



MICHIGAN

OFFICE OF THE AUDITOR GENERAL

REPORT ON INTERNAL CONTROL,
COMPLIANCE, AND OTHER MATTERS

MICHIGAN ECONOMIC DEVELOPMENT CORPORATION
(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

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Michigan
Office of the Auditor General
REPORT SUMMARY

*Report on Internal Control, Compliance, and
 Other Matters*
Michigan Economic Development Corporation
(A Discretely Presented Component Unit of the State of Michigan)
Fiscal Year Ended September 30, 2013

Report Number:
 271-0406-14M

Released:
 March 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 Economic Development Corporation (MEDC).

Financial Statements:

Auditor's Report Issued

We have audited MEDC's basic financial statements as of and for the fiscal year ended September 30, 2013 and have issued a separate report thereon dated January 24, 2014. We issued an unmodified opinion on MEDC'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 MEDC'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 opinion on the basic financial statements, but not for the purpose of expressing an opinion on the effectiveness of MEDC's internal control. Accordingly, we do not express an opinion on the effectiveness of MEDC'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 significant deficiencies (Findings 1 through 3). 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.

Investment Impairment Losses

MEDC's internal control over financial reporting did not ensure that it properly recorded and reported investment

impairment losses in accordance with generally accepted accounting principles (Finding 1).

Great Plains Access Controls

MEDC had not established effective access controls over its Great Plains accounting system (Finding 2).

Salesforce Access Controls

MEDC had not established effective access controls over its Salesforce customer relationship management system (Finding 3).

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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 3 findings and 3 corresponding recommendations. MEDC's preliminary response indicates that it agrees with all of the recommendations.

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Background:

Article VII, Section 28 of the Michigan Constitution and Act 7, P.A. 1967, provided for the creation of MEDC as a public body corporate. MEDC was created in April 1999 by a 10-year contract (interlocal agreement, as amended) between a participating local economic development corporation formed under Act 338, P.A. 1974, as amended, and the Michigan Strategic Fund. Article VI of the interlocal agreement provides for the automatic renewal of this initial 10-year term for two renewal periods of five years each. In April 2009, this interlocal agreement was automatically renewed for another five years. MEDC is a separate legal entity created to promote economic growth by developing strategies and providing services to create and retain good jobs and a high quality of life for Michigan residents. Under the terms of the agreement, the governance of MEDC resides in an Executive Committee of 20 members appointed to eight-year, staggered terms by the Governor.

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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

March 27, 2014

Mr. Michael A. Finney, President and Chief Executive Officer
and
Mr. Doug Rothwell, Executive Committee Chair
Michigan Economic Development Corporation
300 North Washington Square
Lansing, Michigan

Dear Mr. Finney and Mr. Rothwell:

We have audited the basic financial statements of the Michigan Economic Development Corporation (MEDC), a discretely presented component unit of the State of Michigan, as of and for the fiscal year ended September 30, 2013 and have issued a separate report thereon dated January 24, 2014. In planning and performing our audit of the basic financial statements, we considered MEDC'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 MEDC 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 findings, our recommendations, and the agency preliminary responses; and a glossary of abbreviations and terms.

The agency preliminary responses were taken from the agency'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 recommendations 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



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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. Michael A. Finney, President and Chief Executive Officer
and
Mr. Doug Rothwell, Executive Committee Chair
Michigan Economic Development Corporation
300 North Washington Square
Lansing, Michigan

Dear Mr. Finney and Mr. Rothwell:

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 basic financial statements of the Michigan Economic Development Corporation, 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 basic financial statements and have issued our report thereon dated January 24, 2014.

Internal Control Over Financial Reporting

In planning and performing our audit of the basic financial statements, we considered the Michigan Economic Development Corporation'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 opinion on the basic financial statements, but not for the purpose of expressing an opinion on the effectiveness of the Michigan Economic Development Corporation's internal control. Accordingly, we do not express an opinion on the effectiveness of the Michigan Economic Development Corporation'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 certain deficiencies in internal control, as described in Findings 1 through 3, that we consider to be significant deficiencies.

Compliance and Other Matters

As part of obtaining reasonable assurance about whether the Michigan Economic Development Corporation'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*.

Michigan Economic Development Corporation's Response to Findings

The Michigan Economic Development Corporation's preliminary responses to the findings identified in our audit are included in the body of our report. The Michigan Economic Development Corporation's preliminary responses were not subjected to the auditing procedures applied in the audit of the basic financial statements and, accordingly, we express no opinion on them.

Purpose of This Report

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

Sincerely,



Thomas H. McTavish, C.P.A.
Auditor General
January 24, 2014

FINDINGS, RECOMMENDATIONS, AND AGENCY PRELIMINARY RESPONSES

FINDING

1. Investment Impairment Losses

The Michigan Economic Development Corporation's (MEDC's) internal control* over financial reporting did not ensure that it properly recorded and reported investment impairment losses in accordance with generally accepted accounting principles* (GAAP). As a result, MEDC overstated its investments and net increase in fair value of investments by \$2.2 million in its fiscal year 2012-13 financial statements.

Section I50.121 of the *Codification of Governmental Accounting and Financial Reporting Standards*, published by the Governmental Accounting Standards Board* (GASB), provides that, when using the cost method to account for common stock investments, a decrease in value of the investment should be recognized when factors indicate that a nontemporary impairment loss has occurred, such as a series of operating losses of the investee.

As of September 30, 2013, MEDC reported the value of its venture capital investments as \$7.3 million. Our testing of MEDC's reported value of its venture capital investments disclosed:

- a. MEDC did not recognize an impairment loss for two investments totaling \$1.3 million, although MEDC determined that its separate loans receivable from these two investees were uncollectible.
- b. MEDC did not recognize an impairment loss for one investment totaling \$0.9 million, although MEDC was aware that the investee had sustained significant losses over the past five years.

MEDC informed us that it did not adjust investment values for nontemporary impairment losses unless a significant event occurred, such as a bankruptcy filing or the closing of the investee's business. MEDC did not consider other factors that could cause an investment impairment loss, such as sustained operating losses of an investee or nonpayment of the investee's outstanding loans.

* See glossary at end of report for definition.

RECOMMENDATION

We recommend that MEDC implement internal control over financial reporting to ensure that it properly records and reports investment impairment losses in accordance with GAAP.

AGENCY PRELIMINARY RESPONSE

MEDC agrees with the recommendation and indicated that MEDC's long-standing policy has been to adjust investment values for impairment losses only when a significant event occurred, such as bankruptcy filing or the closing of the investee's business. MEDC indicated that it will implement a process to also include an annual review of investments that will consider any known factors that could cause an investment impairment loss.

FINDING

2. Great Plains Access Controls

MEDC had not established effective access controls* over its Great Plains accounting system (Great Plains). As a result, MEDC could not ensure that it was able to prevent or detect errors or irregularities that may be caused by users performing unauthorized activities.

Department of Technology, Management, and Budget (DTMB) Administrative Guide policy 1335 and related technical standards provide that management of State agency information systems implement sufficient system access controls to ensure that users perform only authorized activities relevant to their respective job requirements and to ensure adequate segregation of duties* in performing activities. DTMB Administrative Guide policy 1335 and related technical standards also provide that management should perform a regular review of all accounts and related privileges and require password changes in State agency information systems at least every 90 days.

MEDC uses Great Plains to record disbursements and other accounting transactions related to its nonappropriated funded activity. MEDC issued payments totaling \$42.8 million to vendors using Great Plains in fiscal year 2012-13.

* See glossary at end of report for definition.

Our review of MEDC's access controls over Great Plains disclosed:

- a. MEDC did not restrict the ability to update vendor information in Great Plains to the one individual who was assigned this responsibility. We noted that 21 users had the ability to create and edit vendor information, including the ability to edit vendor names, addresses, and bank account information used to wire payments. In addition, we noted that 7 (33.3%) of these 21 users also had the ability to approve payments.

MEDC informed us that it was unaware that the 21 users' access rights allowed them to also update vendor information.

- b. MEDC did not require the periodic changing of the password used to release transactions and did not know when the password was last changed.

RECOMMENDATION

We recommend that MEDC establish effective access controls over Great Plains.

AGENCY PRELIMINARY RESPONSE

MEDC agrees with the recommendation and indicated that it has already implemented the following corrective actions:

- a. At MEDC's request, CBI Partners, the software hosting provider, has removed the ability to create and edit vendor information for all employees except the two employees responsible for vendor management. These employees are not involved in creating purchase orders or issuing payments.
- b. At MEDC's request, new passwords have been assigned for each process and a process has been added to have CBI Partners change them every six months.

FINDING

3. Salesforce Access Controls

MEDC had not established effective access controls over its Salesforce customer relationship management system (Salesforce). As a result, MEDC could not

ensure that payment requests initiated through Salesforce were properly authorized and for the correct amounts prior to recording the payments in its financial accounting systems.

DTMB Administrative Guide policy 1335 and related technical standards provide that management of State agency information systems implement sufficient system access controls to ensure that users perform only authorized activities relevant to their respective job requirements and to ensure adequate segregation of duties in performing activities. DTMB Administrative Guide policy 1335 and related technical standards also provide that management should perform a regular review of all accounts and related privileges.

MEDC uses Salesforce to track and document payment requests for many of its grants, loans, and contracts. MEDC reported that total payments authorized through Salesforce for both MEDC and Michigan Strategic Fund programs totaled \$71.3 million in fiscal year 2012-13.

Our review of MEDC's access controls over Salesforce disclosed:

- a. MEDC did not limit the number of system administrators* and did not assign appropriate access rights to system administrators to ensure proper segregation of duties. We noted 18 system administrators who had the ability to log in as other users and perform activities without the use of a user password.
- b. MEDC did not sufficiently monitor user activity, including system administrators, within Salesforce to ensure that users performed only authorized activities relevant to their respective jobs and positions. For example, users with the ability to approve grant payments also had the ability to change payment amounts prior to approving payments in Salesforce. MEDC informed us that, although an audit trail exists in Salesforce, it did not regularly monitor this audit trail.
- c. MEDC had not established a formal process to periodically review user access rights to ensure that only authorized users had access to Salesforce and that the users' access rights were commensurate with their job duties.

* See glossary at end of report for definition.

RECOMMENDATION

We recommend that MEDC establish effective access controls over Salesforce.

AGENCY PRELIMINARY RESPONSE

MEDC agrees with the recommendation and indicated that it has implemented or will implement corrective action. MEDC also believes that it is important to note there is no evidence or even a suggestion of abuse of Salesforce system administrator privileges. However, MEDC informed us that it has implemented the following corrective actions:

- In response to part a., MEDC has reduced the number of system administrators from 18 to 13 and will review the necessity of these privileges on an ongoing basis.
- In response to part b., MEDC has determined that Salesforce has the capability to disable the global capability for system administrators to log on as other users. MEDC has requested Salesforce to disable this feature.

The following corrective actions will be implemented within the next 60 days:

- In response to part b., MEDC will set up procedures to monitor existing payment-related audit trails on a regular basis.
- In response to part c., MEDC will set up a process to periodically check user access rights and privileges to ensure that the users' access rights are in sync with their job duties.

GLOSSARY

Glossary of Abbreviations and Terms

| | |
|---|--|
| access controls | Controls that protect data from unauthorized modification, loss, or disclosure by restricting access and detecting inappropriate access attempts. |
| 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. |
| DTMB | Department of Technology, Management, and Budget. |
| 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. |
| generally accepted accounting principles (GAAP) | A technical accounting term that encompasses the conventions, rules, guidelines, and procedures necessary to define accepted accounting practice at a particular time; also cited as "accounting principles generally accepted in the United States of America." |
| Governmental Accounting Standards Board (GASB) | An arm of the Financial Accounting Foundation established to promulgate standards of financial accounting and reporting with respect to activities and transactions of state and local governmental entities. |
| Great Plains | Great Plains accounting system. |
| 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 basic financial statements will not be prevented, or detected and corrected, on a timely basis.

MEDC Michigan Economic Development Corporation.

Salesforce Salesforce customer relationship management system.

segregation of duties Assigning different people the responsibilities of authorizing transactions, recording transactions, and maintaining custody of assets to reduce the opportunities to allow any person to be in a position to both perpetrate and conceal errors or fraud in the normal course of his or her duties. Proper segregation of duties requires separating the duties of reporting, review and approval of reconciliations, and approval and control of documents.

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.

system administrator The person responsible for administering use of a multiuser computer system, communications system, or both.

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.

