



MICHIGAN

OFFICE OF THE AUDITOR GENERAL

REPORT ON INTERNAL CONTROL,
COMPLIANCE, AND OTHER MATTERS

MICHIGAN STRATEGIC FUND

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

Fiscal Year Ended September 30, 2014



Doug A. Ringler, CPA, CIA
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>



OAG

Office of the Auditor General

Report Summary

Report on Internal Control, Compliance, and Other Matters

Michigan Strategic Fund

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

Fiscal Year Ended September 30, 2014

**Report Number:
271-0401-15M**

**Released:
March 2015**

Generally accepted government auditing standards require an auditor to report on internal control over financial reporting; compliance with provisions of laws, regulations, contracts, or grant agreements that have a material effect on the financial statements; and other matters coming to the attention of the auditor during the completion of a financial audit. We are issuing this report in conjunction with our independent auditor's report on the Michigan Strategic Fund's (MSF's) financial statements dated February 25, 2015.

Findings Related to Internal Control, Compliance, and Other Matters	Material Weakness	Significant Deficiency	Agency Preliminary Response
MSF did not have sufficient internal control in place to ensure that it properly recorded and reported MSF's financial activity in accordance with generally accepted accounting principles (Finding 1).	X		Agrees
MSF did not have sufficient internal control over financial reporting to ensure that it adhered to established deadlines for recording and reporting its financial activity (Finding 2).		X	Agrees

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>

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

Doug A. Ringler, CPA, CIA
Auditor General

Laura J. Hirst, CPA
Deputy Auditor General



OAG

Office of the Auditor General

201 N. Washington Square, Sixth Floor • Lansing, Michigan 48913 • Phone: (517) 334-8050 • <http://audgen.michigan.gov>

Doug A. Ringler, CPA, CIA
Auditor General

March 26, 2015

Mr. Steven Arwood
President, Michigan Strategic Fund
Chair, Michigan Strategic Fund Board of Directors
300 North Washington Square
Lansing, Michigan

Dear Mr. Arwood:

We have audited the basic financial statements of the Michigan Strategic Fund (MSF), a discretely presented component unit of the State of Michigan, as of and for the fiscal year ended September 30, 2014 and have issued a separate report thereon dated February 25, 2015. In planning and performing our audit of the financial statements, we considered MSF's internal control over financial reporting and compliance and other matters. This is our report on internal control, compliance, and other matters of MSF for the fiscal year ended September 30, 2014.

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,

Doug Ringler
Auditor General

TABLE OF CONTENTS

MICHIGAN STRATEGIC FUND

	<u>Page</u>
INTRODUCTION	
Report Summary	1
Report Letter	3
INDEPENDENT AUDITOR'S REPORT ON INTERNAL CONTROL AND COMPLIANCE	
Independent Auditor's Report on Internal Control Over Financial Reporting and on Compliance and Other Matters	8
FINDINGS, RECOMMENDATIONS, AND AGENCY PRELIMINARY RESPONSES	
1. Controls Over Financial Reporting	12
2. Timeliness of Financial Reporting	14
GLOSSARY	
Glossary of Abbreviations and Terms	18

INDEPENDENT AUDITOR'S REPORT ON INTERNAL CONTROL AND COMPLIANCE



OAG

Office of the Auditor General

201 N. Washington Square, Sixth Floor • Lansing, Michigan 48913 • Phone: (517) 334-8050 • <http://audgen.michigan.gov>

Doug A. Ringler, CPA, CIA
Auditor General

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

Mr. Steven Arwood
President, Michigan Strategic Fund
Chair, Michigan Strategic Fund Board of Directors
300 North Washington Square
Lansing, Michigan

Dear Mr. Arwood:

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 and each major fund of the Michigan Strategic Fund, a discretely presented component unit of the State of Michigan, as of and for the fiscal year ended September 30, 2014 and the related notes to the financial statements, which collectively comprise the Michigan Strategic Fund's basic financial statements, and have issued our report thereon dated February 25, 2015.

Internal Control Over Financial Reporting

In planning and performing our audit of the basic financial statements, we considered the Michigan Strategic Fund'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 Michigan Strategic Fund's internal control. Accordingly, we do not express an opinion on the effectiveness of the Michigan Strategic Fund's internal control.

Our consideration of internal control was for the limited purpose described in the preceding paragraph and was not designed to identify all deficiencies in internal control that might be material weaknesses or significant deficiencies and, therefore, material weaknesses or significant deficiencies may exist that were not identified. However, as described in the body of our report, we identified a deficiency in internal control that we consider to be a material weakness and another deficiency that we consider to be a significant deficiency.

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. We consider the deficiency described in Finding 1 to be a material weakness.

A significant deficiency is a deficiency, or a combination of deficiencies, in internal control that is less severe than a material weakness, yet important enough to merit attention by those charged with governance. We consider the deficiency described in Finding 2 to be a significant deficiency.

Compliance and Other Matters

As part of obtaining reasonable assurance about whether the Michigan Strategic Fund'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 Strategic Fund's Response to Findings

The Michigan Strategic Fund's preliminary responses to the findings identified in our audit are included in the body of our report. The Michigan Strategic Fund's 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,



Doug Ringler
Auditor General
February 25, 2015

FINDINGS, RECOMMENDATIONS, AND AGENCY PRELIMINARY RESPONSES

FINDING

1. Controls Over Financial Reporting

The Michigan Strategic Fund (MSF) did not have sufficient internal control* in place to ensure that it properly recorded and reported MSF's financial activity in accordance with generally accepted accounting principles* (GAAP). As a result, MSF could not ensure the accuracy of the accounting records and draft financial statements and had to prepare numerous revisions to its financial statements. As noted in Finding 2, this contributed to MSF not adhering to established deadlines.

Section 18.1485 of the *Michigan Compiled Laws* requires MSF to establish and maintain an internal accounting and administrative control system using GAAP, including recordkeeping procedures and internal control techniques that are effective and efficient.

The following summarizes examples of the most significant misstatements resulting from the internal control weaknesses. Subsequent to our review, MSF recorded adjusting entries to correct most of the identified misstatements. Although MSF's final financial statements were materially correct, MSF should address the internal control weaknesses to ensure the proper recording and reporting of accounting transactions and financial statement balances in future years. We noted:

- a. MSF did not record a liability related to tribal gaming revenue that was due to the Michigan Economic Development Corporation (MEDC). Payments to MEDC and amounts due to component units were understated and fund balance was overstated by \$16.5 million in the General Operations Fund, and payments to MEDC and amounts due to component units were understated and net position was overstated by \$16.5 million in the entity-wide financial statements.

MSF maintained a schedule listing activities and transactions to record at the end of the fiscal year, which included recording the various tribal gaming revenue transactions; however, MSF did not track the status to ensure the recording of these transactions.

* See glossary at end of report for definition.

- b. MSF did not record the proper fair value of its investments accounted for in an external investment pool in its Jobs for Michigan Investment Fund. Investments, net decrease in fair value of investments, and fund balance were understated by \$11.1 million in the Jobs for Michigan Investment Fund, and investments, net decrease in fair value of investments, and net position were understated by \$11.1 million in the entity-wide financial statements.

MSF informed us that a calculation error within its internal spreadsheet maintained to track the fair market value of these investments caused the misstatement.

- c. MSF did not record loan and investment disbursements in accordance with GAAP. For example:

- (1) MSF did not reclassify two loan disbursements and one investment disbursement recorded in the Jobs for Michigan Investment Fund. Expenditures were overstated by \$5.9 million, loans receivable were understated by \$4.9 million, investments were understated by \$1.0 million, and fund balance was understated by \$5.9 million in the Jobs for Michigan Investment Fund. Also, expenses were overstated by \$5.9 million, loans receivable were understated by \$4.9 million, investments were understated by \$1.0 million, and net position was understated by \$5.9 million in the entity-wide financial statements.

- (2) MSF did not reverse a \$5 million transaction recorded between the General Operations Fund and Jobs for Michigan Investment Fund related to a loan that was never disbursed. MSF overstated its expenditures and understated cash in the Jobs for Michigan Investment Fund and understated expenditures and overstated cash in the General Operations Fund by \$5 million.

MSF's process was to initially record loan and investment disbursements as expenditures when issuing payments, using specific identifiable coding, to ensure that MSF could track the payments. MSF would then reclassify these as investments or loans receivable on a monthly basis. However, this process was not documented and communicated to all accounting staff to ensure disbursement transactions were coded properly and therefore easily identified as needing to be reclassified or reversed.

- d. MSF did not ensure that amounts reported in its draft financial statements reconciled to its accounting records. We noted numerous significant classification errors due to incorrect classification of expenditures, revenues, assets, liabilities, fund balance, and net position on MSF's governmental fund and entity-wide financial statements.

MSF did not ensure management review of the draft financial statements prior to providing them to the auditors.

RECOMMENDATION

We recommend that MSF improve its internal control to ensure that it properly records and reports MSF financial activity in accordance with GAAP.

AGENCY PRELIMINARY RESPONSE

MSF provided us with the following response:

MSF agrees with the recommendation. MSF will improve its internal control to ensure that it properly records and reports MSF financial activity.

FINDING

2. Timeliness of Financial Reporting

MSF did not have sufficient internal control over financial reporting to ensure that it adhered to established deadlines for recording and reporting its financial activity. As a result, MSF's audited financial statements were not finalized until February 25, 2015.

Section 18.1492 of the *Michigan Compiled Laws* requires MSF's financial statements to be audited and submitted to the State Budget Office for inclusion in the *State of Michigan Comprehensive Annual Financial Report* within 90 days of the close of the State's fiscal year. Also, governmental accounting and reporting standards provide that financial reports should be issued as soon as possible after the end of the reporting period in order for the financial reports to be useful and to impact decision making.

MSF developed a year-end closing schedule identifying specific completion dates for recording accounting entries and performing other procedures necessary to finalize its financial statements and to help ensure the timely submission of its financial statements to the State Budget Office. Also, according to the audit engagement letter terms, MSF agreed on deadlines for providing draft and final financial statements and other necessary information to the auditors to ensure an opinion on the financial statements by December 20, 2014.

MSF did not adhere to key completion dates as follows:

- a. MSF finalized accounting entries 25 days after established deadlines.
- b. MSF provided draft and final financial statements and required supplementary information up to 20 days and 19 days, respectively, after established deadlines.

MSF maintained a schedule listing activities and transactions to record at the end of the fiscal year, which included performing various procedures necessary to accurately and timely finalize its financial statements; however, MSF did not monitor the status of its completion of these procedures. Also, because of the misstatements noted in Finding 1, the draft financial statements were not accurate, which caused further delays in finalizing the financial statements.

RECOMMENDATION

We recommend that MSF improve its internal control over financial reporting to ensure that it adheres to established deadlines for recording and reporting its financial activity.

AGENCY PRELIMINARY RESPONSE

MSF provided us with the following response:

MSF agrees with the recommendation. MSF will improve its internal control over financial reporting to ensure that it adheres to established deadlines for recording and reporting its financial activity.

GLOSSARY

Glossary of Abbreviations and Terms

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.
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."
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.

MSF

Michigan Strategic Fund.

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.

