



# MICHIGAN

OFFICE OF THE AUDITOR GENERAL

REPORT ON INTERNAL CONTROL,  
COMPLIANCE, AND OTHER MATTERS

MICHIGAN FINANCE AUTHORITY

(A Discretely Presented Component Unit of the State of Michigan)

Fiscal Year Ended September 30, 2013



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

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

Audit report information can be accessed at:

*<http://audgen.michigan.gov>*



Michigan  
Office of the Auditor General  
**REPORT SUMMARY**

*Report on Internal Control, Compliance, and  
Other Matters*

**Michigan Finance Authority**

*(A Discretely Presented Component Unit of the State of Michigan)*

**Fiscal Year Ended September 30, 2013**

Report Number:  
271-0340-14M

Released:  
February 2014

*Generally accepted government auditing standards require an auditor to report on internal control over financial reporting; compliance with provisions of laws, regulations, contracts, or grant agreements that have a material effect on the financial statements; and other matters coming to the attention of the auditor during the completion of a financial audit. This report is being issued in conjunction with our financial audit of the Michigan Finance Authority (the Authority).*

**Financial Statements:**

**Auditor's Report Issued**

We have audited the Authority's basic financial statements as of and for the fiscal year ended September 30, 2013 and have issued a separate report thereon dated December 19, 2013. We issued unmodified opinions on the Authority's basic financial statements.

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**Internal Control Over Financial Reporting**

In planning and performing our audit of the basic financial statements, we considered the Authority's internal control over financial reporting (internal control) to determine the audit procedures that are appropriate in the circumstances for the purpose of expressing our opinions on the basic financial statements, but not for the purpose of expressing an opinion on the effectiveness of the Authority's internal control. Accordingly, we do not express an opinion on the effectiveness of the Authority's internal control.

Our consideration of internal control was for the limited purpose described in the preceding paragraph and was not designed to identify all deficiencies in internal control that might be material weaknesses or significant deficiencies. Given these limitations, we did not identify any deficiencies in internal control that we consider to be material weaknesses; however, material weaknesses may exist that have not been identified. We did identify a significant deficiency (Finding 1). A significant deficiency is a deficiency, or combination of deficiencies, in internal control that is less severe than a material weakness, yet important enough to merit attention by those charged with governance.

Controls Over Financial Reporting

The Authority did not establish sufficient controls to ensure that it properly recorded and classified all financial activity in the non-major funds and the Michigan Guaranty Agency Federal Fund (Finding 1).

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**Noncompliance and Other Matters  
Material to the Financial Statements**

We did not identify any instances of noncompliance or other matters applicable to the basic financial statements that are required to be reported under *Government Auditing Standards*.

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**Agency Response:**

This report contains 1 finding and 1 corresponding recommendation. The Authority's preliminary response indicates that it agrees with the recommendation.

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**Background:**

The Authority is a discretely presented component unit of the State of Michigan that consolidated certain public finance authorities in Michigan in accordance with Executive Order No. 2010-2, effective May 30, 2010. The Authority combined the operations of 10 different public finance authorities (Michigan Forest Finance Authority, Michigan

Higher Education Assistance Authority, Michigan Higher Education Facilities Authority, Michigan Higher Education Student Loan Authority, Michigan Municipal Bond Authority, Michigan Public Educational Facilities Authority, Michigan State Hospital Finance Authority, Michigan Tobacco Settlement Finance Authority, Michigan Underground Storage Tank Financial Assurance Authority, and State Higher Education Facilities Commission). In addition, the authorization to finance the facilities of public and private schools, formerly under the Michigan Strategic Fund, and to issue bonds and notes on behalf of the State Land Bank Fast Track Authority was transferred to the Authority.

The Authority offers financing to public and private agencies providing essential services to the citizens of the State of Michigan, including municipalities; healthcare providers; higher education; and public, private, and charter schools.

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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>



Michigan Office of the Auditor General  
201 N. Washington Square  
Lansing, Michigan 48913

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

**Scott M. Strong, C.P.A., C.I.A.**  
Deputy Auditor General



STATE OF MICHIGAN  
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THOMAS H. MCTAVISH, C.P.A.  
AUDITOR GENERAL

February 14, 2014

Mr. R. Kevin Clinton, State Treasurer and Chair  
Michigan Finance Authority Board of Directors  
Richard H. Austin Building  
Lansing, Michigan

Dear Mr. Clinton:

We have audited the financial statements of the governmental activities, the business-type activities, each major fund, and the aggregate remaining fund information of the Michigan Finance Authority (the Authority), a discretely presented component unit of the State of Michigan, as of and for the fiscal year ended September 30, 2013 and the related notes to the financial statements, which collectively comprise the Authority's basic financial statements, and have issued a separate report thereon dated December 19, 2013. In planning and performing our audit of the basic financial statements, we considered the Authority's internal control over financial reporting and compliance and other matters. This report on internal control, compliance, and other matters is being issued in conjunction with our financial audit of the Michigan Finance Authority for the fiscal year ended September 30, 2013.

This report contains our report summary; our independent auditor's report on internal control over financial reporting and on compliance and other matters; our finding, our recommendation, and the agency preliminary response; and a glossary of abbreviations and terms.

The agency preliminary response was taken from the Authority's response at the end of our audit fieldwork. The *Michigan Compiled Laws* and administrative procedures require that the audited agency develop a plan to comply with the audit recommendation and submit it within 60 days after release of the audit report to the Office of Internal Audit Services, State Budget Office. Within 30 days of receipt, the Office of Internal Audit Services is required to review the plan and either accept the plan as final or contact the agency to take additional steps to finalize the plan.

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

Sincerely,

A handwritten signature in black ink that reads "Thomas H. McTavish".

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



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# INDEPENDENT AUDITOR'S REPORT ON INTERNAL CONTROL AND COMPLIANCE



STATE OF MICHIGAN  
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THOMAS H. MCTAVISH, C.P.A.  
AUDITOR GENERAL

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

Mr. R. Kevin Clinton, State Treasurer and Chair  
Michigan Finance Authority Board of Directors  
Richard H. Austin Building  
Lansing, Michigan

Dear Mr. Clinton:

We have audited, in accordance with the auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards* issued by the Comptroller General of the United States, the financial statements of the governmental activities, the business-type activities, each major fund, and the aggregate remaining fund information of the Michigan Finance Authority (the Authority), a discretely presented component unit of the State of Michigan, as of and for the fiscal year ended September 30, 2013 and the related notes to the financial statements, which collectively comprise the Authority's basic financial statements, and have issued our report thereon dated December 19, 2013.

### **Internal Control Over Financial Reporting**

In planning and performing our audit of the basic financial statements, we considered the Authority's internal control over financial reporting (internal control) to determine the audit procedures that are appropriate in the circumstances for the purpose of expressing our opinions on the basic financial statements, but not for the purpose of expressing an opinion on the effectiveness of the Authority's internal control. Accordingly, we do not express an opinion on the effectiveness of the Authority's internal control.

A deficiency in internal control exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent, or detect and correct, misstatements on a timely basis. A material weakness is a deficiency, or a combination of deficiencies, in internal control such that there is a reasonable possibility that a material misstatement of the entity's basic financial statements will not be prevented, or detected and corrected, on a timely basis. A significant deficiency is a deficiency, or a combination of deficiencies, in internal control that is less severe than a material weakness, yet important enough to merit attention by those charged with governance.

Our consideration of internal control was for the limited purpose described in the first paragraph of this section and was not designed to identify all deficiencies in internal control that might be material weaknesses or significant deficiencies and, therefore, material weaknesses or significant deficiencies may exist that were not identified. Given these limitations, during our audit we did not identify any deficiencies in internal control that we consider to be material weaknesses. However, material weaknesses may exist that have not been identified. We did identify a deficiency in internal control, as described in Finding 1, that we consider to be a significant deficiency.

### **Compliance and Other Matters**

As part of obtaining reasonable assurance about whether the Authority's basic financial statements are free from material misstatement, we performed tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements, noncompliance with which could have a direct and material effect on the determination of financial statement amounts. However, providing an opinion on compliance with those provisions was not an objective of our audit, and accordingly, we do not express such an opinion. The results of our tests disclosed no instances of noncompliance or other matters that are required to be reported under *Government Auditing Standards*.

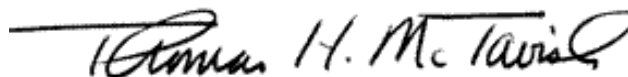
### **Authority's Response to Finding**

The Authority's preliminary response to the finding identified in our audit is included in the body of our report. The Authority's response was not subjected to the auditing procedures applied in the audit of the basic financial statements and, accordingly, we express no opinion on it.

### **Purpose of This Report**

The purpose of this report is solely to describe the scope of our testing of internal control and compliance and the results of that testing, and not to provide an opinion on the effectiveness of the entity's internal control or on compliance. This report is an integral part of an audit performed in accordance with *Government Auditing Standards* in considering the entity's internal control and compliance. Accordingly, this communication is not suitable for any other purpose.

Sincerely,



Thomas H. McTavish, C.P.A.  
Auditor General  
December 19, 2013

FINDING, RECOMMENDATION, AND  
AGENCY PRELIMINARY RESPONSE

## **FINDING**

### **1. Controls Over Financial Reporting**

The Michigan Finance Authority (the Authority) did not establish sufficient controls to ensure that it properly recorded and classified all financial activity in the non-major funds and the Michigan Guaranty Agency (MGA) Federal Fund. Immediately upon bringing the misstatements to the Authority's attention, the Authority corrected the accounting records and made appropriate revisions to the non-major funds and the MGA Federal Fund.

Our audit procedures identified the following internal control\* weaknesses and financial statement errors:

- a. The Authority did not properly record Federal Family Education Loan (FFEL) Program receivables and accrued revenues. As a result, the receivable from federal government and federal revenue in the MGA Federal Fund were overstated by \$8.1 million.

MGA guarantees the purchase of defaulted loans from lenders in the FFEL Program. Section N50.112 of the *Codification of Governmental Accounting and Financial Reporting Standards* (Codification), published by the Governmental Accounting Standards Board (GASB), states that, for these voluntary nonexchange transactions, the recipient (the Authority) has no receivable and revenue until it has incurred costs in accordance with the U.S. Department of Education's program requirements. Title 34, Part 682, section 406(a)(9) of the *Code of Federal Regulations* states that the Authority cannot request reinsurance from the U.S. Department of Education until it has paid the lender. Therefore, the Authority should record a receivable and accrued revenue after it pays the lender.

The Authority determined that it had incurred costs at the time that it recorded accounts payable and accrued expenditures for payments that it owed to lenders; therefore, the Authority recorded receivables and accrued revenues at that time. However, the Authority had not yet incurred reimbursable costs because it had not paid the lenders' claims.

\* See glossary at end of report for definition.

- b. The Authority did not record Teacher Loan Forgiveness (TLF) Program payments and reimbursements in the MGA Federal Fund. As a result, student loan claims paid to lenders and federal revenue in the MGA Federal Fund were understated by \$1.3 million.

GASB Codification Section 1100.110 requires that financial statements of fiduciary funds be reported using the economic resources measurement focus and the accrual basis of accounting, which requires revenues and expenses for nonexchange transactions to be recognized in accordance with GASB Codification Section N50.

The Authority informed us that, because of staff retirements, it did not have the program history of why it had not recorded the TLF Program payments and reimbursements and had historically treated the transactions as a cash pass-through from the Authority.

- c. The Authority did not properly classify the non-major funds transfer to the MGA Federal Fund. As a result, non-major funds other administrative expense was overstated by \$1.0 million and non-major funds transfers to other funds was understated by \$1.0 million.

GASB Codification Section 1800.102 defines interfund transfers as flows of assets without equivalent flows of assets in return and without a requirement for repayment.

The Authority recorded the transfer as an other administrative expense in the non-major funds because it had determined that this was how another state's guaranty agency had recorded the accounting transaction.

## **RECOMMENDATION**

We recommend that the Authority establish sufficient controls to ensure that it properly records and classifies all financial activity in the non-major funds and the MGA Federal Fund.

## **AGENCY PRELIMINARY RESPONSE**

The Authority agrees with the recommended adjustments to the MGA Federal Fund and the MGA Operating Fund financial statements. However, the Authority does not agree that the recommended adjustments comprise a significant deficiency in internal control over financial reporting and notes that the recommended adjustments were not material to the financial statements and represented less than 1% of the MGA transactions recorded in fiscal year 2012-13.

## **OFFICE OF THE AUDITOR GENERAL EPILOGUE**

The Authority stated in the agency preliminary response that it does not agree that the recommended adjustments comprise a significant deficiency and noted that the recommended adjustments represented less than 1% of the MGA transactions recorded in fiscal year 2012-13. The number of transactions recorded during the fiscal year was not relevant in determining that a significant deficiency exists. The adjustments resulted in a decrease in net position held in trust in the statement of fiduciary net position from \$12.4 million to \$4.3 million. In accordance with auditing standards, we are required to report deficiencies in internal control when there is a reasonable possibility that the Authority's internal control would not prevent, or detect and correct, a material misstatement of the Authority's financial statements on a timely basis.

# GLOSSARY



## Glossary of Abbreviations and Terms

Authority	Michigan Finance Authority.
deficiency in internal control over financial reporting	The design or operation of a control that does not allow management or employees, in the normal course of performing their assigned functions, to prevent, or detect and correct, misstatements on a timely basis.
FFEL Program	Federal Family Education Loan Program.
financial audit	An audit that is designed to provide reasonable assurance about whether the basic financial statements of an audited entity are presented fairly, in all material respects, in accordance with the applicable financial reporting framework.
Governmental Accounting Standards Board (GASB)	An arm of the Financial Accounting Foundation established to promulgate standards of financial accounting and reporting with respect to activities and transactions of state and local governmental entities.
internal control	A process, effected by those charged with governance, management, and other personnel, designed to provide reasonable assurance about the achievement of the entity's objectives with regard to the reliability of financial reporting, effectiveness and efficiency of operations, and compliance with applicable laws and regulations.
material misstatement	A misstatement in the basic financial statements that causes the statements to not present fairly the financial position or the changes in financial position, and, where applicable, cash flows thereof, in accordance with the applicable financial reporting framework.

material weakness in internal control over financial reporting	A deficiency, or a combination of deficiencies, in internal control such that there is a reasonable possibility that a material misstatement of the financial statements will not be prevented, or detected and corrected, on a timely basis.
MGA	Michigan Guaranty Agency.
significant deficiency in internal control over financial reporting	A deficiency, or a combination of deficiencies, in internal control that is less severe than a material weakness, yet important enough to merit attention by those charged with governance.
TLF Program	Teacher Loan Forgiveness Program.
unmodified opinion	The opinion expressed by the auditor when the auditor, having obtained sufficient appropriate audit evidence, concludes that the basic financial statements are presented fairly, in all material respects, in accordance with the applicable financial reporting framework.



