



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, 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

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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, 2014

Report Number:
271-0406-15M

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 Economic Development Corporation's (MEDC's) financial statements dated January 30, 2015.

Finding Related to Internal Control, Compliance, and Other Matters	Material Weakness	Significant Deficiency	Agency Preliminary Response
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) (<u>Finding 1</u>).		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



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Doug A. Ringler, CPA, CIA
Auditor General

March 17, 2015

Mr. Steven Arwood, Chief Executive Officer
and
Mr. Doug Rothwell, Executive Committee Chair
Michigan Economic Development Corporation
300 North Washington Square
Lansing, Michigan

Dear Mr. Arwood 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, 2014 and have issued a separate report thereon dated January 30, 2015. In planning and performing our audit of the financial statements, we considered MEDC's internal control over financial reporting and compliance and other matters. This is our report on internal control, compliance, and other matters of MEDC 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 finding, our recommendation, and the agency preliminary response; and a glossary of abbreviations and terms.

The agency preliminary response was 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 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,

Doug Ringler
Auditor General

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INDEPENDENT AUDITOR'S REPORT ON
INTERNAL CONTROL AND COMPLIANCE



Doug A. Ringler, CPA, CIA
Auditor General

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

Mr. Steven Arwood, Chief Executive Officer
and
Mr. Doug Rothwell, Executive Committee Chair
Michigan Economic Development Corporation
300 North Washington Square
Lansing, Michigan

Dear Mr. Arwood 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, 2014 and the related notes to the basic financial statements and have issued our report thereon dated January 30, 2015.

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. 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 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 Finding

The Michigan Economic Development Corporation's preliminary response to the finding identified in our audit is included in the body of our report. The Michigan Economic Development Corporation'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,



Doug Ringler
Auditor General
January 30, 2015

FINDING, RECOMMENDATION, AND
AGENCY PRELIMINARY RESPONSE

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). MEDC initially overstated its investments and net increase in fair value of investments by \$3.3 million. After our review, MEDC recorded adjusting entries to correct the misstatement. Although MEDC's final, audited financial statements were materially correct, MEDC should address the internal control weakness to help ensure the accuracy of the investments and net increase or decrease in fair value of investments in subsequent years.

Section 150.121 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. Also, Question 6.12.2 of the GASB Comprehensive Implementation Guide provides that for investments reported using cost-based measures, the valuation should consider whether the fair value of the investment is significantly affected by the impairment of the credit standing of the issuer or by other factors.

MEDC identified investment impairment losses totaling \$3.3 million for its venture capital stock investments; however, MEDC did not record and report these in its fiscal year 2014 draft financial statements.

Our prior audit contained a finding that MEDC had not developed a process to adjust investment values for nontemporary impairment losses. During fiscal year 2014, MEDC implemented a process for its portfolio managers to evaluate the fair value of its venture capital investments, and MEDC identified impairment losses. However, MEDC did not record the investment impairment losses in its accounting records. MEDC maintained a schedule listing activities and transactions to record at the end of the fiscal year, which included recording the fair value of investments; however, MEDC did not track the status to ensure recording of these transactions.

* See glossary at end of report for definition.

RECOMMENDATION

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

AGENCY PRELIMINARY RESPONSE

MEDC provided us with the following response:

MEDC agrees with the recommendation. MEDC implemented a process during the fiscal year to evaluate the value of its investments and record investment impairment loss to reflect fair market value. MEDC prepared the investment impairment loss calculation worksheet and provided it to the auditors. The draft financial statements provided to the auditors were not yet reflective of this adjustment. MEDC will ensure that all entries are properly entered into accounting records before the draft statements are provided to the auditors.

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."
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 basic financial statements will not be prevented, or detected and corrected, on a timely basis.

MEDC

Michigan Economic Development Corporation.

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.

