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

# State of Michigan Annual Comprehensive Financial Report
State Budget Office

Fiscal Year Ended September 30, 2024

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

171-0010-25

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*

Report Summary

*Report on Internal Control, Compliance, and Other Matters*
*State of Michigan Annual Comprehensive Financial Report (SOMACFR)*
*State Budget Office*
*Fiscal Year Ended September 30, 2024*

**Report Number:**
**171-0010-25**

**Released:**
**June 2025**

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 *SOMACFR* dated April 25, 2025.

| Findings Related to Internal Control, Compliance, and Other Matters | Material Weakness | Significant Deficiency | Agency Preliminary Response |
|---|---|---|---|
| The Department of Treasury (Treasury) did not establish a liability estimation methodology to record unearned corporate income tax revenues or complete a more thorough analysis to comprehensively support its position the liability is not measurable (Finding 1). | X | | Disagrees |
| The Statewide Integrated Governmental Management Applications (SIGMA) Operations and Support, within the State Budget Office, should continue to improve internal control over the State's vendor file to help reduce the risk of fraudulent payments (Finding 2). | | X | Agrees |
| Treasury should continue to enhance its internal control to help prevent, or detect and correct, misstatements and help ensure the reasonableness and accuracy of tax accruals (Finding 3). | | X | Agrees |
| Various State agencies did not have sufficient internal control to help ensure the accuracy of all accounting information recorded in the *SOMACFR* (Finding 4). | | X | Agrees |

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

June 25, 2025

Jennifer L. Flood, State Budget Director
State Budget Office
George W. Romney Building
Lansing, Michigan

Director Flood:

This report on internal control, compliance, and other matters is being issued in conjunction with our financial audit of the *State of Michigan Annual Comprehensive Financial Report* for the fiscal year ended September 30, 2024.

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, as appropriate, 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 State 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

Doug Ringler
Auditor General

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## STATE OF MICHIGAN ANNUAL COMPREHENSIVE FINANCIAL REPORT

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# INDEPENDENT AUDITOR'S REPORT ON INTERNAL CONTROL OVER FINANCIAL REPORTING AND ON COMPLIANCE AND OTHER MATTERS

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

Jennifer L. Flood, State Budget Director
State Budget Office
George W. Romney Building
Lansing, Michigan

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, 2024 and the related notes to the financial statements, which collectively comprise the State's basic financial statements, and have issued our report thereon dated April 25, 2025. 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 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
- Western Michigan University
- Central 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.

**Report on Internal Control Over Financial Reporting**
In planning and performing our audit of the 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 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 were not 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 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 4 to be significant deficiencies.

**Report on Compliance and Other Matters**

As part of obtaining reasonable assurance about whether the State's 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*.

**State'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, as appropriate, for corrective action, consistent with your responsibility for financial accounting and reporting under Sections 18.1141 and 18.1421 of the *Michigan Compiled Laws*.

*Government Auditing Standards* require the auditor to perform limited procedures on the State's preliminary response to the findings identified in our audit. The response is included after the respective finding. The response was not subjected to the other auditing procedures applied in the audit of the financial statements and, accordingly, we express no opinion on the response.

**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.

Doug Ringler

Doug Ringler
Auditor General
April 25, 2025

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# FISCAL YEAR 2024

# FINDINGS, RECOMMENDATIONS, AND AGENCY PRELIMINARY RESPONSES

## FINDING 1

**Liabilities for CIT overpayments not recorded.**

The Department of Treasury (Treasury) cannot adequately ensure the corporate income tax (CIT) tax revenue recorded in the financial statements is materially accurate. Treasury records estimated CIT receipts as revenue, without a corresponding liability for unearned amounts or overpayments, unless a refund is specifically requested by the taxpayer. Treasury acknowledges a liability exists, yet contends the liability cannot be reasonably estimated, although it has not completed a comprehensive assessment to support this claim.

Our preliminary estimate indicates the current accounting practices potentially overstate CIT revenues and could materially misstate General Fund fund balance by hundreds of millions of dollars as of September 30, 2024. Because of the impact of this issue, we added an Emphasis of Matter paragraph within our opinion on the State's *Annual Comprehensive Financial Report* to draw attention to Note 24. The Note discloses the extent of the credit forwards and the absence of an associated liability for the overpayments.

Section N50.113 of the *Codification of Governmental Accounting and Financial Reporting Standards** (Codification), published by the Governmental Accounting Standards Board* (GASB), requires governments to recognize assets from derived tax revenue transactions in the period when the exchange transaction on which the tax is imposed occurs or when the resources are received, whichever occurs first. Also, resources received in advance should be reported as liabilities until the period of the exchange. GASB Codification Section N50.127 requires governments to recognize revenue in the period when the underlying exchange transaction occurs and the resources are available. When the taxpayer files their annual tax return, it ensures both criteria are met. GASB Codification N50.108 requires recognition of derived tax revenue transactions in the financial statements unless the transactions are not measurable (reasonably estimable). Treasury now has 12 years of CIT information to evaluate taxpayer trends since its inception in 2012.

Tax overpayments are the result of taxpayers' estimated payments exceeding their tax obligation for a given time period (tax year). The total amount of taxes owed is evidenced through the filing of an annual tax return. Treasury records estimated CIT payments as revenue during the fiscal year in which the State receives these payments. Although Treasury informs taxpayers their estimated payments should approximate their tax obligation, in the absence of a tax return, the actual tax owed by the taxpayers is unknown to Treasury because the amounts are not reported with submission of estimated payments. Taxpayers filing a return showing an overpayment of their tax obligation can choose to receive the overpayment as a refund or advance the amount as a credit forward against potential future tax

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

obligations. The State records a liability for refunds requested on tax returns; however, it does not record a liability or reduce the revenue already recorded in relation to credit forward amounts.

As of November 30, 2024, CIT credit forward amounts reflected on taxpayers' most recent annual tax returns processed by Treasury totaled $952.9 million. In addition, Treasury provided us a schedule showing nearly $4.4 billion in recorded CIT revenue for collections obtained with "no cleared annual return." Those collections (and revenues recorded in the State's financial statements) extend back to CIT's inception in tax year 2012. Although we are not implying all of these funds are unearned, it speaks to the need for a more thorough evaluation of those receipts by Treasury to determine those which should be properly recorded as revenue.

We first commented on this issue during the fiscal year 2022 *State of Michigan Annual Comprehensive Financial Report* (*SOMACFR*) audit. At that time, Treasury and the Office of Financial Management (OFM), within the State Budget Office (SBO), agreed a more comprehensive evaluation of the credit forwards should occur to determine if related estimated liabilities are reasonably measurable. We re-emphasized our concern during the fiscal year 2023 *SOMACFR* audit recommending Treasury complete an extensive analysis of the 11 years of CIT data it possessed at the time to either support its assertion a liability is not measurable or establish a liability estimation methodology. In its response to the 2023 audit, Treasury disagreed with our conclusion for a variety of reasons and made no commitment to further assess taxpayer trends to assess whether a liability is reasonably estimable.

Over the past two years, we performed detailed analyses of the extensive CIT data maintained by Treasury, including evaluations of taxpayer behavior and credit forward use. During fiscal year 2024, we calculated an estimated liability based on the credit forward use trends of all 26,000 taxpayers with a credit forward balance. We conclude existing data provides Treasury the ability to establish a reasonable estimation methodology. We shared our analysis, along with estimation methodologies used by several other states, with Treasury; however, it continues to assert a reasonable estimate is not possible, including:

- A taxpayer's past behavior is not a valid indicator of their future behavior.

  However, this assertion conflicts with existing estimation methodologies used by Treasury to record various other tax receivables and tax liabilities at fiscal year-end. Also, our analysis indicated in November 2024 approximately 115 taxpayers comprised about 40% of our estimated unrecorded liability. With 12 years of taxpayer data, it appears a reasonable estimate of overpayments is within reach.

- Even if a taxpayer has the same credit forward balance for two consecutive tax years, it does not mean that none of it was earned by the State.

  Treasury views estimated payments and credit forwards as a rolling balance across tax periods. However, over half of the taxpayers with credit forward balances in our estimated liability had balances in all five years we evaluated. If after 2, 3, or more consecutive tax years the amount overpaid by a taxpayer, and essentially held on deposit by the State, remains the same or increases across tax periods, it provides further evidence that the amount was not earned by the State and represents a liability.

Continuing its current accounting practices, without sufficient analysis regarding CIT credit forwards, is a generally accepted accounting principles* (GAAP) violation and represents a potential misstatement in future fiscal years. Over the past 12 years, total credit forwards have grown, with the balance increasing from $365 million to $953 million since we first raised this issue with Treasury. These balances grew in proportion to CIT revenues, indicating the credit forwards consistently exist from year to year and represent an unrecorded liability. This results in overstated revenues, but it also understates the State's liability to taxpayers, which could have a significant impact on future years' recorded revenue and the General Fund fund balance should taxpayers begin to use accumulated credit forwards rather than making estimated payments.

We consider this finding to be a material weakness* because of the significant dollar amounts involved, the continued increase in the aggregate CIT credit forward balance year-over-year, and the potential impact on our future opinions as to whether the State's financial statements are materially accurate.

**RECOMMENDATION**

We recommend Treasury establish a liability estimation methodology to record unearned CIT revenues. Alternatively, Treasury should complete a more thorough analysis to comprehensively support its position the liability is not measurable.

**AGENCY PRELIMINARY RESPONSE**

The response OFM provided indicates Treasury disagrees with the finding. The response and our auditor's comments to agency preliminary response* are presented on page 24.

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

## FINDING 2

**Improvements needed over vendor file fraud controls.**

The Statewide Integrated Governmental Management Applications* (SIGMA) Operations and Support (SOS), within SBO, should continue to improve internal control* over the State's vendor file to help reduce the risk of fraudulent payments.

The U.S. Government Accountability Office's (GAO's) Federal Information System Controls Audit Manual* (FISCAM) states organizations should appropriately control and monitor changes to master data to prevent or detect unauthorized changes and help ensure the accuracy and validity of the records.

During fiscal year 2024, a vendor contacted the State regarding missing payments. Upon review, the State determined unauthorized access to the vendor's account occurred and a change was made to the vendor's banking account information resulting in the payments being misdirected.

We commented on known fraud occurrences related to the vendor file during the fiscal year 2021 and 2022 *SOMACFR* audits. In response to those prior occurrences, SOS implemented enhanced vendor controls. Because the fiscal year 2024 fraud was initiated using the authorized user credentials for the vendor's SIGMA account, SOS's enhanced controls were not effective in preventing or detecting the identified occurrence.

**RECOMMENDATION**

We recommend SOS continue to improve internal control over the State's vendor file.

**AGENCY PRELIMINARY RESPONSE**

OFM provided us with the following response:

*SOS and OFM agree with the recommendation. SOS will continue to review and enhance controls related to the State's vendor file.*

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

## FINDING 3

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

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

Section 18.1485 of the *Michigan Compiled Laws* states 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.

Our review of tax accruals for fiscal year 2024 disclosed:

a. Treasury did not ensure the estimated liability for the flow-through entity (FTE) tax was accurately recorded. Liabilities were overstated and revenues were understated in the General Fund and net position was understated in the governmental activities of the government-wide financial statements by $45.1 million. Treasury corrected these items prior to the *SOMACFR's* issuance.

   In fiscal year 2022, Treasury developed a methodology utilizing FTE tax return and payment information from the business tax system and information from processed individual income tax (IIT) returns to estimate the amount of refunds resulting from unprocessed or unclaimed FTE tax credits as of November 30th. Treasury updated its methodology for the fiscal year 2024 year-end closing process; however, the revised methodology did not fully exclude the impact of voided returns and unusually large dollar value refunds from the estimate calculation.

b. Treasury did not ensure tax refunds were properly classified. The State of Michigan Financial Management Guide (FMG) (Part II, Chapter 1, Section 200) requires out-of-period refunds over $5 million to be recorded as an expenditure instead of a reduction of current year revenue. Treasury did not reclassify a $7.2 million use tax refund, issued in fiscal year 2024 and related to tax year 2020, as an expenditure. Because the tax refund was recorded as a revenue reduction, both revenue and expenditures were understated. Treasury corrected this item prior to the *SOMACFR's* issuance.

c. Treasury did not ensure October and November tax refunds were accurately recorded. Revenues were understated and liabilities were overstated in the General Fund and net position was understated in the governmental activities of the government-wide financial statements by $1.6 million. Treasury corrected this item prior to the *SOMACFR's* issuance.

   At year-end, Treasury accrues refunds processed during October and November back to the prior fiscal year. Occasionally, refunds are canceled in the business tax system and reprocessed before a payment is issued in SIGMA. In fiscal year 2024, we noted the report containing accrued business tax refunds processed during October and November included refunds that were subsequently canceled and reprocessed. As a result, those refunds were duplicated in the report and mistakenly accrued more than once. Treasury attributed this to an unintended change made to the design of the report in December 2023.

d. Treasury had not developed a methodology to estimate City of Detroit income tax receivable (on the accrual basis), resulting in an unknown misstatement amount in the City Income Tax Trust Fund. Treasury policy generally requires five years of tax data to complete a reasonable estimation of the receivable, which it does possess; however, Treasury indicated it is still addressing limitations within the data structure to develop an appropriate estimate.

e. Treasury had not developed a process to reconcile the IIT legacy system and SIGMA. Processes utilizing data from the IIT legacy system to determine the year-end accruals, including the estimated accrual basis receivable, may not be fully accurate and the General Fund and School Aid Fund balances in the *SOMACFR* may be misstated. Treasury informed us it does not complete a reconciliation because the IIT legacy system does not contain the necessary general ledger information.

f. Treasury did not ensure the reports used to estimate the assessed tax receivables (ATR) and receivables to be assessed (RTBA) at year-end contained accurate assessment payment information. As a result, the ATR and RTBA may be overstated by $1.6 million.

   At year-end, Treasury uses historical data from its delinquent tax collection system to estimate the amount of ATR and RTBA balances expected to be received in future years. Specifically, Treasury uses tax assessment payments received in the most recent fiscal year to calculate collectability percentages which it then uses to estimate the receivable recorded in the *SOMACFR*.

   For fiscal year 2024, Treasury implemented a new delinquent tax collection system and developed new reports for its year-end ATR and RTBA estimates calculation. Our review of the payment activity included in these reports noted some payments were counted multiple times, which impacted the collectability percentages and ultimately the estimated receivable. Treasury attributed the issue to the new collection system implementation and a design deficiency within the reports.

g. Treasury had not fully implemented a process to compare and properly evaluate all significant accounting estimates with subsequent activity for tax accruals. 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 methodologies.

   In its approval of accrual methodologies, OFM advises State departments 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 amounts and determine if a change to the methodology is needed.

   Treasury did not complete a comprehensive evaluation of the estimated FTE payable recorded at year-end and did not ensure its evaluation of the RTBA included actual collections from the Michigan Motor Fuel and Tobacco Tax System. Treasury cited lack of a reporting mechanism as the reason for not completing the evaluation of FTE and system limitations as the reason for not including actual collections in its evaluation of RTBA. Without performing these evaluations, Treasury cannot determine if its estimation methodologies for FTE and RTBA are appropriate.

h. Treasury did not ensure IIT estimated payments received in October and November were properly recorded. Revenues and receivables may be understated in the General Fund and net position may be understated in the governmental activities of the government-wide financial statements by $2.7 million.

   At year-end, Treasury records a receivable for IIT estimated payments received in October and November. Some IIT taxpayers remit their calendar year fourth quarter estimated payments early, which includes their September tax liability. When determining the final amount of October and November IIT estimated payments to accrue, Treasury reviews a sample of the remittances to identify payment amounts applicable to tax periods after September 30th and adjusts the accrued receivable accordingly.

   Our review of Treasury's adjustment process determined Treasury improperly projected the results of its sample testing to a larger population than what it used for sampling.

**RECOMMENDATION**

We recommend Treasury continue to enhance its 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 4

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

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

Section 18.1485 of the *Michigan Compiled Laws* states 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 who maintain a level of competence; and internal control techniques that are effective and efficient. Each principal department head shall document the system and ensure the system functions as intended. Also, the GAO's FISCAM states interface controls should be established and implemented to reasonably ensure data transferred from a source system to a receiving system is processed completely and accurately. Interfaced data should be reconciled, and reports used in the reconciliation should provide adequate information to reconcile each transaction processed.

We noted:

a. The Department of Technology, Management, and Budget (DTMB) did not properly record 5 (83%) of 6 software subscriptions initiated in fiscal year 2024, resulting in a $121.1 million overstatement of capital assets, a $114.2 million overstatement of liabilities (vendor financing obligations), and a $4.8 million overstatement of accumulated depreciation in the Information Technology Fund. OFM requires departments to evaluate all new software subscriptions and submit a completed evaluation form which OFM uses to create the depreciation and amortization schedules. We noted DTMB did not appropriately evaluate the software subscription terms when completing the evaluation form. DTMB corrected this item prior to the *SOMACFR's* issuance.

b. The Michigan Department of Health and Human Services (MDHHS) did not:

   (1) Properly calculate the Medicaid long-term care accrual, resulting in a $49.8 million payable overstatement and a $32.4 million receivable overstatement in the General Fund. MDHHS attributed the errors to a system issue and a keying mistake.

   (2) Properly record adjusting entries for a prior year error related to a federal disallowance, resulting in a $47.5 million understatement in revenues and expenditures in the General Fund. MDHHS did not fully consider the impact on fiscal year 2024 operating statement activity when processing the

adjusting entries to eliminate the receivable and payable balances established in the prior year.

(3) Properly calculate the Medicaid inpatient hospital accrual, resulting in a $0.6 million payable understatement and a $0.4 million receivable understatement in the General Fund. We identified a formula error in MDHHS's accrual workbook.

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

c. The Michigan Department of State Police (MSP) had not established an accrual methodology to record estimated payables and receivables related to Federal Emergency Management Agency (FEMA) grants, resulting in a potential $46.9 million understatement of expenditures, payables, revenues, and receivables in the General Fund. FEMA grantees submit reimbursement requests to MSP throughout the year for grant expenditures related to federally declared disasters. MSP's existing accounting practice is limited to only recording expenditures and revenues associated with reimbursement requests for which it has finalized review by mid-October.

d. The Department of Environment, Great Lakes, and Energy (EGLE) and the Michigan Department of Agriculture and Rural Development (MDARD) should develop a reconciliation process to help ensure all data exchanged between their information systems and the Michigan Cashiering and Receivable System (MiCARS), and ultimately SIGMA, is processed completely and accurately. EGLE and MDARD interfaced $19.8 million and $6.9 million, respectively, in revenue from their systems into MiCARS in fiscal year 2024.

e. The Michigan Department of Transportation (MDOT) did not perform reconciliations between the MDOT Permit Gateway (MPG) and the State's Centralized Electronic Payment Authorization System or SIGMA. MDOT interfaced $7.6 million in revenue from MPG to SIGMA in fiscal year 2024. The lack of a reconciliation increases the risk that all transactions are not processed completely and accurately. MDOT informed us it did not have the reports necessary to perform the reconciliations.

f. OFM did not:

(1) Properly record interest expense, resulting in a $6.9 million overstatement of expenses and payables in the governmental activities of the government-wide financial statements. OFM mistakenly included fiscal year 2025 interest

amounts related to a structured settlement agreement.

(2) Properly eliminate interfund activity, resulting in a $2.8 million understatement of payables and $0.6 million understatement of internal balances in the governmental activities and a corresponding $2.8 million overstatement of payables and $0.6 million overstatement of internal balances in the business-type activities of the government-wide financial statements. OFM incorrectly classified amounts related to internal service funds as business-type activities in its calculation of interfund activity.

OFM corrected these items prior to the *SOMACFR's* issuance.

g. DTMB and the Department of Labor and Economic Opportunity (LEO) did not properly account for cash advances. Specifically:

(1) DTMB did not properly record an advance to an external entity, resulting in a $2.6 million overstatement of expenditures and federal revenue and an understatement of other current assets and unearned revenue in the General Fund. DTMB attributed the error to miscommunication within DTMB.

(2) LEO did not properly adjust an advance to the Michigan State Housing Development Authority (MSHDA) for emergency rental assistance, resulting in a $2.3 million understatement of current assets and unearned revenue in the General Fund. At year-end, LEO adjusts MSHDA's advance for any unspent funds. MSHDA did not report the correct amount of unspent funds to LEO as of year-end.

DTMB and LEO corrected these items prior to the *SOMACFR's* issuance.

h. Treasury did not properly record a canceled refund, resulting in a $2.0 million overstatement of payables and understatement of revenue in the General Fund. Treasury mistakenly issued a tax refund in fiscal year 2024 and subsequently canceled the refund check in October 2025. However, Treasury recorded the revenue impact related to the cancellation in fiscal year 2025 instead of fiscal year 2024. Treasury indicated it followed existing guidance for processing the entry without questioning the appropriateness of the end result between fiscal years. Treasury corrected this item prior to the *SOMACFR's* issuance.

Although not all the deficiencies noted above resulted in significant misstatements to the financial statements, the potential for a material misstatement* exists in subsequent years if the underlying internal control is not enhanced.

**RECOMMENDATION**

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

**AGENCY PRELIMINARY RESPONSE**

OFM provided us with the following response:

*State agencies and OFM agree that internal control should be improved to help ensure the accuracy of the accounting information recorded in the SOMACFR.*

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

# AGENCY PRELIMINARY RESPONSE

STATE OF MICHIGAN ANNUAL COMPREHENSIVE FINANCIAL REPORT
Report on Internal Control, Compliance, and Other Matters
Fiscal Year Ended September 30, 2024
State Budget Office

Finding 1 Agency Preliminary Response and Auditor's Comments to Agency Preliminary Response

This section contains OFM's preliminary response to Finding 1 and our auditor's comments providing further clarification and context where necessary.

**Finding 1: Liabilities for CIT overpayments not recorded.**

OFM provided us with the following response:

| AGENCY PRELIMINARY RESPONSE | AUDITOR'S COMMENTS TO AGENCY PRELIMINARY RESPONSE |
|---|---|
| Treasury disagrees with the audit finding. The OAG states that Treasury "cannot adequately ensure the CIT tax revenue recorded in the financial statements is materially accurate" and that "continuing [Treasury's] current accounting practices, without sufficient analysis regarding CIT credit forwards, is a GAAP violation." Treasury strongly disagrees with these statements. | See the following auditor's comments regarding Treasury's reasons for disagreement. Treasury's response does not provide persuasive information to warrant changes to our Finding; therefore, the Finding and recommendation stand as written. |
| In addition, Treasury disagrees with the OAG's assertion that it has not completed an assessment to support its claim that the liability cannot be reasonably estimated. Treasury has provided an in-depth response to the OAG supporting its claim using the OAG's analysis to illustrate our position. Treasury's response included concerns with the OAG's assumptions that lead to the OAG concluding that existing data provides the ability to establish a reasonable estimation methodology. | Treasury has not provided the OAG with evidence of a comprehensive analysis of taxpayer data to support its position. Instead, Treasury provided its review of 8 individual taxpayers with large credit forward balances to refute our analysis. While some of Treasury's review identified circumstances requiring consideration in a more detailed liability estimation methodology, Treasury could not demonstrate that the circumstances of 8 unique taxpayers were representative of the 26,000 taxpayers with a credit forward balance included in the OAG analysis. The remainder of Treasury's review remains grounded mostly in theory, without application of the theory to actual Michigan taxpayer trends and analysis. |
| Treasury's current accounting methodology for credit carryforwards has been in place since the inception of the individual income tax and other business taxes. Treasury's approach is the same as more than half of the states reviewed by Treasury and the OAG. Treasury's carryforward methodology was explicitly explained and included in its audit methodology 15 years ago. The OAG reviewed and approved that methodology then and then annually for the next ten years before changing its opinion three years ago. | The OAG's view as to the proper accounting treatment has not changed and remains consistent with Treasury policy that the portion of revenue amounts received, carried forward, and not yet earned should be deferred. Although the OAG has audited Treasury's methodology in prior years, this was under the premise that Treasury did not possess sufficient data to estimate a credit forward liability. Treasury now has 12 years of CIT history to reflect upon. The corresponding taxpayer behaviors and trends that can be derived through analysis and evaluation of this data impacted our view on the measurability. Also, the continued growth of the credit forward balance to $952.9 million as of November 2024 increased the significance of the matter. Further, the liability recognition in other states lends support to our recommendation. |

While the OAG has changed its opinion and decided that attempting to estimate an unearned amount and booking a payable would be preferable to the current ACFR disclosure, that does not make Treasury's approach noncompliant with GAAP. The OAG states "GASB Codification N50.108 requires recognition of derived tax revenue transactions in the financial statements unless the transactions are not measurable (reasonably estimable)." As previously indicated, Treasury has provided evidence to the OAG that the liability related to the carryforward balance is not reasonably estimable. GASB Codification N50.108 also states that when the transactions are not measurable then disclosure is required. The full amounts of the carryforward balances are disclosed in the footnotes of the ACFR.

Given the immeasurability, Treasury's approach is to fully disclose credit forwards in the Annual Comprehensive Financial Report (ACFR). This complies with GASB Codification N50.108 and is more useful to the financial statement user than booking a payable that could be inaccurate by hundreds of millions of dollars.

As noted in our previous auditor's comments, the OAG's view as to the proper accounting treatment has not changed.

Also, accounting principles dictate the information needed for users of the State's financial statements to make informed judgments. Under these standards, solely disclosing the CIT credit forward balance in the notes would only be appropriate if the balance was not measurable. The Finding notes our detailed analysis of taxpayer behavior and credit forward usage concludes existing data provides Treasury the ability to establish a reasonable estimation methodology.

In addition, the disclosure is not necessarily more useful to all financial statement users. The lack of a recorded payable overstates fund balance and provides those parties charged with governance an inflated impression of amounts available for State spending, especially should taxpayers begin to use accumulated credit forwards rather than making estimated payments.

Treasury further notes that the OAG's arguments hinge on a misunderstanding of the criteria needed to earn revenue. For example, the OAG states:

> *GASB Codification Section N50.127 requires governments to recognize revenue in the period when the underlying exchange transaction occurs and the resources are available. When a taxpayer files their annual return, it ensures both criteria are met.*

While an annual return ensures both criteria are met, both criteria can be met without the filing of an annual return. What is needed, as noted in the GASB statement quoted by the OAG, is for the underlying exchange transaction to have occurred. The OAG does not directly say that the filing of an annual return is needed prior to revenue recognition, but it strongly suggests an annual return is vital for revenue recognition determination. For example, the OAG states:

> *The total amount of taxes owed is evidenced through the filing of an annual tax return.*
>
> And
>
> *Although Treasury informs taxpayers their estimated payments should approximate their tax obligation, in the absence of an annual return, the actual tax owed by the taxpayer is unknown to Treasury because the amount is not reported with the submission of estimated payments.*
>
> And
>
> *In addition, Treasury provided us a schedule showing nearly $4.4 billion in recorded revenue for collections obtained with 'no cleared annual return.'*

Treasury's response appears to infer the mere receipt of estimated payments from taxpayers is the underlying exchange transaction. However, the existence of business income and the associated tax obligation, information unknown to Treasury without receiving the corresponding annual return, represents the actual underlying exchange transaction. Our position is monies received with estimated payments should be recognized by the State without an annual return, assuming an appropriate liability is also recognized. As noted in the Finding, with nearly $4.4 billion in recorded CIT revenue, not yet associated with the tax obligation from an annual return, and $953 million in CIT credit forward amounts reflected on taxpayers' most recent annual tax returns processed by Treasury, Treasury should perform a more thorough evaluation of those receipts to ensure the revenue has been earned.

Treasury continues to assert that credit carryforwards are indistinguishable from estimated payments. Instead, the OAG has indicated it believes that credit carryforwards should be treated like refunds. For example, the OAG states:

> *The State records a liability for refunds requested on tax returns; however, it does not record a liability or reduce the revenue already recorded in relation to credit forward amounts.*

The state does not record a liability because the taxpayer has not requested a refund. The taxpayer has said to treat the amount as an estimated payment. At the point the taxpayer requests a carryforward, it should be presumed earned as estimated payments since the taxpayer has indicated they wish to apply the overpayment to their tax liability. While it is possible that some portion is not earned, the same can be said for any cash estimated payment. If the OAG believes that estimated payments are not earned until an annual return is filed, it should state that plainly.

Section 205.30(2) of the *Michigan Compiled Laws* states if a tax return reflects an overpayment or credit in excess of the tax, the declaration of that fact on the return constitutes a claim for refund. Also, by making an estimated payment, the taxpayer is not sacrificing those funds to the State to record as revenue. If the estimated payments ultimately result in an overpayment, the State owes the monies back to the taxpayer. As noted in the Finding, our detailed analysis of taxpayer trends and credit forward usage supports that many taxpayers maintain a credit forward balance in consecutive years, further supporting the revenue has not been earned by the State. As noted in our previous auditor's comments, in the absence of an annual return, Treasury should conduct a more thorough evaluation of the payments received to determine the amount earned. Further, we strongly believe 12 years of data is a sufficient basis to analyze taxpayer behavior to determine the portion of estimated payments not yet earned in the absence of a filed annual return.

Although Treasury disagrees with this finding, it is committed to continue working with the OAG to resolve this matter.

Although we have and will continue to work with Treasury to analyze data, Treasury's focus seems to be on isolated examples instead of an analysis of all relevant taxpayers, such as the one we performed. Before Treasury can demonstrate these amounts are truly not measurable, it will need to commit to and deliver a much more thorough analysis to comprehensively support its position.

Go Back to Finding 1

Go to Finding 2

# FISCAL YEAR 2023
# REPORT ON INTERNAL CONTROL, COMPLIANCE, AND OTHER MATTERS
# FOLLOW-UP

Below is the status of the reported findings from the 2023 *State of Michigan Annual Comprehensive Financial Report's* report on internal control, compliance, and other matters (071-0010-24):

| Prior Audit Finding Number | Topic Area | Current Status | Current Finding Number |
|---|---|---|---|
| 1 | Treasury - Tax Credit Forwards | Rewritten* | 1 |
| 2a | Treasury - FTE Tax | Repeated* | 3a |
| 2b - 2c | Treasury - Various Tax Accrual Items | Complied | Not applicable |
| 2d | Treasury - City Income Tax Receivable | Repeated | 3d |
| 2e | Treasury - IIT Legacy System Reconciliation | Repeated | 3e |
| 2f | Treasury - Evaluation of Tax Accrual Receivable Estimates | Repeated | 3g |
| 2g | Treasury - IIT Payable | Complied | Not applicable |
| 3 | Various Agencies - Financial Accounting Practices | Complied | Not applicable |
| 4 | MDOC - Confidential Information in SIGMA | Complied | Not applicable |
| 5a(1) | Treasury - User Access Reviews | No longer applicable | |
| 5a(2) | Treasury - User Access Reviews | Complied | Not applicable |
| 5b | Treasury - Deactivation of User Accounts | Complied | Not applicable |
| 6 | Various Agencies - MiCARS Internal Control | Complied | Not applicable |
| 7 | MDOT/DNR - Recording of CIP | Complied | Not applicable |
| 8a | Treasury - Subservice Provider SOC Reports | Complied | Not applicable |
| 8a | MDHHS - Subservice Provider SOC Reports | No longer applicable | |
| 8b | Treasury - Complementary User-Entity Controls | Complied | Not applicable |
| 9 | MPSERS - Accounting Transaction Internal Control | Complied | Not applicable |

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

## GLOSSARY OF ABBREVIATIONS AND TERMS

| | |
|---|---|
| **ATR** | assessed tax receivables. |
| **auditor's comments to agency preliminary response** | Comments the OAG includes in an audit report to comply with *Government Auditing Standards*. Auditors are required 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. |
| **CIT** | corporate income tax. |
| ***Codification of Governmental Accounting and Financial Reporting Standards* (Codification)** | An integration of currently effective accounting and reporting standards for state and local governments. |
| **deficiency in internal control over financial reporting** | The design or operation of a control not allowing 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. |
| **EGLE** | Department of Environment, Great Lakes, and Energy. |
| **Federal Information System Controls Audit Manual (FISCAM)** | A methodology published by the U.S. Government Accountability Office (GAO) for performing information system control audits of federal and other governmental entities in accordance with *Government Auditing Standards*. |
| **FEMA** | Federal Emergency Management Agency. |
| **financial audit** | An audit designed to provide reasonable assurance about whether the 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. |

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|---|---|
| **FTE** | flow-through entity. |
| **GAO** | U.S. Government Accountability Office. |
| **generally accepted accounting principles (GAAP)** | A technical accounting term encompassing 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. |
| **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. |
| **LEO** | Department of Labor and Economic Opportunity. |
| **material misstatement** | A misstatement in the financial statements causing 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 a reasonable possibility exists a material misstatement of the financial statements will not be prevented, or detected and corrected, on a timely basis. |
| **MDARD** | Michigan Department of Agriculture and Rural Development. |
| **MDHHS** | Michigan Department of Health and Human Services. |
| **MDOT** | Michigan Department of Transportation. |
| **MiCARS** | Michigan Cashiering and Receivable System. |

| | |
|---|---|
| **MPG** | MDOT Permit Gateway. |
| **MPSERS** | Michigan Public School Employees' Retirement System. |
| **MSHDA** | Michigan State Housing Development Authority. |
| **MSP** | Michigan Department of State Police. |
| **OFM** | Office of Financial Management. |
| **repeated** | 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 warranting the prior audit recommendation to be revised for the circumstances. |
| **RTBA** | receivables to be assessed. |
| **SBO** | State Budget Office. |
| **significant deficiency in internal control over financial reporting** | A deficiency, or a combination of deficiencies, in internal control less severe than a material weakness, yet important enough to merit attention by those charged with governance. |
| ***SOMACFR*** | *State of Michigan Annual Comprehensive Financial Report.* |
| **SOS** | SIGMA Operations and Support. |
| **Statewide Integrated Governmental Management Applications (SIGMA)** | The State's enterprise resource planning business process and software implementation suite supporting budgeting, accounting, purchasing, human resource management, and other financial management activities. |
| **Treasury** | Department of Treasury. |
| **unmodified opinion** | The opinion expressed by the auditor when the auditor, having obtained sufficient appropriate audit evidence, concludes the financial statements are presented fairly, in all material respects, in accordance with the applicable financial reporting framework. |

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