MICHIGAN

OFFICE OF THE AUDITOR GENERAL

AUDIT REPORT

PERFORMANCE AUDIT
OF THE

BIENNIAL INTERNAL CONTROL EVALUATION PROCESS

DEPARTMENT OF COMMUNITY HEALTH

March 2007

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

391-0101-05

The auditor general shall conduct post audits of financial transactions and accounts of the state and of all branches, departments, offices, boards, commissions, agencies, authorities and institutions of the state established by this constitution or by law, and performance post audits thereof.

– Article IV, Section 53 of the Michigan Constitution

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REPORT SUMMARY

Performance Audit

Biennial Internal Control Evaluation Process

Department of Community Health

Report Number:
391-0101-05

Released:
March 2007

In accordance with State law, the Department of Community Health (DCH) reports biennially on evaluations of its internal control. The biennial internal control evaluation (ICE) report is to be completed by May 1 of each odd numbered year and is to be provided to various parties, including the Governor, the Auditor General, and legislative committees and agencies. The ICE process is an integral tool to help ensure that a department's system of internal control has been established and is functioning as required by law.

Audit Objective:
To assess the effectiveness of DCH's efforts in coordinating the development of the biennial ICE process.

Audit Conclusion:
DCH's efforts were moderately effective in coordinating the development of the biennial ICE process.

Material Condition:
DCH needs to improve its efforts to oversee ICE activities to help ensure that all critical ICE activities are completed within established time frames. DCH also needs to complete all detailed internal control assessments to help ensure that the DCH biennial ICE report is completed in accordance with State law. (Finding 1)

Reportable Conditions:
DCH did not complete the departmentwide application control assessments for its computer applications. In addition, DCH had not established a formal methodology to determine which of its critical computer applications should be subject to specific application control assessments. (Finding 2)

DCH did not provide sufficient training or communicate clear expectations to its assessable units' management staff to help prepare them for their role in the biennial ICE process (Finding 3).

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Audit Objective:
To assess the effectiveness of DCH assessable units' efforts in evaluating their internal control.

Audit Conclusion:
DCH assessable units' efforts were not effective in evaluating their internal control.

Material Condition:
DCH assessable units did not sufficiently evaluate and document their internal control (Finding 4).

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Audit Objective:
To assess the effectiveness of the Office of Audit's efforts in evaluating DCH's biennial ICE process.

Audit Conclusion:
The Office of Audit's efforts were effective in evaluating DCH's biennial ICE process.

Reportable Condition:
The Office of Audit needs to improve its efforts to evaluate DCH's ICE activities (Finding 5).

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Agency Responses:
Our audit report contains 5 findings and 7 corresponding recommendations. DCH's preliminary response indicates that it generally agrees with the 7 recommendations.

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A copy of the full report can be obtained by calling 517.334.8050 or by visiting our Web site at: http://audgen.michigan.gov

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

March 8, 2007

Ms. Janet Olszewski, Director
Department of Community Health
Capitol View Building
Lansing, Michigan

Dear Ms. Olszewski:

This is our report on the performance audit of the Biennial Internal Control Evaluation Process, Department of Community Health.

This report contains our report summary; description of process; audit objectives, scope, and methodology and agency responses; comments, findings, recommendations, and agency preliminary responses; and a glossary of acronyms and terms.

Our comments, findings, and recommendations are organized by audit objective. The agency preliminary responses were taken from the agency's responses subsequent to our audit fieldwork. The *Michigan Compiled Laws* and administrative procedures require that the audited agency develop a formal response within 60 days after release of the audit report.

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

Sincerely,

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

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DEPARTMENT OF COMMUNITY HEALTH

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Description of Process

Sections 18.1483 - 18.1489 of the *Michigan Compiled Laws* require the head of each principal department to establish and maintain an internal accounting and administrative control system (i.e., internal control*). The purpose of internal control is to provide management with reasonable assurance that measures are being taken to safeguard assets, to check the accuracy and reliability of accounting data, to promote operational efficiency*, and to encourage adherence to prescribed managerial policies. In accordance with State law, the Department of Community Health (DCH) reports biennially on evaluations of its internal control.

In accordance with Section 18.1484 of the *Michigan Compiled Laws*, the Department of Management and Budget (DMB) issued guidelines, entitled *Evaluation of Internal Controls - A General Framework and System of Reporting* (General Framework), for use by the principal departments in performing and reporting on evaluations of their internal control. The General Framework defines internal control as a process, effected by the director, management, and support staff of each State department, designed to provide reasonable assurance toward accomplishment of each principal department's mission, objectives, and goals. The General Framework provides the necessary guidance for evaluating internal control in State government. The General Framework also provides the basic structure for planning and conducting evaluations of a department's internal control with references to evaluation tool sets. State departments are encouraged to obtain, review, and modify these evaluation tools to best address the unique requirements of each department's environment.

Section 18.1485 of the *Michigan Compiled Laws* requires DCH to complete the biennial internal control evaluation (ICE) report by May 1 of each odd numbered year and to provide the report to the Governor, the Auditor General, the Senate and House Appropriations Committees, the Senate and House Fiscal Agencies, and the DMB director. The report shall include a description of any material inadequacy or weakness discovered in connection with the evaluation of DCH's internal accounting and administrative control system as of September 30 of the preceding year. In addition, the report shall include the plans and a time schedule for correcting any weaknesses noted in the internal accounting and administrative control system. The ICE process is an

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

integral tool to help ensure that a department's system of internal control has been established and is functioning as required by law.

The biennial ICE report that was due on May 1, 2005 covered the period October 1, 2002 through September 30, 2004. To complete this report, DCH identified 69 specific assessable units* within DCH and required each assessable unit to complete an internal control assessment. The assessable units were based at the division level and reported approximately 500 functions for evaluation. DCH also identified 6 specific computer applications and completed assessments for each of these applications. DCH then used the individual internal control assessments for each assessable unit and computer application assessments to prepare its overall biennial ICE report.

In accordance with DMB Administrative Guide procedure 1270.01, DCH's Office of Audit is required to conduct a review of the biennial ICE process to determine whether DCH has performed an evaluation of its internal control in accordance with the General Framework guidelines and carried out the evaluation in a reasonable and prudent manner. The Office of Audit is then required to report this information to the DCH director.

DCH was appropriated $10.2 billion and 5,118.6 full-time equated positions for fiscal year 2004-05.

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

Audit Objectives, Scope, and Methodology and Agency Responses

Audit Objectives

Our performance audit* of the Biennial Internal Control Evaluation (ICE) Process, Department of Community Health (DCH), had the following objectives:

1. To assess the effectiveness* of DCH's efforts in coordinating the development of the biennial ICE process.

2. To assess the effectiveness of DCH assessable units' efforts in evaluating their internal control.

3. To assess the effectiveness of the Office of Audit's efforts in evaluating DCH's biennial ICE process.

Audit Scope

Our audit scope was to examine the Department of Community Health's records related to its biennial internal control evaluation process. Our audit was conducted in accordance with *Government Auditing Standards* issued by the Comptroller General of the United States and, accordingly, included such tests of the records and such other auditing procedures as we considered necessary in the circumstances. Our audit procedures, performed primarily from June through October 2005, included examination of DCH records and activities related primarily to the biennial ICE report submitted May 1, 2005, which covered the period October 1, 2002 through September 30, 2004.

Audit Methodology

To accomplish our first objective, we interviewed DCH staff involved in coordinating the ICE activities and assessed DCH's efforts to prepare for the biennial ICE process. We determined if DCH adhered to established time frames and performed scheduled ICE procedures. In addition, we evaluated DCH's efforts to include relevant programs and computer applications in the biennial ICE process. Further, we evaluated the departmentwide training provided in preparation for the biennial ICE process.

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

To accomplish our second objective, we reviewed the completeness of the internal control assessments prepared by the 69 DCH assessable units. In addition, we judgmentally selected the following 5 DCH assessable units: Medicaid Payments; Medicaid Revenue and Reimbursement; Immunization; Women, Infants, and Children (WIC); and Community Services. We reviewed supporting documentation for and assessed the sufficiency of information contained in these 5 assessable units' internal control assessments.

To accomplish our third objective, we interviewed DCH's Office of Audit staff and inquired about their efforts to evaluate DCH's biennial ICE process. We reviewed the Office of Audit's working papers that pertained to evaluation efforts and the required letter from the Office of Audit director to the DCH director concerning the biennial ICE process.

We use a risk and opportunity based approach when selecting activities or programs to be audited. Accordingly, our audit efforts are focused on activities or programs having the greatest probability for needing improvement as identified through a preliminary review. By design, our limited audit resources are used to identify where and how improvements can be made. Consequently, our performance audit reports are prepared on an exception basis.

Agency Responses

Our audit report contains 5 findings and 7 corresponding recommendations. DCH's preliminary response indicates that it generally agrees with the 7 recommendations.

The agency preliminary response that follows each recommendation in our report was taken from the agency's written comments and oral discussion subsequent to our audit fieldwork. Section 18.1462 of the *Michigan Compiled Laws* and Department of Management and Budget Administrative Guide procedure 1280.02 require DCH to develop a formal response to our audit findings and recommendations within 60 days after release of the audit report.

COMMENTS, FINDINGS, RECOMMENDATIONS, AND AGENCY PRELIMINARY RESPONSES

EFFORTS TO COORDINATE THE DEVELOPMENT OF THE BIENNIAL INTERNAL CONTROL EVALUATION (ICE) PROCESS

COMMENT

Background: The Department of Community Health (DCH) was created by an executive order in 1996 and is generally composed of the former State Departments of Mental Health and Public Health and the Medical Services Administration, which was part of the Family Independence Agency (currently the Department of Human Services).

DCH informed us that the responsibilities for the first three biennial ICEs conducted for the new DCH (1998, 2000, 2002) were assigned to three different areas within DCH. In 2004, the responsibility for the ICE was permanently assigned to the Bureau of Finance. DCH informed us that its preparation activities for the May 1, 2005 biennial ICE report had evolved significantly since the May 1, 2003 biennial ICE report, which covered the period October 1, 2000 through September 30, 2002.

DCH also informed us that during the 2004 ICE process, departmentwide training sessions were initiated for all employees who were section managers and above. DCH presented the key components of the model developed by the Committee of Sponsoring Organizations (COSO) of the Treadway Commission to all the managers for use as an evaluation tool. Fifteen critical information technology applications were evaluated for the first time. An electronic questionnaire to test soft controls was distributed via DCH's intranet and included employees at all levels. Newly designed risk assessment work sheets, organized by major functions within DCH, were implemented. A chapter summarizing the last four years of external and internal DCH audits was included in the final report, which identified reportable conditions* and material weaknesses*.

Audit Objective: To assess the effectiveness of DCH's efforts in coordinating the development of the biennial ICE process.

Conclusion: We concluded that DCH's efforts were moderately effective in coordinating the development of the biennial ICE process. Our review disclosed one material condition*. DCH needs to improve its efforts to oversee ICE activities to help ensure that all critical ICE activities are completed within established time frames.

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

DCH also needs to complete all detailed internal control assessments to help ensure that the DCH biennial ICE report is completed in accordance with State law. (Finding 1)

In addition, our review disclosed reportable conditions related to computer application assessments and training (Findings 2 and 3).

FINDING

1. Oversight of ICE Activities

   DCH needs to improve its efforts to oversee ICE activities to help ensure that all critical ICE activities are completed within established time frames. DCH also needs to complete all detailed internal control assessments to help ensure that the DCH biennial ICE report is completed in accordance with State law.

   Section 18.1485 of the *Michigan Compiled Laws* requires the head of each principal department to establish and maintain an internal accounting and administrative control system. The head of each principal department is also required to provide a biennial report on the ICE of the department's internal accounting and administrative control system to the Governor, the Auditor General, the Senate and House Appropriations Committees, the Senate and House Fiscal Agencies, and the director of the Department of Management and Budget (DMB).

   A well-designed ICE process would be an exceptional tool for DCH to use to monitor its system of internal control and also the effectiveness of its overall operations.

   DMB issued guidelines, entitled *Evaluation of Internal Controls - A General Framework and System of Reporting* (General Framework), for the preparation of the biennial ICE report. The General Framework states that scheduling departmentwide evaluations of internal control should be done carefully with special consideration given to resource availability, the effectiveness of departmental monitoring efforts, and the cyclical nature of certain activities. In addition, by May 1 of odd numbered years, the department's internal auditor is required to report on whether the biennial ICE process was carried out by appropriate staff in a reasonable and prudent manner.

   For its May 1, 2005 biennial ICE report, DCH distributed internal control assessment work sheets to 69 assessable units in July 2004 and required the

assessable units to complete and return the assessments by August 30, 2004. DCH intended the assessments to provide a brief overview of the assessable units' risks, controls, and monitoring activities. DCH informed us that it had planned to analyze the assessments, judgmentally select certain assessable units with high-risk functions, and require those assessable units to perform detailed risk evaluations by November 30, 2004 to ensure that sufficient controls and monitoring activities were in place to mitigate risks. DCH also informed us that it had planned to distribute surveys to all DCH employees on October 1, 2004 inquiring about the general environment or culture of DCH, such as trust, openness, and high ethical standards.

Our review of the completion of activities for DCH's May 1, 2005 ICE disclosed:

a. DCH did not require any of its assessable units to perform detailed risk evaluations. DCH advised us that the assessable units' untimely submissions of their assessments (item c.) and a lack of staff resources precluded DCH from performing the detailed risk evaluations. DCH based its conclusions for the overall biennial ICE report entirely on the information contained in the assessments. Our review identified significant deficiencies with the assessable units' assessments (Finding 4).

b. DCH did not require its assessable units to include an overall conclusion when completing the assessments.

   We found that none of the 69 assessable units included an overall conclusion in their assessments concerning the risks that were listed and the adequacy of the controls and monitoring activities identified to mitigate those risks.

c. DCH did not ensure that the assessable units submitted their assessments in a timely manner. Of the 69 assessable units, 38 (55%) did not complete and submit their assessments to DCH's ICE coordinator by August 30, 2004, as required. These 38 assessable units completed and submitted their assessments between September 2004 and March 2005. As a result, DCH was unable to analyze the assessments in time to judgmentally select units with high-risk functions and require them to perform detailed risk evaluations by November 30, 2004.

d. DCH did not develop a time frame for completion and submission of the biennial ICE report to its Office of Audits.

Office of Audit staff indicated that they received the most recent biennial ICE report in mid to late March 2005 and that the submission of the biennial ICE report came too late for them to perform a detailed review (Finding 5). Office of Audit staff informed us that they did not perform any review of the biennial ICE report for fiscal years 2000-01 and 2001-02 because they did not receive the biennial ICE report until it was too late in the process.

In addition, DCH required 12 (17%) of the 69 assessable units to make revisions to their original assessments. The Office of Audit did not receive the revised assessments until May 12, 2005 after it had already issued its biennial ICE report for fiscal years 2002-03 and 2003-04. We determined that 3 (25%) of the 12 revised assessments had changed significantly from the original submissions.

e. DCH did not distribute the surveys inquiring about the general environment or culture of DCH to its employees until April 2005. DCH allowed its employees one week to complete the surveys. According to DCH records, 379 (26%) of the 1,477 employees who received the survey completed and returned it to DCH.

DCH conducted the survey on its intranet and informed us that delays in the development of its intranet combined with a lack of sufficient staff resources caused the surveys to be available later than expected.

f. DCH did not require the managers of the assessable units to sign the assessments. Requiring managers to sign these assessments would help ensure accountability for the information submitted by the assessable units and would help DCH ensure that the information is accurate and useful.

RECOMMENDATIONS

We recommend that DCH improve its efforts to oversee ICE activities to help ensure that all critical ICE activities are completed within established time frames.

We also recommend DCH complete all detailed internal control assessments to help ensure that the DCH biennial ICE report is completed in accordance with State law.

AGENCY PRELIMINARY RESPONSE

DCH generally agrees with the finding and corresponding recommendations. DCH will continue to strive to improve its oversight activities related to the ICE process to help ensure that all critical activities are completed within established time frames. In addition, DCH will strive to ensure that assessments are complete and in sufficient detail to ensure that the completed report complies with statutory requirements.

To improve the process for the fiscal year 2005-06 assessment, DCH will require the assessable units to complete the detailed ICE work sheets developed by DMB's Office of Financial Management (OFM). The work sheets are designed to focus on critical functions based on the assessable units' major processes or activities. To improve accountability, the work sheets have been designed to require the assessable units to include an overall conclusion concerning the adequacy of the controls, to specifically identify any material weaknesses identified through audits, to include a plan of correction to address identified weaknesses, and to require a signature from the responsible official attesting to the information included in the assessment. The DCH employee survey, used to evaluate DCH's soft controls by obtaining feedback from employees about DCH's general environment or culture, was distributed and completed using DCH's intranet during November and December 2006.

Descriptions of the activities included in the next assessment period will be forwarded to the Office of Audit as they are completed by the assessable units. The assessments for all of the required activities are expected to be completed and forwarded to the Office of Audit for review by March 1, 2007.

FINDING

2. Computer Application Assessments

DCH did not complete the departmentwide application control assessments for its computer applications. In addition, DCH had not established a formal methodology

to determine which of its critical computer applications should be subject to specific application control assessments.

Failure to complete departmentwide application control assessments for its computer applications diminished DCH's ability to ensure that specific controls established for individual computer applications functioned as designed and precluded DCH from further ensuring the integrity of financial transactions that DCH processed electronically each year. In addition, because DCH had not established a formal methodology to determine which of its critical computer applications should be subject to specific application control assessments, DCH cannot ensure that any critical computer applications excluded from review during the current ICE assessment would be included in subsequent ICE assessments.

Application controls include the structure, policies, and procedures that apply to DCH's overall computer operations. If these controls are weak, they severely diminish the reliability of controls associated with individual applications. Application controls may also include controls related to agency management aims and objectives; departmentwide security program planning and management; access controls; application software development and change controls that prevent unauthorized programs or modifications to an existing program from being implemented; segregation of duties; and service continuity controls to ensure that, when unexpected events occur, critical operations continue without interruption or are promptly resumed and crucial and sensitive data is protected. Ensuring these controls are in place is primarily the responsibility of DCH. However, the responsibility for some of these controls may cross over into joint responsibility with Department of Information Technology (DIT) management. Application specific controls include computerized and manual controls used to ensure the completeness, accuracy, and validity of information processed by each respective application system.

DCH divided the application control assessment activities for the May 1, 2005 biennial ICE report into 24 specific chapters. Because of the joint responsibility for some of the application environment controls, DCH was responsible for completing 13 chapters and DIT was responsible for completing the remaining 11 chapters.

Our review of DCH's efforts to evaluate controls over its computer applications disclosed:

a. DCH did not complete its evaluation of the 13 chapters for the application control assessment.

   The executive summary included in the ICE documents indicated that DCH would have its portion of the evaluation finalized by May 15, 2005. However, as of September 2005, DCH had still not completed its evaluation of application controls and no new deadline had been established for its completion.

   DCH staff indicated that this was the first time they had attempted to include computer application assessments in the biennial ICE report and a lack of staff resources resulted in the inability to complete the application control evaluation.

b. DCH was unable to provide us with a complete listing of its computer applications. We obtained a listing of computer applications from both DCH and DIT and determined that both listings were incomplete. The listing provided by DCH identified 83 computer applications and the listing provided by DIT identified only 80. When we combined the two listings, we identified 90 different computer applications.

   DCH staff indicated that they used the listing of computer applications to help select which critical systems to assess controls for in the ICE. DIT staff indicated that they used the listing of computer applications to track what applications DIT supports in order to maintain database versions, server names, and other information that is needed for the DIT programmers.

   Both DCH and DIT staff indicated that clearer roles need to be established between the two departments to maintain an accurate listing of computer applications.

c. DCH did not evaluate application specific controls for some of its computer applications. Instead, DCH selected 15 (17%) of its 90 computer applications that it considered to be critical to its operations. DCH included the Medicaid Management Information System, which consists of several integrated

computer applications that processed expenditure transactions of approximately $5.2 billion during fiscal year 2004-05. DCH indicated that it did not select more computer applications for review because it did not know the amount of staff resources and time that would be necessary to complete the evaluations because previous biennial ICE reports had not included any computer applications. However, we noted several significant computer application systems that were not included in the current ICE process, such as:

(1) Itemized Billing System - This system collects data and performs the calculations necessary to produce a bill for services received within a DCH mental health facility. During fiscal year 2003-04, a total of approximately $167.4 million was processed through the Itemized Billing System.

(2) Birth Registry System - This system captures legal and statistical information regarding State of Michigan births. It also responds to citizens' requests for copies of birth information or changes in that information. In addition, the system provides data, as authorized, to internal systems and other State and federal agencies.

(3) School Immunization Registry System - This system tracks school and day care immunization levels by shot series. Data from this system is utilized by local health departments and DCH's Immunization Division.

(4) The Bio-Terrorism Tracking System - This system is used to track telephone calls associated with potential nonhuman bio-terrorism attacks, such as anthrax.

RECOMMENDATIONS

We recommend that DCH complete the departmentwide application control assessments for its computer applications.

We also recommend that DCH establish a formal methodology to determine which of its critical computer applications should be subject to specific application control assessments.

AGENCY PRELIMINARY RESPONSE

DCH generally agrees with the finding and corresponding recommendations.

For the next evaluation period, DCH will complete the departmentwide application control assessments for its critical applications. DCH will utilize the information technology risk assessment work sheets developed by DMB's OFM. DCH has now compiled a complete listing of its computer applications and expects to complete evaluations for 34 systems. The evaluations will include assessments of the 4 critical applications referred to in item c. of the finding that were not reviewed during the previous evaluation.

FINDING

3. Training

DCH did not provide sufficient training or communicate clear expectations to its assessable units' management staff to help prepare them for their role in the biennial ICE process.

Insufficient training contributed to inconsistent and sometimes inaccurate methodologies employed by the various assessable units when preparing their individual assessments. In addition, because DCH did not sufficiently communicate expectations to the assessable units, some units put forth only minimal effort and submitted incomplete assessments for inclusion in the biennial ICE process.

DMB's General Framework requires that orientation and training sessions be provided to explain the objectives of and procedures for conducting internal control monitoring efforts. Because DCH's approach for conducting its ICE has been to require its assessable units to prepare assessments, it is critical that DCH provide the assessable units with sufficient training on how to prepare an effective internal control assessment.

DCH required its assessable units to complete their assessments using the COSO model.

DCH requested the managers of the 69 assessable units to attend one 30-minute training session in summer 2004. We reviewed a videotape of the training session

and determined that this training was not detailed enough to provide the managers with a sufficient understanding of the various technical terms that were new to many of them or to provide the managers with a sufficient understanding of the COSO model and the tools DCH would require the units to use when completing their assessments. In addition, we interviewed management staff from 5 of the units and determined that 1 (20%) unit had no representation at the training. We also determined that 2 (40%) of the units we interviewed had someone other than the representatives who attended the training complete the evaluations.

DCH's internal auditor noted in his review of the fiscal years 2002-03 and 2003-04 biennial ICE report that:

> It also became clear that the various units had differing understandings of how to assess the level of risk and what was expected. For example, some units appeared to assign risk factors under the assumption that no controls were in place, while others considered the controls when assigning a risk factor. This inconsistency made it difficult to draw any conclusions relating to the level of risk assigned to the various activities.

The internal auditor also noted that DCH needs to place much more emphasis on training if DCH's biennial ICE process is to improve in the future.

RECOMMENDATION

We recommend that DCH provide sufficient training and communicate clear expectations to its assessable units' management staff to help prepare them for their role in the biennial ICE process.

AGENCY PRELIMINARY RESPONSE

DCH agrees with the finding and corresponding recommendation. Mandatory training sessions of much greater length have been completed for the 2006 assessment period. All participants were given a manual that included the General Framework developed by DMB's OFM, which provides a framework for performing evaluations based on the widely accepted COSO model. The manual included assessment work sheets designed by OFM and step-by-step instructions explaining the process and requirements for completing the work sheets. The sessions were much more detailed, covered the entire manual, and placed

particular emphasis on DCH's expectations of what is expected from each assessable unit's management.

EFFORTS TO EVALUATE INTERNAL CONTROL

COMMENT

Objective: To assess the effectiveness of DCH assessable units' efforts in evaluating their internal control.

Conclusion: We concluded that DCH assessable units' efforts were not effective in evaluating their internal control. Our review disclosed one material condition. DCH assessable units did not sufficiently evaluate and document their internal control (Finding 4).

FINDING

4. Internal Control Assessments

DCH assessable units did not sufficiently evaluate and document their internal control. As a result, DCH's internal control assessments for some of its assessable units were materially deficient and did not provide an effective basis for DCH to evaluate or document its overall internal control or to support the overall conclusions in DCH's most recent biennial ICE report.

DCH identified 69 assessable units based at the division level within DCH and required each of those units to perform assessments and also to document their systems of internal control. DCH relied extensively on these assessments for the preparation of the DCH biennial ICE report that is required by Section 18.1485 of the *Michigan Compiled Laws*.

DCH informed us that its original intent was to use these assessments as a basis to select some of the more critical units for further, more detailed risk evaluations. However, these detailed risk evaluations never occurred (Finding 1).

In addition, DCH instructed the assessable units to complete an assessment consisting of two work sheets to document their systems of internal control. In the first work sheet, DCH asked the units to identify up to 10 functions or responsibilities and to relate each of them to DCH's stated overall objectives

(mission, vision, goals, statutory requirements, etc.). In the second work sheet, DCH asked the units to identify the risks associated with each identified function or responsibility, to identify controls designed to mitigate those risks, and to identify monitoring activities performed to ensure that the controls functioned as designed.

We reviewed the completeness of the work sheets for all 69 assessable units. In addition, we made other observations concerning the overall evaluation process for all 69 assessable units. Our review disclosed:

a. Thirty-two (46%) assessable units, including 4 (31%) of the 13 Medicaid units, did not perform their assessments as instructed. The assessable units generally identified appropriate functions and responsibilities. However, we noted that 24 (35%) assessable units did not identify all monitoring activities for the identified controls; 19 (28%) assessable units did not identify control activities in place to mitigate all identified risks; 12 (17%) assessable units did not specify a risk level (low, medium, or high) for all risks identified; and 8 (12%) units did not relate each listed function or responsibility to one or more departmental objective. Each assessable unit had left the applicable spaces blank on the work sheets where documentation should have existed.

b. Three (4%) assessable units did not identify or recognize a total of five material weaknesses in their internal control that were identified in audits and reviews of DCH's operations.

   Our audits and our follow-up reviews of our prior audits disclosed material conditions related to DCH's Certificate of Need Program activities, surveys and inspections of licensed health care facilities, and DCH's Center for Medicare and Medicaid Services certified facilities seeking reimbursement of unpaid Medicare deductibles and coinsurances of Medicare enrolled patients. In its responses to these audits, DCH indicated that it generally agreed with the findings and recommendations in these reports.

   DCH's letter to the Governor on its overall ICE did report that external audits of DCH had identified material weaknesses. However, the assessable units did not identify these weaknesses during their own assessments and DCH did not instruct the assessable units to include the material weaknesses that were reported in audits and reviews of DCH's operations.

c. Four (6%) assessable units did not perform all required risk assessments.

For example, our DCH Single Audit* for the period October 1, 2001 through September 30, 2003 disclosed weaknesses related to one of the assessable unit's financial controls. Although the unit identified internal control weaknesses, the unit did not perform financial risk assessments for any of its stated functions to identify the financial impact of the weaknesses. The assessable unit subsequently did not identify internal control and monitoring activities to mitigate the financial risks and also did not identify the control weaknesses disclosed in our DCH Single Audit.

We also selected 5 DCH assessable units for additional analysis: Medicaid Payments; Medicaid Revenue and Reimbursement; Immunization; Women, Infants, and Children (WIC); and Community Services. We analyzed their efforts to perform and document their evaluations:

(a) For each of the 5 assessable units, we selected three functions or responsibilities and reviewed the documentation for the associated risks, controls, and monitoring activities. The templates DCH provided to the units allowed them to perform risk assessments in five different categories (financial, policies/procedures, staffing, legal issues, and general public) for each function or responsibility. The 5 assessable units did not perform 9 of the 75 possible risk assessments in the various categories for the 15 functions and responsibilities that we selected.

(b) Our review disclosed numerous instances in which the assessable units had inconsistent approaches to completing the work sheets and did not provide sufficient detail in their evaluation work sheets for the various required elements of the evaluation. We noted through our discussions with the assessable units' management staff that some had incorrectly assessed risk levels assuming controls were already in place and functioning as designed. This approach could result in an inaccurate assessment of risk level and could preclude the assessable units from accurately concluding on the effectiveness of their internal control. For example, one of the units in our sample reported that it had recovered Medicaid revenue and reimbursement amounts totaling

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

$79.3 million over the two-year period October 1, 2002 through September 30, 2004. The federal government has determined that Medicaid is inherently a high-risk program; however, the assessable unit assessed all risks related to its Medicaid revenue and reimbursement functions and responsibilities as low because it assumed all identified controls were in place and functioning as designed to mitigate all risks.

The following table illustrates the exceptions we noted during our review of the 66 risk assessments done by the 5 assessable units:

Exceptions	Number (Percentage) of Instances	Number of Units
Insufficient detail to determine what the risks were*	25 (38%)	5
Risks were incorrectly assessed assuming controls already in place	39 (59%)	3
Insufficient detail to determine the control activity	4 (6%)	2
Insufficient detail to determine the monitoring activity	6 (9%)	2
Insufficient documentation to support identified control activity	6 (9%)	2
Insufficient documentation to support identified monitoring activity	7 (11%)	4

* Assessable unit management staff explained to us after our initial review what they had intended the risks to be.

RECOMMENDATION

We recommend that DCH improve its biennial ICE process to help ensure that DCH assessable units sufficiently evaluate and document their internal control.

AGENCY PRELIMINARY RESPONSE

DCH substantially agrees with the finding and agrees with the corresponding recommendation. To improve the evaluation process for the next assessment period, DCH scheduled and conducted more extensive training sessions during which DCH's expectations for each assessable unit's management was clearly emphasized. The assessable units' completed work sheets will be carefully reviewed by DCH's designated internal control official and incomplete or improperly completed work sheets will be returned for further analysis. While recognizing that

there were clear inconsistencies among the assessable units in terms of how the previous assessment was conducted, DCH does not expect the current assessment to address in detail every conceivable activity conducted throughout DCH. The determination of what constitutes a major process or activity requires a certain degree of individual judgment. DCH informed us that the example cited in item c. referred to a finding from the previous Single Audit and represents an example of a situation in which opinions differ. The finding was not classified as material and there is no clear-cut definitive criteria specifically defining this as a high-risk activity that must be assessed.

EFFORTS TO EVALUATE THE BIENNIAL ICE PROCESS

COMMENT

Objective: To assess the effectiveness of the Office of Audit's efforts in evaluating DCH's biennial ICE process.

Conclusion: The Office of Audit's efforts were effective in evaluating DCH's biennial ICE process. However, we noted a reportable condition related to the Office of Audit's evaluation of ICE activities (Finding 5).

FINDING

5. Office of Audit's Evaluation of ICE Activities

The Office of Audit needs to improve its efforts to evaluate DCH's ICE activities.

An improved biennial ICE process would help the Office of Audit in its effort to independently verify the integrity of the internal control assessments submitted by the assessable units that serve as the basis for DCH's biennial ICE report and ensure compliance with State requirements.

According to DMB Administrative Guide procedure 1270.01, a departmental internal auditor's responsibilities in completing the biennial ICE report are to conduct a review to determine whether the department has performed its evaluation of its internal control in accordance with the DMB General Framework guidelines, has carried out the evaluation in a reasonable and prudent manner, and has submitted a report to the department director. In addition, the General Framework states that internal auditors serve as an extension of the department's

senior management acting to independently verify the integrity of the department's system of internal control.

Our review of the Office of Audit's evaluation efforts disclosed:

a. The Office of Audit did not use an audit program for its review of the biennial ICE process. The lack of an audit program could result in an inefficient or incomplete review, as there is no formalized plan for guidance to ensure that all areas of the ICE were included in the review.

   Within DMB's Summary of Agency Practices report for the period ended September 30, 2002, DMB stated that internal auditors should develop a prescribed audit program for use in reaching overall conclusions of the agency's biennial ICE processes. This will formalize the collection and evaluation of underlying evidence by internal auditors.

b. In its report to the DCH director, the Office of Audit did not conclude whether DCH staff carried out the May 1, 2005 ICE in accordance with the DMB General Framework guidelines and in a reasonable and prudent manner.

   Within its report to the DCH director on the biennial ICE process, the Office of Audit stated that its objective was to determine whether the evaluation was carried out in a reasonable and prudent manner. The Office of Audit's report explained the deficiencies noted in the assessable units' assessment work sheets and the inconsistencies in the methodologies used to complete the assessments. However, Office of Audit staff indicated that they purposely excluded an overall conclusion because the problems noted made it difficult to determine whether the biennial ICE process was carried out in a reasonable and prudent manner.

RECOMMENDATION

We recommend that the Office of Audit improve its efforts to evaluate DCH's ICE activities.

AGENCY PRELIMINARY RESPONSE

DCH generally agrees with the finding and corresponding recommendation. DCH informed us that an improved ICE process would help to improve the Office of

Audit's efforts to evaluate DCH's ICE activities. The Office of Audit will develop and utilize an audit program as part of its assessment for the next reporting cycle. The final report issued by the internal auditor to the director will include a conclusion as warranted based on the results of the Office of Audit's assessment.

GLOSSARY

Glossary of Acronyms and Terms

assessable unit	One of 69 administrative or program functions that make up DCH.
COSO	Committee of Sponsoring Organizations.
DCH	Department of Community Health.
DIT	Department of Information Technology.
DMB	Department of Management and Budget.
effectiveness	Program success in achieving mission and goals.
efficiency	Achieving the most outputs and outcomes practical with the minimum amount of resources.
ICE	internal control evaluation.
internal control	A process, effected by management, designed to provide reasonable assurance regarding the reliability of financial reporting, effectiveness and efficiency of operations, and compliance with applicable laws and regulations.
material condition	A reportable condition that could impair the ability of management to operate a program in an effective and efficient manner and/or could adversely affect the judgment of an interested person concerning the effectiveness and efficiency of the program.
material weakness	A serious reportable condition in which the design of the department's internal control structure does not adequately reduce, to an acceptable level, the risk that errors and irregularities can occur.

OFM	Office of Financial Management.
performance audit	An economy and efficiency audit or a program audit that is designed to provide an independent assessment of the performance of a governmental entity, program, activity, or function to improve public accountability and to facilitate decision making by parties responsible for overseeing or initiating corrective action.
reportable condition	A matter that, in the auditor's judgment, represents either an opportunity for improvement or a significant deficiency in management's ability to operate a program in an effective and efficient manner.
Single Audit	A financial audit, performed in accordance with the Single Audit Act Amendments of 1996, that is designed to meet the needs of all federal grantor agencies and other financial report users. In addition to performing the audit in accordance with the requirements of 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, a Single Audit requires the assessment of compliance with requirements that could have a direct and material effect on a major federal program and the consideration of internal control over compliance in accordance with U.S. Office of Management and Budget Circular A-133.

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