliation process, additional enhancements would ensure that information interfaced with SIGMA is complete and accurate.

- b. MSP did not maintain sufficient segregation of duties\* over the reconciliation of the interface between MiCARS and SIGMA.

\* See glossary at end of report for definition.

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.

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. We noted that the MSP head cashier prepared all of the reconciliations while also having the ability to write off and adjust invoices in MiCARS. Also, we noted a separate MSP staff person performed write-offs and adjustments in MiCARS as well as the corresponding write-offs in SIGMA; however, this person's access to MiCARS was removed in September 2020. Separate staff should perform write-offs, adjustments, and reconciliations to maintain appropriate segregation of duties, unless MSP implements compensating controls.

We commented on MSP's internal control over the reconciliation process during the fiscal year 2019 *Annual Report* audit. MSP informed us that it is still in the process of corrective action and has not written additional procedures to provide sufficient segregation of duties.

- c. State agencies utilizing MiCARS (MDOT, MSP, Michigan Department of Agriculture and Rural Development [MDARD], Department of Environment, Great Lakes, and Energy, and DNR) did not ensure that all MiCARS transactions received management approval prior to creating or adjusting 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 valid and that an automated workflow exists to initiate the approval process. Management approval would help ensure that all transactions are authorized, complete, and accurate.

We commented on the various departments' lack of management approval for MiCARS transactions during the fiscal year 2019 *Annual Report* audit. State agencies informed us that MiCARS still does not allow for approvals within MiCARS for all types of transactions and that compensating controls had not been established to approve all transactions outside of MiCARS. DNR and MSP informed us that a system enhancement planned for fiscal year 2021 will allow for the approval of manual invoices in MiCARS. Also, MDARD informed us that it plans to implement compensating controls during fiscal year 2021 for all transactions processed through MiCARS.

**RECOMMENDATION**

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

**AGENCY  
PRELIMINARY  
RESPONSE**

OFM provided us with the following response:

*State agencies and OFM agree that internal controls related to MiCARS transactions should continue to be enhanced to help ensure the completeness and accuracy of the Annual Report.*

## **FINDING #6**

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

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

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. MDHHS did not:

- (1) Have a process in place to assess their estimated accrual amounts when the actual amounts were known.
  - (a) The Michigan Public Health Institute Egrams liabilities were overstated by a known amount of \$1.7 million and a projected amount of \$12.5 million.
  - (b) The Special Needs Access Fund liability for one university was understated by \$1.5 million.
  - (c) The Women, Infants, and Children (WIC) rebate receivable was overstated by \$634,967. MDHHS recorded the receivable based on the estimated accrual methodology, rather than using the actual amount which was already available.

MDHHS corrected these items prior to the *Annual Report's* issuance.

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. Also, the FMG (Part II, Chapter 1, Section 300) requires departments to validate accrual methodologies by comparing the estimated accrual with current year actual expenditures and evaluate the results of the comparison.

- (2) Maintain sufficient documentation to support accounts payable recorded for the Foster Care program. Although MDHHS maintains a tracking spreadsheet, no other support was provided to validate the payables recorded.

b. MDOT did not:

- (1) Sufficiently evaluate and write off prior year's outstanding accounts receivable related to the Gordie Howe International Bridge project at fiscal year-end, resulting in an \$11.7 million accounts payable overstatement. MDOT corrected this issue prior to the *Annual Report's* issuance.
- (2) Ensure that expenditures were properly accounted for in the correct fiscal year when establishing accounts payable. Rail invoices totaling \$4.4 million from fiscal year 2020 were paid in fiscal year 2021, resulting in an understatement of expenditures and accounts payable. MDOT does not establish an estimated accrual for work performed through September 30. MDOT corrected the issue prior to the *Annual Report's* issuance.
- (3) 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 biweekly 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 first commented on this issue during the fiscal year 2019 *Annual Report* audit. MDOT agreed with the recommendation and implemented a semiannual review that began in December 2020.

c. DTMB did not:

- (1) Properly record \$1.1 million of administrative contract fee revenue in the correct fiscal year, resulting in an understatement of revenue and accounts receivable. DTMB records the contract fee revenue in the period it is received rather than when it is earned. DTMB corrected the issue prior to the *Annual Report's* issuance.

- (2) Ensure that expenditures were accounted for in the correct fiscal year when processing payments and establishing accounts payable. DTMB informed us that payables are not recorded when an invoice includes contractor work that crosses fiscal years because the amounts would not be material.

Our financial and performance audit of the Information Technology Fund and IT Billings, issued in May 2020 and located at [audgen.michigan.gov/wp-content/uploads/2020/05/r071013719-0077.pdf](http://audgen.michigan.gov/wp-content/uploads/2020/05/r071013719-0077.pdf), identified similar concerns in Finding #1. DTMB agreed with the recommendation and indicated that it would review and improve the year-end closing payables estimation process for information technology vendors.

**RECOMMENDATION**

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

**AGENCY  
PRELIMINARY  
RESPONSE**

OFM provided us with the following response:

*State agencies and OFM agree that internal controls should be improved to help ensure the accuracy of the accounting information recorded in the Annual Report. However, for part a.(1)(c), MDHHS was aware of the WIC rebate receivable prior to any involvement from the OAG and planned to correct the amount prior to closing.*

## **FINDING #7**

### **Improved oversight needed for third party service organization monitoring.**

The State should continue to enhance its oversight of third party service organizations (TPSOs). 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 some instances, the departments have not effectively applied this guidance.

The 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 TPSOs and noted that State agencies did not:

- a. Document their review of 6 (15%) of the 39 SOC reports within 60 days. The State agencies completed the 6 reviews between 80 and 198 days. Also, two of the reviews were not completed on the OIAS template as required by the FMG.

Timely review is essential to ensure that the SOC report does not identify weaknesses that require the State's immediate attention.

- b. Consider the need to obtain SOC reports for the vendor's subservice providers for 2 (8%) of the 24 SOC reports reviewed that referenced subservice providers.
- c. Document the State agencies' review of complementary user-entity controls for 5 (14%) of the 36 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.

## **RECOMMENDATION**

We recommend that the State continue to enhance its oversight of TPSOs.

\* See glossary at end of report for definition.

**AGENCY  
PRELIMINARY  
RESPONSE**

OFM provided us with the following response:

*State agencies and OFM agree that internal controls related to the oversight of third party service organizations should continue to be enhanced.*

FISCAL YEAR 2019  
REPORT ON INTERNAL CONTROL,  
COMPLIANCE, AND OTHER MATTERS  
FOLLOW-UP

Below is the status of the reported findings from the 2019 *Annual Report's* report on internal control, compliance, and other matters.

Prior Audit Finding Number	Topic Area	Current Status	Current Finding Number
1a	Treasury - TPSO Oversight - SOC Report Lacking Essential Information	Complied	Not applicable
1b	SBO - TPSO Oversight - SOC Report Coverage For SIGMA	Complied	Not applicable
1c(1)	TPSO Oversight - Insufficient SOC Coverage	Complied	Not applicable
1c(2)	TPSO Oversight - Lack of Bridge Letters	Complied	Not applicable
1c(3) – 1c(5)	TPSO Oversight - Agency Review and Monitoring of SOC Reports	Repeated*	7
2	Confidential Information in SIGMA	Repeated	3
3a	Treasury - Estimated Receivables	Rewritten*	4a
3b	Treasury - Receivable Estimation Methodology	Complied	Not applicable
3c	Treasury - Evaluation of Accounting Estimates	Repeated	4e
3d	Treasury - IIT Collections	Complied	Not applicable
3e	Treasury - November Tax Estimate Adjustment	Rewritten	4f
3f	Treasury - State Education Tax Estimated Receivable	Repeated	4h
3g	Treasury - Sales Tax Revenue	Repeated	4g
3h	Treasury - Business Taxes November Payable	Complied	Not applicable
4a	MSP - Segregation of Duties Over Reconciliation of MiCARS to SIGMA	Repeated	5b
4b	Management Approval of MiCARS Invoices	Rewritten	5c

\* See glossary at end of report for definition.

Prior Audit Finding Number	Topic Area	Current Status	Current Finding Number
5a	MDOT - Interface Controls - Reconciliation of AASHTOWare to SIGMA	Complied	Not applicable
5b	MSP - Interface Controls - Reconciliation of MiCARS to SIGMA	Repeated	5a
6a	OFM - SBO - Compensated Absence Liability	Complied	Not applicable
6b	DTMB - Information Technology Fund Accounting Practices	Complied	Not applicable
6c	MDE - School Aid Fund Accounts Payable	Complied	Not applicable
6d	Treasury - Financial Accounting Practices	Complied	Not applicable
6e(1)	MDHHS - Estimated Accruals	Repeated	6a(1)
6e(2)	MDHHS - Child Support Accrual	Complied	Not applicable
6e(3)	MDHHS - Adult Home Help Program Documentation	No longer applicable	
6f	MDOC - Contingent Liabilities	Complied	Not applicable
6g	MSP - Accounts Payable Evaluation and Write-off	Complied	Not applicable
6h(1)	MDOT - Local Transit Authorities - Netting Payables and Receivables	Complied	Not applicable
6h(2)	MDOT - Field Manager System Access Regarding Inspector Daily Reports	Repeated	6b(3)
6h(3)	MDOT - Segregation of Duties Over Inspector Daily Reports	Complied	Not applicable
7a	Capital Asset Disposals	Repeated	2a
7b	Capital Asset Leases	Complied	Not applicable
8	MDOT - Accounts Payable	Complied	Not applicable
9a	MDHHS - Medicaid Accrual - Inpatient Hospital Accrual	Complied	Not applicable
9b	MDHHS - Medicaid Accrual - Special Needs Access Fund	Rewritten	6a(1)

Prior Audit Finding Number	Topic Area	Current Status	Current Finding Number
9c	MDHHS - Medicaid Accrual - Health Plans Services Accrual	Complied	Not applicable
9d	MDHHS - Medicaid Accrual - Full Cost Clinic Accrual	Complied	Not applicable

## GLOSSARY OF ABBREVIATIONS AND TERMS

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AICPA	American Institute of Certified Public Accountants.
<i>Annual Report</i>	<i>State of Michigan Comprehensive Annual Financial Report.</i>
ASAP	Adult Services Authorized Payments.
Bridges	Bridges Integrated Automated Eligibility Determination System.
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.
<i>Codification of Governmental Accounting and Financial Reporting Standards (Codification)</i>	An integration of currently effective accounting and reporting standards for state and local governments.
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> .
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.
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.
MDARD	Michigan Department of Agriculture and Rural Development.
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.
MiSACWIS	Michigan Statewide Automated Child Welfare Information System.
MSP	Michigan Department of State Police.
NICA	net investment in capital assets.
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.
SBA	State Building Authority.
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.
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.

TPSO

third party service organization.

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.

WIC Women, Infants and Children Federal Program.





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