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Oversight Review

May 22, 2009

Report on Review of the Department of Military and Veterans Affairs Single Audit for the Audit Period October 1, 2005 through September 30, 2007

Report No. D-2009-6-005

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Acronyms

OMB	Office of Management and Budget
AICPA	American Institute of Certified Public Accountants

INSPECTOR GENERAL
DEPARTMENT OF DEFENSE
400 ARMY NAVY DRIVE
ARLINGTON, VIRGINIA 22202-4704

MAY 22 2009

Chief Financial Officer
Department of Military and Veterans Affairs

Auditor General
Office of the Auditor General, State of Michigan

Chief
National Guard Bureau

SUBJECT: Report on Review of the Department of Military and Veterans Affairs Single Audit for the Audit Period October 1, 2005 through September 30, 2007 (Report No. D-2009-6-005)

We are providing this report for your review and comment. We considered management comments on the draft of this report when preparing the final report. As a result of management comments to the draft report, we added Recommendations 3a and 3b to the Chief of the National Guard Bureau to the final report, and request that the Chief provide written comments to the additional recommendations. We also request that the Chief Financial Officer, Department of Military and Veterans Affairs reconsider its position on Recommendation 1a and the Auditor General, Office of the Auditor General, State of Michigan, reconsider its position on Recommendation 2a and provide comments to these recommendations in response to this final report. Additionally, we request that the Office of the Auditor General provide us with a written timeline of completion dates for implementing the recommendations to address the deficiencies identified in this report. Comments to the final report including planned completion dates for implementation of the recommendations should be provided to our office by July 24, 2009.

As the cognizant Federal agency for the Department of Military and Veterans Affairs, we performed a review of the Office of the Auditor General, State of Michigan, single audit and supporting workpapers for the audit period October 1, 2005 through September 30, 2007 (biennial audit period), to determine whether the audit was conducted in accordance with government auditing standards and the auditing and reporting requirements of Office of Management and Budget (OMB) Circular A-133, "Audits of States, Local Governments, and Non-Profit Organizations," (OMB Circular A-133). Appendix A contains additional background, scope and methodology for the review and Appendix B lists the compliance requirements applicable to the biennial audit period ended September 30, 2007.

Background. The Department of Military and Veterans Affairs is a State of Michigan department with three primary missions: 1) to execute the duties laid down by various statutes and the governor, 2) administration of state-supported veterans programming, and 3) military preparedness to assist both state and federal authorities. The Department of Military and Veterans Affairs is funded with both state and Federal funds and operates under various

cooperative agreements with the National Guard Bureau. For the biennial audit period ended September 30, 2007, the Department of Military and Veterans Affairs expended $168.5 million in Federal awards of which $129.1 million was expended for Department of Defense programs.

The Office of the Auditor General audited the National Guard Operations and Maintenance program, Catalog of Federal Domestic Assistance 12.401, and the National Guard Civilian Youth Opportunities program, Catalog of Federal Domestic Assistance 12.404, as major programs for the Department of Military and Veterans Affairs single audit for the biennial audit period.

Review Results. The Department of Military and Veterans Affairs did not meet OMB Circular A-133 reporting requirements because they did not prepare financial statements and did not correctly prepare the Schedule of Expenditures of Federal Awards. The auditors did not meet government auditing standards and OMB Circular A-133 requirements for the Department of Military and Veterans Affairs single audit. Specifically, the auditors did not:

- report the lack of financial statements as a noncompliance with OMB Circular A-133 requirements (Finding A);
- audit the National Guard Military Construction program as a separate major program (Finding B);
- perform adequate audit procedures for the audit of the National Guard Operations and Maintenance program to support their opinion on the major Federal program (Finding C); and
- report a finding on subrecipient monitoring for the National Guard Civilian Youth Opportunities program (Finding D).

As a result of these deficiencies, Federal agencies cannot rely on the audit report for assurance that the Department of Military and Veterans Affairs is managing Federal awards in compliance with laws, regulations, and award provisions.

Management Comments and DoD IG Response. The Office of the Auditor General management comments to the findings and recommendations were partially responsive. However, the Office of the Auditor General has agreed to perform additional audit procedures to address certain deficiencies identified in this report and will be reissuing the single audit report for the Department of Military and Veterans Affairs. Comments from the Chief Financial Officer, Department of Military and Veterans Affairs, were partially responsive. Management comments and our responses are discussed in the Finding and Recommendation sections and are included in their entirety at the end of this report.

Findings

Finding A. Financial Statements Audit. The Department of Military and Veterans Affairs did not prepare financial statements for the single audit of the biennial audit period ended September 30, 2007. Rather, the Department of Military and Veterans Affairs prepared financial schedules (scope limitation) which do not constitute a complete financial presentation of the organization because the financial schedules only provide information on revenues and the disposition of authorizations. OMB Circular A-133 §___.310(a) requires the auditee to prepare financial statements that reflects its financial position, results of operations or changes in net assets, and where appropriate, cash flows for the fiscal year audited.

Because the Department of Military and Veterans Affairs did not prepare financial statements, the audit work performed by the auditors to support the Independent Auditor's Report on the Financial Statements and Independent Auditor's Report on Internal Control Over Financial Reporting and on Compliance and Other Matters was restricted to limited information contained in the financial schedules. This is in noncompliance with OMB Circular A-133 §__.500(b) which requires the auditor to determine whether the financial statements of the auditee are presented fairly in all material respects in conformity with generally accepted accounting principles. In our opinion, the auditors should have reported the lack of financial statements as a finding in the single audit report and issued a disclaimer of opinion because of a scope limitation. In addition, since the Department of Military and Veterans Affairs did not prepare financial statements, the auditors did not perform the required audit procedures to determine whether the Schedule of Expenditures of Federal Awards was presented fairly in all material respects in relation to the financial statements taken as a whole as required in OMB Circular A-133 §__.500(b).

Office of the Auditor General Management Comments on the Finding. The Office of the Auditor General management believed that the Department of Military and Veterans Affairs financial schedules meet OMB Circular A-133 reporting requirements for financial statements because the Circular does not prescribe the basis of accounting that must be used by the auditee to prepare financial statements. The Office of the Auditor General management stated that the departments that are only a part of a complete fund, such as the Department of Military and Veterans Affairs, must issue a financial presentation that is less than a complete fund presentation. They further stated that the Department of Military and Veterans Affairs followed the financial reporting format designated by the Office of Financial Management, State of Michigan, and that the Department of Military and Veterans Affairs presented its financial information on an "other comprehensive basis of accounting." Because the presentation is on an other comprehensive basis of accounting, their report was modified to include the required language and a disclaimer of opinion would not have been appropriate.

DoD IG Response. OMB Circular A-133 §___.310(a) requires the auditee to prepare financial statements that reflects its financial position, results of operations or changes in net assets, and, where appropriate, cash flows for the fiscal year audited. We do not believe that the financial

schedules prepared by the Department of Military and Veterans Affairs meets the requirements of OMB Circular A-133. Furthermore, the basis of accounting used by an auditee has no relevance on the auditee's ability to prepare financial statements. While the Department of Military and Veterans Affairs may have followed the financial reporting format prescribed by the State of Michigan, that format does not comply with the requirements of OMB Circular A-133 which implements the requirements of the Single Audit Act Amendments of 1996, Public Law 104-156. We consider the Department of Military and Veterans Affairs financial schedules to be "special reports" for the State of Michigan that are outside the realm of the single audit requirements and do not satisfy the requirement for financial statements. Single audit reports are for the use of Federal agencies and pass-through entities and need to comply with the financial reporting requirements of OMB Circular A-133.

Finding B. Schedule of Expenditures of Federal Awards and Major Program Determination. The Department of Military and Veterans Affairs did not correctly prepare the Schedule of Expenditures of Federal Awards because they did not separately identify expenditures for the National Guard Military Construction program, Catalog of Federal Domestic Assistance 12.400. The Schedule of Expenditures of Federal Awards serves as the primary basis for the selection of major programs subject to audit under OMB Circular A-133 requirements. OMB Circular A-133 §__.310(b)(3) requires that the Schedule of Expenditures of Federal Awards provide total Federal awards expended for each individual Federal program and the program Catalog of Federal Domestic Assistance number. Instead, the major military construction expenditures for Catalog of Federal Domestic Assistance 12.400 were commingled with the expenditures for the National Guard Operations and Maintenance program, Catalog of Federal Domestic Assistance 12.401. Based on our discussion with Department of Military and Veterans Affairs personnel this occurred because the expenditures for military construction are not separately coded in the accounting system to differentiate expenditures between the Operations and Maintenance program and the Military Construction program. OMB Circular §___.300(a) states that the auditee shall identify, in its accounts, all Federal awards received and expended and the Federal programs under which they were received. We obtained information from the National Guard that shows the Department of Military and Veterans Affairs was reimbursed approximately $47.5 million under the Military Construction program during FYs 2006 and 2007. While the auditors performed extensive audit procedures to assess the completeness of the Schedule of Expenditures of Federal Awards, they failed to recognize that the expenditures for major military construction should have been reported as a separate Federal program on the Schedule of Expenditures of Federal Awards. As a result, the auditors did not identify the Military Construction program as a separate major program for audit using the risk-based approach for major program determination. Under OMB Circular A-133 criteria, the amount of program expenditures and the fact that the program had not been audited in the prior two audit periods, would have required the Military Construction program to be selected for audit as a major program. Since the program was not selected for audit, there is no assurance that the Department of Military and Veterans Affairs is managing the Military Construction program in compliance with laws, regulations, and award provisions.

Office of the Auditor General Management Comments on the Finding. The Office of the Auditor General management agreed that the funding for the Military Construction program, Catalog of Federal Domestic Assistance 12.400, was misclassified as the Operations and Maintenance program, Catalog of Federal Domestic Assistance 12.401. However, they believe that our draft report does not accurately reflect the audit procedures performed to ensure the completeness and fair presentation of the information on the Schedule of Expenditures of Federal Awards. The Office of the Auditor General management stated that had the required information been provided by the National Guard to the Department of Military and Veterans Affairs, they would have detected the reporting of Catalog of Federal Domestic Assistance 12.400. Nevertheless, the Office of the Auditor General management stated that the Military Construction program is not subject to the Single Audit Act because the description provided in the Catalog of Federal Domestic Assistance for the program makes no mention of the single audit requirement. As a result, the Office of the Auditor General management is requesting written confirmation on whether the Military Construction program is subject to the Single Audit Act and that they be allowed to postpone the audit of the program until the next single audit of the Department of Military and Veterans Affairs.

DoD IG Response. Government auditing standards require auditors to plan and perform the audit with due professional care. This requires obtaining an understanding of the entity and its environment including its internal control, and the laws, regulations, and provisions of grants and contracts sufficient to assess the risk of material misstatement and noncompliance. Because of the complexities of the National Guard programs, this should include inquiries of not only Department of Military and Veterans Affairs management and employees, but also of National Guard personnel. We found that the Department of Military and Veterans Affairs Administrative Services Manager involved in the administration of construction projects and the on-site National Guard internal auditor to be aware of and very knowledgeable about the Military Construction agreements and the regulations related to funding requirements.

While the National Guard cooperative agreements may not have included the Catalog of Federal Domestic Assistance numbers, the OMB Circular A-133 Compliance Supplement for the National Guard Operations and Maintenance program contained guidance on funding limitations when using operations and maintenance funds for minor construction. Had the auditors gained the knowledge and understanding of National Guard programs and applicable regulatory and agreement requirements, they would have been aware that the costs associated with the various Department of Military and Veterans Affairs construction projects exceeded the funding cap allowed by Federal statute for use of operations and maintenance funds. We believe this would have alerted the auditors to make further inquiries leading to identifying the existence of the Military Construction program.

Based on our discussions with the National Guard Bureau Chief of Grants and Cooperative Agreements, the Military Construction program is subject to the Single Audit Act. We agree with the Office of the Auditor General that the Catalog of Federal Domestic Assistance descriptions should be up-to-date and that Catalog of Federal Domestic Assistance numbers should be included in award documents. Therefore, we will recommend that the National Guard

Bureau update the description for the Military Construction program, Catalog of Federal Domestic Assistance 12.400, to include the audit requirements of the Single Audit Act. We will also recommend that the National Guard Bureau include the Catalog of Federal Domestic Assistance numbers in all cooperative agreements awarded so that recipients can better report the expenditures by program on their Schedule of Expenditures of Federal Awards.

Finding C. Federal Program Audit. The auditors did not perform adequate audit procedures for the audit of the National Guard Operations and Maintenance program to support their opinion over the major Federal program and did not perform adequate audit procedures for the Period of Availability compliance requirement for both the National Guard Operations and Maintenance and Civilian Youth Opportunities programs.

Sampling Methodology and Reliability of Audit Procedures Performed. The sampling methodology used by the auditors to select their sample to test internal controls and compliance for the audit of the Operations and Maintenance program is flawed because the population from which the transactions were selected included capital outlay expenditures from another Federal program, the Military Construction program. As a result, 8 of the 17 capital outlay transactions selected to test internal controls and compliance for the Operations and Maintenance program came from the Military Construction program. Because statistical sampling was used to determine the sample size necessary to provide sufficient appropriate evidence, the auditors did not perform the planned level of testing for the Operations and Maintenance program to support their opinion on this major program.

Furthermore, we question the reliability of the overall test results since it is unclear what evidence was examined that enabled the auditor to conclude that the Department of Military and Veterans Affairs is in compliance with the requirements of the Operations and Maintenance program when 8 of the transactions were related to the Military Construction program. Since the Military Construction program was not identified and selected for audit, the auditors did not gain an understanding of the unique laws, regulations, and requirements applicable to the program. Consequently, there is no assurance that the auditors tested the 8 transactions against the appropriate requirements.

The American Institute of Certified Public Accountants (AICPA) audit guide states that if more than one major program uses a common system of internal controls, the transactions of those programs could be combined into one population for selecting sample sizes. Therefore, if the auditors choose to select audit samples from the entire universe of transactions for both the Operations and Maintenance and Military Construction programs, the auditors need to perform audit procedures to determine the similarities and differences in the requirements and the internal controls of both programs. Under this approach, the auditor is also required to obtain sufficient evidence to support an opinion on compliance for each major Federal program and the audit documentation should be presented in such a fashion that it clearly indicates that the results of such samples, together with other audit evidence, are sufficient to support the opinion on compliance for each major program.

Activities Allowed/Unallowed and Allowable Costs/Cost Principles Compliance Requirements. The auditors did not perform internal control and compliance testing over payroll for FY 2007 for the Activities Allowed/Unallowed and the Allowable Costs/Cost Principles compliance requirements. The auditors documented that since an extensive review of payroll was performed in FY 2006 and that the payroll structure remained unchanged for FY 2007, it was not necessary to separately test payroll transactions. For FY 2006, the auditors isolated payroll transactions into a separate population so that a separate sample comprised of only payroll transactions would be selected for testing. However, a different sampling methodology was used for FY 2007 in which payroll transactions were included in the overall population of expenditures from which the sample transactions were selected. As a result, only one payroll transaction was included in the sample for FY 2007 used to test internal control and compliance for the Operations and Maintenance program. In our opinion, the auditors should have tested additional payroll transactions for FY 2007 because payroll is a material expenditure under the Operations and Maintenance cooperative agreement. Based on information received from the National Guard, we determined that payroll costs represent approximately 46 percent of the total expenditures for the Operations and Maintenance program when costs for capital outlays are properly identified to the Military Construction program. In addition, the Compliance Supplement for the Operations and Maintenance program expresses the concerns and expectations of the National Guard for the audit of payroll costs. Specifically, the Compliance Supplement states that individual employee compensation comprises a significant portion of total costs charged to the Cooperative Agreement appendices. Therefore, the auditor should give particular attention to the allocability of these costs and include tests of the time and effort reporting system to support the distribution of compensation costs in accordance with applicable Federal cost principles and the terms and conditions in the agreement appendices.

Davis-Bacon Compliance Requirement. The auditors did not perform adequate audit procedures for the Davis-Bacon compliance requirement. The auditors concluded that the Department of Military and Veterans Affairs was exempt from the Davis-Bacon compliance requirement based on their discussion with the Department of Military and Veterans Affairs Administrative Services Manager and a memorandum issued by the National Guard, dated November 24, 1993. The memorandum states that all State contracts are exempt from the provisions of the Davis-Bacon Act even though they are funded 100 percent by Federal funds contributed to the State from the National Guard. However, the memo also states that there are cases when the Davis-Bacon Act applies when it is required by the Federal grant program legislation.

According to the OMB Circular A-133 Compliance Supplement for the Operations and Maintenance program, the Davis-Bacon Act applies only to environmental remediation construction subject to the Comprehensive Environmental Response, Compensation, and Liability Act of 1980, as amended. In addition, Appendix 2 of the National Guard Master Cooperative Agreement states that when required by Federal environmental program legislation, the Davis-Bacon Act compliance, as supplemented by Department of Labor regulations is required in construction contracts over $2,000 that are awarded by States and State contractors and subcontractors. Based on this guidance, the Department of Military and Veterans Affairs is

not completely exempt from the Davis-Bacon Act since there may be instances where it may be applicable. Therefore, the auditors should perform audit procedures to determine whether any construction projects during the audit period require compliance with the Davis-Bacon Act and perform additional audit procedures as needed.

Matching Compliance Requirement. The auditors did not perform sufficient audit procedures for the Matching compliance requirement. While the auditors performed audit procedures to verify whether the Department of Military and Veterans Affairs met their matching contributions by ensuring that the State matching requirement is correctly recorded in the project files and accounting system and corresponds to the requirements specified in the Appendices of the Cooperative Agreements, the auditors did not perform audit procedures to verify whether the matching contributions came from an allowable source.

OMB Circular A-102 Common Rule (§___.24) established the basic criteria for acceptable matching contributions (requirements are codified in the Department of Defense Grant and Agreement Regulation, 3210.6-R, Part 33). This includes that matching funds:

- Are verifiable from the non-Federal entity's records.
- Are not included as contributions for any other federally assisted project or program, unless specifically allowed by Federal program laws and regulations.
- Are necessary and reasonable for proper and efficient accomplishment of project or program objectives.
- Are allowed under the applicable cost principles.
- Are not paid by the Federal Government under another award, except where authorized by Federal statute to be allowable for cost sharing or matching.
- Are provided for in the approved budget when required by the Federal awarding agency.
- Conform to other applicable provisions of the A-102 Common Rule and the laws, regulations, and provisions of contract or grant agreements applicable to the program.

Period of Availability Compliance Requirement. The audit work performed by the auditors for the Period of Availability compliance requirement cannot be relied upon. The transactions used to test internal controls and compliance for Period of Availability included 8 capital outlay transactions that belong to the Military Construction program which is funded with 5-year appropriations. Because the auditors were not aware that the Military Construction program was a separate program, the auditors tested the selected transactions against the period of availability for the Operations and Maintenance program which is funded with 1-year appropriations. As a result, it is questionable as to what the auditors reviewed to ensure that funds were obligated within the period of availability and liquidated within the required timeframe.

The Compliance Supplement for the Operations and Maintenance program states that 1) obligations may not be incurred against Federal funds for a specified year before or after the Federal fiscal year in which the funds were appropriated, and 2) if unliquidated claims and

undisbursed obligations arising from the State's performance of the agreement will remain 90 days after the close of the fiscal year, the State Military Department shall provide the National Guard a detailed listing of uncleared obligations.

The auditors performed audit procedures to determine if the expenditures for the Civilian Youth Opportunities program were charged prior to the beginning date or after the end date of the grant award and determined a total of 322 transactions were charged to the grant with effective dates after the end of the grant award. However, the auditors did not perform audit procedures to determine whether the Department of Military and Veterans Affairs had obligated the funds for these transactions prior to the end date of the grant award in accordance with the National Guard requirements.

Procurement, Suspension, and Debarment Compliance Requirement. The auditors did not perform sufficient audit procedures for the Procurement, Suspension, and Debarment compliance requirement. While the auditors performed adequate audit procedures for the procurements contracted through the Department of Management and Budget, the auditors did not perform audit procedures for the procurements made directly by the Department of Military and Veterans Affairs. The Department of Management and Budget is a State department under the State of Michigan that provides contracting and bill paying services for the Department of Military and Veterans Affairs. Based on our discussions with the Department of Military and Veterans Affairs Administrative Services Manager, there are certain procurement contracts that are contracted directly by the Department of Military and Veterans Affairs and not serviced through the Department of Management and Budget. While we do not know the monetary significance of the procurements made directly by the Department of Military and Veterans Affairs, these procurements are made outside the controls of the Department of Management and Budget procurement process. As a result, the auditors should perform audit procedures to assess the adequacy of internal control and compliance over these procurements.

Office of the Auditor General Management Comments on the Finding. The Office of the Auditor General management disagreed with the blanket statement that they did not perform adequate audit procedures to support their opinion on the National Guard Operations and Maintenance program. However, based on information provided by the DoD IG, they have determined that they need to perform additional audit procedures related to the compliance requirements for Davis-Bacon Act; Matching; Period of Availability; and Procurement, Suspension, and Debarment. The Office of the Auditor General management disagreed with the finding related to the audit work performed for the Activities Allowed/Unallowed and the Allowable Costs/Cost Principles compliance requirements over payroll expenditures and stated that OMB Circular A-133 does not require the testing of separate payroll expenditures for each fiscal year.

DoD IG Response. We commend the Office of the Auditor General for planning to perform additional audit procedures to address the majority of the deficiencies specified in Finding C. However, in relation to the deficiency on payroll costs for the Activities Allowed/Unallowed and the Allowable Costs/Cost Principles compliance requirements, we still recommend additional

audit procedures. AICPA auditing standards requires the auditor to exercise professional judgment when planning, conducting, and evaluating the results of compliance testing in a single audit. This includes considering the assessment of audit risk and materiality related to each major program as well as for each direct and material compliance requirement related to the major program in determining the nature, timing, and extent of compliance tests to perform to reduce detection risk to an acceptable level. The evidence provided by those tests, along with evidence regarding inherent risk and control risk, provides the basis for expressing an opinion on whether the auditee complied, in all material respects, with the direct and material compliance requirements. Since payroll is a material expenditure under the Operations and Maintenance cooperative agreement, the auditors should test additional payroll transactions for FY 2007 to support their opinion on the Activities Allowed/Unallowed and Allowable Costs/Cost Principles compliance requirements.

After consideration of the Office of the Auditor General management comments related to the audit work performed on the final close-out memorandums for the reporting compliance requirement and additional research performed, we have removed the statement pertaining to the auditor not performing audit procedures related to the notification of unliquidated claims and undisbursed obligations for the Period of Availability compliance requirement from the final report. However, for future reference, the auditors need to better reference the audit work performed on the compliance requirement if part of the test objectives of that compliance requirement is performed and documented under another compliance requirement.

Finding D. Reporting Findings on the Schedule of Findings and Questioned Costs. The auditors did not report a finding on the lack of written policies and procedures over subrecipient monitoring on the Schedule of Findings and Questioned Costs.

Finding on Subrecipient Monitoring. For the audit of the National Guard Civilian Youth Opportunities program, Catalog of Federal Domestic Assistance 12.404, the auditors determined that there were no written policies and procedures in place to ensure compliance with the Subrecipient Monitoring compliance requirement. The auditors verbally advised the Department of Military and Veterans Affairs to establish and implement written policies and procedures over subrecipient monitoring. According to the audit staff, they did not report this deficiency as a finding in the single audit report because they considered this to be a control deficiency not a noncompliance issue and, therefore, did not meet the threshold to be considered a significant deficiency for reporting. For FYs 2006 and 2007, the Department of Military and Veterans Affairs expended $2.8 million and $3.5 million respectively for the Civilian Youth Opportunities program. Of these amounts, the Department of Military and Veterans Affairs passed through $1.1 million in FY 2006 and $1.7 million in FY 2007 to Starbase Inc., a nonprofit organization to manage the Starbase program, a sub-program under Catalog of Federal Domestic Assistance 12.404. The funds issued to Starbase Inc. represent approximately 45 percent of the Civilian Youth Opportunities program, a significant portion of the major program.

According to OMB Circular A-133 §___510(a)(1), the auditor is required to report as audit findings in the Schedule of Findings and Questioned Costs significant deficiencies in internal

control over major programs. The AICPA audit guide states that any significant deficiencies in internal control over compliance for major programs that are noted should be reported as an audit finding. In our opinion, the lack of written policies and procedures for subrecipient monitoring is a significant internal control deficiency that should have been reported as a finding on the Schedule of Findings and Questioned Costs. An entity's policies and procedures serves as the basis for the control activities that helps ensure the entity complies with the compliance requirements.

Office of the Auditor General Management Comments on the Finding. The Office of the Auditor General management disagreed that the lack of written formal procedures for subrecipient monitoring is a significant deficiency in internal control that needs to be reported as a finding. They also disagreed that the audit finding related to the Schedule of Expenditures of Federal Awards be reported in both sections of the Schedule of Findings and Questioned Costs.

DoD IG Response. According to the AICPA 2008 Audit Guide on OMB Circular A-133 audits, policies and procedures that are incomplete, inadequate, outdated, or lacking for the activities subject to a type of compliance requirement are significant deficiencies in internal control. We believe that the lack of written policies and procedures for subrecipient monitoring is a significant internal control deficiency that should have been reported as a finding on the Schedule of Findings and Questioned Costs.

After consideration of the Office of the Auditor General management comments on the reporting of the Schedule of Expenditures of Federal Awards audit finding in both sections of the Schedule of Findings and Questioned Costs, we have removed the reporting of this issue from the final report.

Recommendations, Management Comments, and DoD IG Response

Recommendation 1. **We recommend that the Chief Financial Officer, Department of Military and Veterans Affairs:**

a. **Prepare complete financial statements and revise the Schedule of Expenditures of Federal Awards according to the requirements of Office of Management and Budget Circular A-133 and provide them to the Office of the Auditor General, State of Michigan to perform additional audit procedures necessary for the biennial audit period ended September 30, 2007 single audit at no additional cost to the Federal government.**

Department of Military and Veterans Affairs Comments. The Department of Military and Veterans Affairs management concurred with the recommendation to revise the Schedule of Expenditures of Federal Awards but nonconcurred with the recommendation to prepare complete

financial statements. The Department of Military and Veterans Affairs management stated that the Schedule of Revenue and the Schedule of Sources of Disposition of Authorization serves as their financial statements and that the preparation of additional financial statements is unnecessary. The Department of Military and Veterans Affairs management stated that OMB Circular A-133 §__.310(a) allows financial statements to reflect the results of operations or changes in net assets and that they chose to present their financial statements to show the results of operations instead of changes in net assets.

DoD IG Response. OMB Circular A-133 §___.310(a) requires the auditee to prepare financial statements that reflects its financial position, results of operations or changes in net assets, and where appropriate, cash flows for the fiscal year audited. The "or" is only between the option of reporting financial information on the results of operations and changes in net assets. Financial statements that reflect the auditee's "financial position" should always be provided. The Department of Military and Veterans Affairs Schedule of Revenue and the Schedule of Sources of Disposition of Authorization does not meet the requirements of OMB Circular A-133. We request that the Chief Financial Officer, Department of Military and Veterans Affairs, reconsider its position on this recommendation and comment on it in response to this final report.

b. Identify all costs related to the National Guard Bureau Military Construction program as a separate Federal program in the accounting system and accounts.

Department of Military and Veterans Affairs Comments. The Department of Military and Veterans Affairs management concurred with the recommendation. The Department of Military and Veterans Affairs will ensure that the required steps are taken to identify the National Guard Bureau Military Construction Program as a separate Federal program on the Schedule of Expenditures of Federal Awards and that a separate accounting code will be used to properly track the expenditures in the accounting system. The Department of Military and Veterans Affairs suggest that the Department of Defense include the Catalog of Federal Domestic Assistance numbers in all National Guard Bureau agreements.

DoD IG Response. In response to the Department of Military and Veterans Affairs suggestion, we have added Recommendation 3a to the Chief of the National Guard Bureau to this report.

c. Notify the DoD Office of Inspector General when the Office of the Auditor General, State of Michigan, provides the revised reporting package to the Department of Military and Veterans Affairs so that we can perform a follow-up quality control review before the Department of Military and Veterans Affairs submits the revised single audit reporting package to the Federal Audit Clearinghouse.

Department of Military and Veterans Affairs Comments. The Department of Military and Veterans Affairs management concurred with the recommendation.

d. **Identify as unallowable any costs associated with the audit services provided by the Office of the Auditor General, State of Michigan, until the audit is performed in accordance with OMB Circular A-133 and government auditing standards.**

Department of Military and Veterans Affairs Comments. The Department of Military and Veterans Affairs management concurred with the recommendation.

Recommendation 2. **We recommend that the Auditor General, Office of the Auditor General, State of Michigan:**

a. **Redo the single audit of the Department of Military and Veterans Affairs for the biennial audit period ended September 30, 2007, at no additional cost to the Federal government and revise the reporting package to reflect at a minimum, the date the work is completed. The audit procedures should address the deficiencies identified in this report and be performed in accordance with the requirements of Office of Management and Budget Circular A-133 and government auditing standards. The revised reporting package should be provided to the Department of Military and Veterans Affairs.**

Office of the Auditor General Comments. The Office of the Auditor General management believes that the Department of Military and Veterans Affairs financial schedules meet OMB Circular A-133 reporting requirements for financial statements. The Office of the Auditor General management have evaluated the effect of the misclassification of the Military Construction program on the sufficiency of their audit procedures and opinions on the financial schedules and the Department of Military and Veterans Affairs' compliance with Federal program requirements for the other 2 major programs audited, the National Guard Operations and Maintenance program and the Civilian Youth Opportunities program. Accordingly, the Office of the Auditor General will be reissuing the single audit report for the Department of Military and Veterans Affairs. As stated in their management comments to the finding, the Office of the Auditor General management has requested a waiver to postpone the audit of the National Guard Military Construction program until the next single audit of the Department of Military and Veterans Affairs.

DoD IG Response. We consider the Office of the Auditor General management comments to the findings and corrective action taken and planned to be partially responsive to the recommendation. We maintain that the financial schedules prepared by the Department of Military and Veterans Affairs do not meet the financial reporting requirements of OMB Circular A-133 as stated above in our response to the Office of the Auditor General management comments to Finding A. We do not have the authority to waive Single Audit Act auditing requirements and we do not believe that it is in the best interest of the Federal government to do so. We request that the Auditor General reconsider its position on this recommendation and comment on it in response to the final report by July 24, 2009.

Recommendation 3. **We recommend that the Chief, National Guard Bureau:**

a. **Require grants officers to identify and include the Catalog of Federal Domestic Assistance title and number in award documents for all National Guard cooperative agreements awarded to the States and the U.S. territories in accordance with the requirements of the Office of Management and Budget Circular A-133 §__.400(c)(1).**

b. **Update the description for the National Guard Bureau Military Construction program, Catalog of Federal Domestic Assistance number 12.400, to include language for the audit requirements of the Single Audit Act. The updated language will provide guidance to recipients and auditors that funds received under the Military Construction program are subject to single audit.**

Other Matters. The audit work performed by the auditors for the Reporting compliance requirement for the Standard Form 270 report is adequate. However, based on information received from the National Guard Bureau United States Property Fiscal Officer office, the Standard Form 272 report will be used for advance payments when draw downs are by electronic fund transfers. As a result, the auditors will also need to perform audit procedures on the Standard Form 272 report in future single audits.

We appreciate the courtesies extended to the audit staff. For additional information on this report, please contact me at (703) 604-8877 (DSN 664-8877) or Ms. Janet Stern at (703) 604-8750 (DSN 664-8750).

Carolyn R. Davis

Carolyn R. Davis
Assistant Inspector General
for Audit Policy and Oversight

Appendix A. Quality Control Review Process

Background, Scope and Methodology

The Single Audit Act, Public Law 98-502, as amended, was enacted to improve the financial management of State and Local Governments and nonprofit organizations by establishing one uniform set of auditing and reporting requirements for all Federal award recipients required to obtain a single audit. OMB Circular A-133 establishes policies that guide implementation of the Single Audit Act and provides an administrative foundation for uniform audit requirements of non-Federal entities administering Federal awards. Entities that expend $500,000 are subject to the Single Audit Act and the audit requirements in OMB Circular A-133 and therefore must have an annual single or program-specific audit performed under Government Auditing Standards and submit a complete reporting package to the Federal Audit Clearinghouse.

We reviewed the Office of Auditor General single audit of the Department of Military and Veterans Affairs for the biennial audit period ended September 30, 2007 and the resulting reporting package that was submitted to the Federal Audit Clearinghouse dated July 16, 2008, using the 1999 edition of the "Uniform Quality Control Guide for the A-133 Audits" (the Guide). The Guide applies to any single audit that is subject to the requirements of OMB Circular A-133 and is the approved President's Council on Integrity and Efficiency[1] checklist used for performing the quality control reviews. We performed the review from July 2008 through May 2009. The review focused on the following qualitative aspects of the single audit:

- Qualification of Auditors,
- Independence,
- Due Professional Care,
- Planning and Supervision,
- Internal Control and Compliance testing,
- Schedule of Expenditures of Federal Awards, and
- Data Collection Form.

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[1] The President's Council on Integrity and Efficiency and the Executive Council on Integrity and Efficiency combined into the Council of the Inspectors General on Integrity and Efficiency in accordance with the Inspector General Reform Act of 2008.

Appendix B. Compliance Requirements for the Biennial Audit Period

OMB Circular A-133 Compliance Requirements	Operations & Maintenance program (Catalog of Federal Domestic Assistance 12.401)		Civilian Youth Opportunities program (Catalog of Federal Domestic Assistance 12.404)	
	Applicable	**Not Applicable/ Not Material**	**Applicable**	**Not Applicable/ Not Material**
Activities Allowed/Unallowed	X		X	
Allowable Costs/Cost Principles	X		X	
Cash Management	X		X	
Davis-Bacon Act[2]		X		X
Eligibility		X	X	
Equipment and Real Property Management		X		X
Matching, Level of Effort, Earmarking	X		X	
Period of Availability of Federal Funds	X		X	
Procurement, Suspension, and Debarment	X		X	
Program Income		X		X
Real Property Acquisition and Relocation Assistance		X		X
Reporting	X		X	
Subrecipient Monitoring		X	X	
Special Tests and Provisions		X		X

[2] Although the auditors concluded that the Davis-Bacon Act compliance requirement is not applicable, we determined that there may be instances when this compliance requirement may apply.

Department of Military & Veterans Affairs Comments

STATE OF MICHIGAN

JENNIFER M. GRANHOLM
GOVERNOR

DEPARTMENT OF MILITARY & VETERANS AFFAIRS
LANSING

MAJ GEN THOMAS G. CUTLER
ADJUTANT GENERAL AND DIRECTOR

March 12, 2009

Ms. Carolyn R. Davis
Assistant Inspector General
For Audit Policy and Oversight
Inspector General Department of Defense
400 Army Navy Drive
Arlington, Virginia 22202

Dear Ms. Davis:

Thank you for the opportunity to respond to the draft report on the Review of the Department of Military and Veterans Affairs Single Audit for the Audit period October 1, 2005 through September 30, 2007.

Recommendation 1a. Prepare complete financial statements and revise the Schedule of Expenditures of Federal Awards according to the requirements of the Office of Management and Budget Circular A-133 and provide them to the Office of Auditor General, State of Michigan to perform additional audit procedures for the biennial audit period ended September 30, 2007 single audit at no additional costs to the Federal Government.

Response. We disagree with the recommendation to prepare complete financial statements. The Department's Schedule of Revenue and the Schedule of Sources of Disposition of Authorizations, serves as our financial statements. OMB Circular A-133 .310(a) allows financial statements to reflect the results of operations or changes in net assets. The State of Michigan has chosen to present financial statements that show the results of operations instead of a balance sheet or changes in net assets. We believe the preparation of additional financial statements is unnecessary.

We will provide the Office of Auditor General, State of Michigan a revised Schedule of Expenditures of Federal Awards to separately identify expenditures for the NGB Military Construction Program (CFDA 12.400).

Recommendation 1b. Identify all costs related to the National Guard Bureau Military Construction Program as a separate Federal Program in the accounting system and accounts.

Response. We concur. The NGB Military Construction Cooperative Agreements do not indicate what CFDA number they fall under; as a result, the expenditures were combined with the NGB Operations and Maintenance program. According to the requirements of OMB Circular A-133 Subpart D .400(c)(1), The Federal awarding agency shall identify Federal awards made by informing each recipient of the CFDA title and number, award name and number award year, and if the award is for R&D. When some of this information is not available, the Federal agency shall provide information necessary to clearly describe the Federal award.

2500 S. WASHINGTON AVENUE • LANSING, MICHIGAN 48913-5101
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Ms. Carolyn R. Davis
March 12, 2009
Page 2

The department will ensure that required steps are taken to identify the NGB Military Construction Program as a separate Federal program on the SEFA. Also, separate account coding will be used to ensure proper tracking of these expenditures on the state's accounting system. To assist the department in accomplishing this, we suggest the CFDA number be included in all NGB agreements.

Recommendation 1c. Notify the DoD Inspector General when the Office of Auditor General, State of Michigan provides the revised reporting package to the Department of Military and Veterans Affairs so that we can perform a follow up quality control review before the Department of Military Affairs submits the revised single audit reporting package to the Federal Audit Clearinghouse.

Response: We concur

Recommendation 1d: Identify an unallowable any costs associated with the audit services provided by the Office of Auditor General, State of Michigan, until the audit is performed in accordance with OMB Circular A-133 and government auditing standards

Response: We concur

We appreciate the efforts of your office. Should you need any further information, please do not hesitate to contact me.

Sincerely,

Joel A. Wortley, Chief Financial Officer

cc: Mark Freeman, Office of Auditor General

Office of the Auditor General Comments

STATE OF MICHIGAN
OFFICE OF THE AUDITOR GENERAL
201 N. WASHINGTON SQUARE
LANSING, MICHIGAN 48913
(517) 334-8050
FAX (517) 334-8079

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

April 6, 2009

Ms. Carolyn R. Davis
Assistant Inspector General
for Audit Policy and Oversight
400 Army Navy Drive
Room 837
Arlington, VA 22202-4704

Dear Ms. Davis:

We have completed our review of the draft report of your review of the Department of Military and Veterans Affairs (DMVA) Single Audit for the audit period October 1, 2005 through September 30, 2007. In summary, we do not believe that the report accurately reflects our compliance with generally accepted government auditing standards and U.S. Office of Management and Budget (OMB) Circular A-133 requirements. The primary basis for your conclusions seems to relate to DMVA's use of financial schedules rather than financial statements and the misclassification of federal program expenditures of the Military Construction Program (CFDA 12.400) as program expenditures of the National Guard Military Operations and Maintenance Projects (CFDA 12.401).

DMVA's use of financial schedules to report the DMVA financial activity is necessary because DMVA is a part of the State of Michigan's General Fund. It remains our opinion that this presentation of less than a complete fund meets the Circular A-133 reporting requirements. Further, we believe that our report letter has been appropriately modified to address the reporting used. The presentation used and our reporting on the presentation has been in place for over 25 years and has been accepted by our external quality control reviews as well as all of the many Inspector General reviews.

While we do agree that we did not detect the misclassification of the federal program expenditures, we believe that the cause of the misclassification is a result of the Department of Defense not meeting Circular A-133 requirements. Had the required information been provided to DMVA, our audit procedures would have detected the misclassification. As reported in the single audit, we did identify one program that had been initially omitted from DMVA's draft Schedule of Expenditures of Federal Awards (SEFA). We also reported other control weaknesses in DMVA's SEFA preparation process.

Now that we are aware of the misclassification, we have, in accordance with generally accepted auditing standards, evaluated the effect of the misclassification on the sufficiency of our audit procedures and our opinions on the DMVA financial schedules and DMVA's

compliance with federal program requirements for the 2 major programs audited: CFDA 12.401, National Guard Military Operations and Maintenance (O&M) Projects, and CFDA 12.404, National Guard Civilian Youth Opportunities. Accordingly, we will be reissuing the report.

The draft report indicates that you believe that the Military Construction Program is a program that is subject to the Single Audit Act and that we should include the program in the scope of the issued single audit. However, based on the written information published in the *Catalog of Federal Domestic Assistance* and from a review of the actual grant agreements, we do not believe that the program is subject to the Single Audit Act. Consequently, we will need written confirmation from you that the program is subject to the Single Audit Act. If that is the case, we are requesting that you allow us to include the program in the next single audit. The next single audit is scheduled to start in September 2009 and will cover the two-year period ending September 30, 2009.

I am concerned about the lack of due process in your Quality Control Review reports. It is my understanding that we will not have another opportunity to review the report prior to it being finalized, despite the fact that we have only had discussions regarding the report with the individual who performed the review. Considering the nature and significance of the issues, I believe that it would be appropriate to have additional discussions about the report after you have reviewed our detailed response. These additional discussions would also provide the opportunity for us to learn specifically how our audit procedures could be improved.

Attached is our detailed response to the draft report. I look forward to discussing the report with you in the near future. Should you have any questions or concerns or require additional information, please contact me or Scott M. Strong, C.P.A., Deputy Auditor General.

Sincerely,

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

Attachment

c: Sharon Vasquez – Office of Inspector General
Mark A. Freeman

DETAILED RESPONSE TO
THE DRAFT REPORT ON THE QUALITY CONTROL REVIEW OF THE
MICHIGAN DEPARTMENT OF MILITARY AND VETERANS AFFAIRS
SINGLE AUDIT
OCTOBER 1, 2005 THROUGH SEPTEMBER 30, 2007

Finding A: Financial Statements Audit

DRAFT OF PROPOSED REPORT LANGUAGE:

"Because DMVA did not prepare financial statements, the audit work performed by the auditors to support the Independent Auditor's Report on the Financial Statements and Independent Auditor's Report on Internal Control Over Financial Reporting and on Compliance and Other matters was restricted to limited information contained in the financial schedules. This is in noncompliance with OMB Circular A-133 __.500(b) which requires the auditor to determine whether the financial statements of the auditee are presented fairly in all material respects in conformity with generally accepted accounting principles. In our opinion, the auditors should have reported the lack of financial statements as a finding in the single audit report and issued a disclaimer of opinion because of a scope limitation. In addition, since the DMVA did not prepare financial statements, the auditor did not perform the required audit procedures to determine whether the SEFA was presented fairly in all material respects in relation to the financial statements taken as a whole as required in OMB Circular A-133 _.500(b)."

We do not agree with your draft conclusion.

The draft conclusion seems to be based on the assumption that Circular A-133 requires the same financial presentation for all recipients of federal assistance subject to the Single Audit Act. As discussed in the federal register, this is not the case. In the federal Office of Management and Budget (OMB) response to a request that Circular A-133 be modified to specifically allow financial statements prepared in conformity with any of the several other bases of accounting

discussed in the auditing standards issued by the AICPA, OMB stated "Circular A-133 does not prescribe the basis of accounting that must be used by an auditee to prepare their financial statements and the schedule of expenditure of federal awards. However, auditees are required to disclose the basis of accounting and significant accounting policies used in preparing financial statements and Schedule of Expenditures of Federal Awards (SEFA)." (Federal Register Notices, Volume 62, page 35284).

The State of Michigan is required by Section 18.1461 of the *Michigan Compiled Laws* to conduct biennial audits of its State departments and agencies. In following the legal requirements for the department level single audits and financial reporting, those departments which are only a part of a complete fund (such as DMVA) must issue a financial presentation that is less than a complete fund presentation. Section 14.69 of the AICPA Audit and Accounting Guide entitled *State and Local Governments* notes that Governmental Accounting Standards Board (GASB) standards do not address the accounting and financial reporting for separately issued generally accepted accounting principles (GAAP)-based departmental financial statements and, in meeting their reporting obligations, auditors should consider long-established practice dictating that those presentations should apply all relevant GAAP.

DMVA followed the presentation format required by the Office of Financial Management, Department of Management and Budget (DMB), and presents the General Fund Schedule of Revenues and Other Financing Sources and the Schedule of the Sources and Disposition of General Fund Authorizations. DMB is responsible under Act 431, P.A. 1984, as amended, for the financial accounting and reporting of each State agency. Under Section 18.1492 of the *Michigan Compiled Laws*, the DMB Director is required to designate and notify each department of the presentation that is to be followed by each State agency.

DMVA's presentation of a Schedule of General Fund Revenues and Other Financing Sources and a Schedule of Sources and Disposition of General Fund Authorizations with the required disclosures of the basis of accounting and presentation constitutes the relevant information for the accountability center, which is the Department of Military and Veterans Affairs. Consequently, because the presentation meets the Circular A-133 financial reporting requirements, a finding regarding the lack of financial statements was not necessary in our report.

In our opinion, DMVA is presenting its financial information on an "other comprehensive basis of accounting." Because the presentation is "an other comprehensive basis of accounting" as described in the auditing standards, our auditor's report letter is modified to contain the language required under generally accepted auditing standards when reporting on such financial presentations. A disclaimer of opinion would not have been appropriate.

As a side note, the reporting format for less than a complete fund used by DMVA was developed over 25 years ago and has been accepted by our external quality control reviews and all of the many federal Inspector General reviews.

The reviewer is also of the opinion that sufficient audit work was not performed on the SEFA because financial statements were not prepared. We also disagree with this conclusion. Our audit of the SEFA was in relation to DMVA total expenditures reported on the Schedule of Sources and Disposition of General Fund Authorizations. Consequently, the conclusion on the fair statement of the SEFA was not affected by the presentation of financial schedules rather than financial statements.

Finding B: Schedule of Expenditures of Federal Awards and Major Program Determination

DRAFT OF PROPOSED REPORT LANGUAGE:

"We obtained information from the NGB that shows that DMVA was reimbursed approximately $47.5 million under the Military Construction Program during FYs 2006 and 2007. While the auditors performed extensive audit procedures to assess the completeness of the SEFA, they failed to recognize that expenditures for military construction should have been reported as a separate Federal program on the SEFA. As a result the auditors did not identify the Military Construction program as a separate major program for audit using the risk-based approach for major program determination. Under OMB Circular A-133 criteria, the amount of program expenditures and the fact that the program had not been audited in the prior two audit period, would have required the Military Construction program to be selected for audit as a major program. Since the program was not selected for audit, there is no assurance that DMVA is managing the Military Construction program in compliance with laws, regulations, and award provisions."

Based on the information provided by the reviewer, we do agree that the funding received by DMVA for the Military Construction Program (CFDA 12.400) was misclassified as National Guard Military Operations and Maintenance (NGB O&M) Projects (CFDA 12.401). However, we do not believe that the draft report accurately reflects the audit procedures performed to ensure the completeness and fair presentation of the information on the SEFA. Our audit procedures included the following:

1. We reviewed the grant documentation to determine if the federal program information provided to DMVA was consistent with the classification on the SEFA. However, the information required to be provided under Circular A-

133, such as the CFDA number, award name and number, and the award year, was not included on the grant documentation provided by the Department of Defense. Consequently, we relied on the prior history of the reporting of the program, the absence of any questions on the prior reporting from federal agencies, and the DMVA signed representations.

2. We attempted to confirm the federal reimbursements provided to DMVA with the Department of Defense; however, we did not receive a reply.

3. We received a letter of representation from DMVA that stated that it had disclosed to us all of the federal programs.

In performing these audit procedures, we did identify 1 federal program that had been initially omitted from DMVA's SEFA. Our audit report includes a finding that addresses the control weaknesses associated with DMVA's process to prepare the SEFA. We believe that, had the required Circular A-133 information been provided to DMVA, we would also have detected the reporting of CFDA 12.400 under CFDA 12.401.

Our subsequent research into the Military Construction Program leads us to question if the program is subject to the Single Audit Act. In our follow-up, we noted:

1. While the program is listed in the *Catalog of Federal Domestic Assistance* (CFDA), there is no indication that the program is subject to the Single Audit Act. The Department of Defense lists 45 programs in the CFDA. In our review of the CFDA descriptions for all of the 45 programs, we determined that the descriptions specifically state that 21 of the programs are subject to either the Single Audit Act or Circular A-133 audits; 4 of the programs are subject to audit by other audit agencies, such as the Army Audit Agency, the Defense Audit Agency, or the General Accounting

Office (now known as the Government Accountability Office) with no mention of the Single Audit Act; and the audit requirement is not applicable or there is no audit requirement for 20 of the programs. Consequently, considering the varied audit requirements, we have taken the guidance provided in the CFDA at face value and concluded that the program is not subject to the Single Audit Act.

2. Funding received under the Military Construction Program is received for a specific project under a specific agreement. The agreements are silent on the applicability of the Single Audit Act. They do, however, provide for the audit of the program by the Army Audit Agency, the Defense Audit Agency, or the General Accounting Office (now known as the Government Accountability Office) consistent with the information in the CFDA program description. The agreements do not require access to the program records for the auditors completing the single audit and also are silent on the CFDA number, the award name and number, and the award year. We believe that the fact that the individual agreements do not mention the Single Audit Act is further support for not including the program in the DMVA single audit.

Consequently, we are requesting written confirmation that the Military Construction Program (CFDA 12.400) is subject to the Single Audit Act. We are also requesting that, if the program is to be subject to the Single Audit Act, we include the Program as a part of the next DMVA single audit. The audit is scheduled to begin in September 2009 and will cover the two fiscal years ending September 30, 2009.

Single audits are performed for the benefit of the federal awarding agencies. Consequently, the more complete the guidance is regarding the federal program audit requirements, the greater the chance that the report will meet the users' needs. We would appreciate it if the CFDA could be updated to specifically

include indications of the applicability of the Single Audit Act and if the grant agreements, if applicable, could be revised to include the information required under Circular A-133 and a requirement to allow the auditors completing the single audit access to the project records.

Finding C: Federal Program Audit

DRAFT OF PROPOSED REPORT LANGUAGE:

"The auditors did not perform adequate audit procedures for the audit of the NGB Operations and Maintenance program to support their opinion over the major Federal program and did not perform adequate audit procedures for the Period of Availability compliance requirement for both the NGB Operations and Maintenance and Civilian Youth Opportunities programs."

We do not agree with the blanket statement that we did not perform adequate audit procedures to support our opinion(s). The audit was performed based on the best information available to us at the time of the audit. The audit procedures performed would have detected the misclassification of the Military Construction Program expenditures had the Circular A-133 required information been provided to DMVA by the Department of Defense. Based on the information provided by the Inspector General, and in accordance with generally accepted auditing standards, we have evaluated the effect of the new information on the reports issued. As a result of this reassessment, we have determined that we will need to perform additional audit procedures to address DMVA compliance with the procurement, suspension, and debarment requirements and additional internal control testing work for the matching; period of availability; and procurement, suspension, and debarment compliance requirements. Following are our responses related to the detailed components of this finding:

1. Sampling Methodology and Reliability of Audit Procedures Performed

DRAFT OF PROPOSED REPORT LANGUAGE:

"The sampling methodology used by the auditors to select their sample to test internal controls and compliance for the audit of the Operations and maintenance program is flawed because the population from which the transactions were selected included capital outlay expenditures from another federal program, the Military Construction program."

We do not agree that our sampling methodology was flawed. Our methodology was to select a sample from the NGB O&M expenditures. The population was created from the best information available at the time of the audit. The fact that the population was subsequently determined to be in error does not mean that the methodology was incorrect. It was never our intent to draw a sample to evaluate both of the federal programs. As stated earlier in the response, we were not aware that DMVA was receiving federal assistance under 2 federal programs. Based on this new information, we have reevaluated the sufficiency of the sample sizes for the NGB O&M Program and the need to perform additional audit testing. The table below summarizes the results of our evaluation.

Results of reevaluation of sample sizes:

Compliance Requirement	Were sample sizes and procedures sufficient for our Opinion on Federal Program Compliance?	Were sample sizes and procedures sufficient for our Report on Internal Control over Compliance?	Additional procedures performed
Activities Allowed/Unallowed	Yes	Yes	Not Applicable
Allowable Costs/Cost Principles	Yes	Yes	Not Applicable
Matching	Yes	No	Selected 8 additional transactions

Period of Availability	Yes	No	Selected 8 additional transactions
Procurement, Suspension, and Debarment	No – only tested capital outlay transactions because of dollar significance and auditor determined risk.	No	Selected 15 additional transactions
Reporting	No review comments	No review comments	Not Applicable
Cash Managment	No review comments	No review comments	Not Applicable

2. Activities Allowed/Unallowed and Allowable Costs/Cost Principles Compliance Requirements

DRAFT OF PROPOSED REPORT LANGUAGE

"The auditors did not perform internal control and compliance testing over payroll for FY 2007 for the Activities Allowed/Unallowed and the Allowable Costs/Costs Principles compliance requirements."

We disagree with your finding. As identified in the audit working papers, for the two-year audit period, we tested a total of 39 NGB O&M expenditure transactions for which 19 (49%) were payroll expenditures. This is in proportion to the payroll costs to total expenditures of 46% as you have cited in your draft report. In addition, to supplement the statistical sampling work, we conducted analytical review procedures on DMVA payroll expenditures. These analytical procedures would have disclosed any significant changes in the allocation of payroll costs. Further, we disagree with your review comment that the auditors should have selected a separate sample of payroll expenditure transactions for fiscal year 2006-07. Neither the Single Audit Act Amendments of 1996 nor OMB Circular A-133 specify a required testing methodology or require testing to be conducted separately on each fiscal year

in the case of a biennial single audit. Our sample was representative of the audit period and was supplemented by the analytical procedures performed.

3. Davis-Bacon Compliance Requirement

DRAFT OF PROPOSED REPORT LANGUAGE:

"The auditors did not perform adequate audit procedures for the Davis-Bacon compliance requirement. The auditors concluded that DMVA was exempt from the Davis-Bacon compliance requirement based on their discussion with the DMVA Administrative Services Manager and a memorandum issued by the NGB, dated November 24, 1993. The memorandum states that all State contracts are exempt from the provisions of the Davis-Bacon Act even though they are funded 100% by Federal funds contributed to the State from the NGB. However, the memo also states that there are cases when Davis-Bacon Act applies when it is required by the Federal grant program legislation. According to the OMB Circular A-133 Compliance Supplement for the Operations and maintenance program, the Davis Bacon Act applies only to environmental remediation construction subject to the Comprehensive Environmental Response, Compensation, and Liability Act of 1980, as amended...the auditors should perform audit procedures to determine whether any construction projects during the audit period require compliance with the Davis-Bacon Act and perform additional audit procedures as needed."

We have performed additional audit procedures related to the Davis-Bacon requirement and environmental remediation project costs reimbursed through Appendix 2 of the NGB O&M agreement and determined that there is no effect on the scope of the audit or on the audit conclusions. We determined that the total federal awards expended by DMVA for Appendix 2 during the biennial audit period were not material to the NGB O&M Program. Further, of the total Appendix 2 expenditures, DMVA had only one environmental remediation project for which it expended $25,921.06 in NGB O&M Program

funds during the audit period. While not material for the audit period, we have added a step to our audit procedures to ensure that we evaluate the Appendix 2 environmental remediation contracts when determining if the Davis-Bacon requirement is applicable in future audits.

4. Matching Compliance Requirement

DRAFT OF PROPOSED REPORT LANGUAGE:

"The auditors did not perform sufficient audit procedures for the matching compliance requirement. While the auditors performed audit procedures to verify whether DMVA met their matching contributions by ensuring that the State matching requirement is correctly recorded in the project files and accounting system and corresponds to the requirements specified in the Appendices of the Cooperative Agreements, the auditors did not perform audit procedures to verify whether the matching contributions came from an allowable source"

We disagree with your finding. DMVA matching contributions are provided from general State resources through annual appropriation bills. DMVA uses the State's accounting system to allocate the federal and State matching funding to individual transactions. This allocation is accomplished using specific account coding. Therefore, if the federal portion of an expenditure transaction is allowable, then the State-funded portion would also be allowable. In general, all federal revenue is restricted to the activity which generates the basis for the reimbursement. The State-funded portion of the financing of expenditures comes from all other non-restricted revenue (State general purpose) sources. In our testing, we found no instances of unallowable activities or costs. In addition, to verify the reliance of the account coding, we reviewed the allocation for total NGB O&M expenditures at a summary level. Further, for revenue reimbursements of project billings from the Department of Management and Budget, we recalculated DMVA's allocation of the federal and State funding split and reviewed the State-funded

portion within the State's accounting system to ensure that it was recorded correctly.

5. Period of Availability Compliance Requirement

DRAFT OF PROPOSED REPORT LANGUAGE:

"The audit work performed by the auditors for the Period of Availability compliance requirement cannot be relied upon. The transactions used to test internal controls and compliance for Period of Availability included 8 capital outlay transactions that belong to the Military Construction program which is funded with 5-year appropriations. Because the auditors were not aware that the Military Construction was a separate program, the auditors tested the selected transactions against the period of availability for the Operations and maintenance program which is funded with 1-year appropriations. "

We disagree with your finding. In our reevaluation of the effect of the misclassified transactions, we determined that our testing was sufficient to determine DMVA's compliance with NGB O&M program requirements. However, we did select 8 additional sample items for internal control testing to support a low level of control risk.

In the initial sample, we reviewed each sample transaction invoice to ensure that the expenditure was incurred (obligated) within the correct appropriation year according to the Master Cooperative Agreement and applicable appendixes. In addition, in the initial sample and the 8 additional sample items, we tested for appropriate reviews, approval, and account coding designated by key personnel familiar with the Program. We found no noncompliance or control deficiencies.

DRAFT OF PROPOSED REPORT LANGUAGE:
The auditors did not perform audit procedures to determine whether DMVA had obligated the funds for these (322) transactions prior to the end date of grant award in accordance with NGB requirements..

We disagree with your finding. As indicated in the working papers, we reviewed many of the 322 transactions and discussed the processing procedure with the DMVA accounting unit to ascertain the reasonableness and risk associated with the transactions paid after the end of the grant award period. We determined that the expenditures were primarily recurring transactions, such as payroll, and that the obligation and payment dates were within the required period of availability. NGB O&M period of availability requirements allow obligations to be paid or liquidated within 90 days of the end of the grant award period.

DRAFT OF PROPOSED REPORT LANGUAGE:
In addition, the auditors did not perform procedures to determine if DMVA had made the required notification to the NGB United States Property Fiscal Officer for any unliquidated claims and undisbursed obligations.

We disagree with this finding. We reviewed the final close-out memorandums as part of our audit procedures for the reporting compliance requirement. We reported on the timeliness of the DMVA reporting in our audit report, Finding 5110806 b.(2).

6. Procurement, Suspension, and Debarment Compliance Requirement

DRAFT OF PROPOSED REPORT LANGUAGE:
"The auditors did not perform sufficient audit procedures for the Procurement, Suspension, and Debarment compliance requirement."

After reconsidering the required separate reporting for the Military Construction Program, we concur with your finding. We subjected only capital outlay expenditures to federal compliance and internal control tests for the procurement, suspension, and debarment compliance requirements based on our understanding of the risks and magnitude of these expenditures. We have selected a sample of these procurements and are in the process of testing the selected expenditures for procurement, suspension, and debarment compliance requirements.

Finding D: Reported Findings of the Schedule of Findings and Questioned Costs

DRAFT OF PROPOSED REPORT LANGUAGE:

"The auditors did not report a finding on the lack of written policies and procedures over subrecipient monitoring and did not properly report an audit finding that impacts both the financial statements and Federal awards in the Schedule of Findings and Questioned costs."

We do not agree that a finding on written policies and procedures was appropriate. We did not consider the lack of written formal procedures for subrecipient monitoring to be a significant deficiency in internal control. The program has only 1 subrecipient and the subrecipient receives an annual single audit, which is received and reviewed by DMVA. It is our opinion that the unwritten process provided sufficient oversight of the subrecipient. However, we did verbally inform DMVA of the importance of its development of written policies to ensure continued oversight in the future.

We do not agree that the audit finding on the SEFA should have been included in both Section II and Section III of the Schedule of Findings and Questioned Costs. The audit finding related to the financial reporting requirements of Circular A-133

regarding the completeness and accuracy of the financial reporting of the SEFA and not to specific federal program compliance.

Inspector General
Department of Defense